GMO

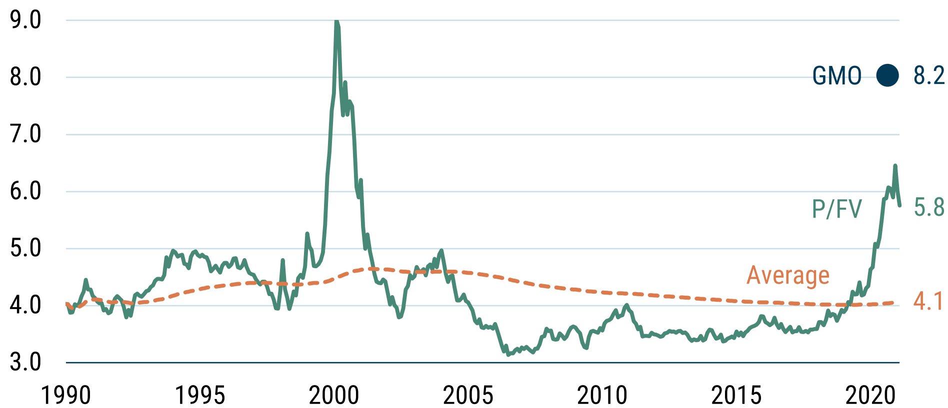
ASSET ALLOCATION INSIGHTS

GROWTH VS. VALUE: MINE THE GAP

Asset Allocation Team | April 2021

PRICE TO FAIR VALUE THROUGH TIME

The ratio of the most expensive quintile over the cheapest quintile



As of 2/28/2021 | Source: MSCI, GMO

- Using traditional, backward-looking valuation metrics, the valuation gap between Growth and Value has reached historic levels. Interesting. Traditional metrics, however, are often critiqued for not giving Growth companies enough credit for their bright futures.
- GMO's Price to Fair Value (P/FV) model helps solve for this by using a *forward-looking* dividend discount model, valuing companies with high growth prospects more fairly. Even with this approach, Growth still looks extremely expensive relative to Value. A long Value/short Growth portfolio can exploit this phenomenon.
- The chart above puts today's opportunity into historical perspective, using GMO's P/FV metric. The green line tracks the ratio between the most expensive quintile of the global universe (predominantly Growth names) and the cheapest quintile (predominantly Value) through time; the higher the ratio, the better the opportunity for a long/short approach. Historically, the expensive quintile has traded at 4.1x its cheap counterpart. Today it stands at 5.8x, more than 40% above normal.
- With active management, we can focus even further on the most compelling candidates. The 8.2x blue dot labeled "GMO" represents the ratio between the actual short and long baskets of stocks in GMO's Equity Dislocation Strategy.
- If you are concerned that this Growth rally remains in speculative territory or that you simply have too much Growth exposure in your portfolio today, it's time to think about how to "play this bubble." One possible solution is a global, diversified, long/short portfolio like Equity Dislocation, thoughtfully constructed to monetize this valuation gap.

Disclaimer

The P/FV ratio is the P/FV of the most expensive quintile of the ACWI index divided by the P/FV of the cheapest quintile of the ACWI index, with P/FV calculated relative to country and weighted by the square root of market cap. As of 2/28/21, the ratio of the P/FV of the short side of the Equity Dislocation Strategy over the long side of the Equity Dislocation Strategy was 8.2. Averages are calculated using harmonic means.

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