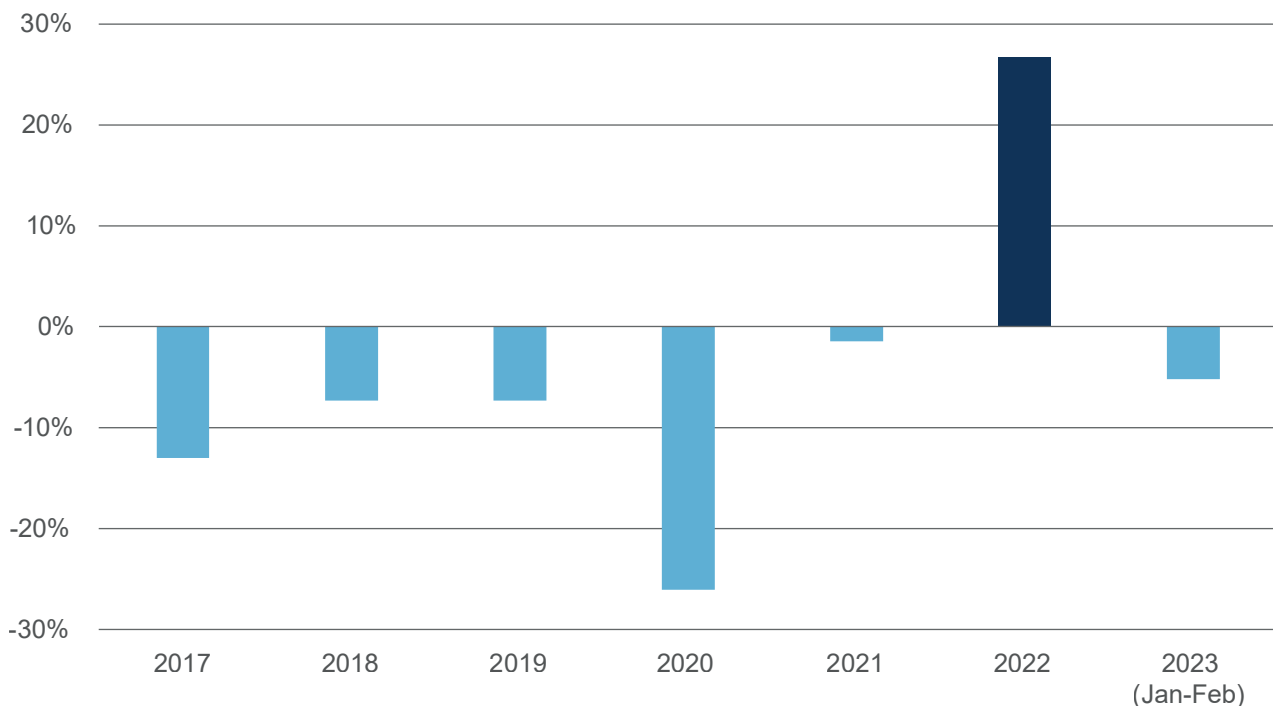


Is Value Back?

While many look at 2022 as a bad year for markets, value investors had something to celebrate due to the strong return of the value premium. After being out of favor for 5 consecutive calendar years, value stocks outperformed their growth counterparts by

25%. However, some argue that the value rebound has run its course, citing the recent outperformance of growth stocks of +5% through the first two months of 2023 as evidence.

Exhibit 1. Annual Value Premium Performance, 2017 to Present



Value premium is defined as the performance of Russell 3000 Value Total Return Index minus the performance of Russell 3000 Growth Total Return Index. Source: Innealta Capital, using monthly data from 1/2017 to 2/2022.

Is value now back out of favor? To provide an answer to this question, we can look at the ability for value's recent performance to

predict future value performance, as well as current valuation spreads against the backdrop of historical observations.

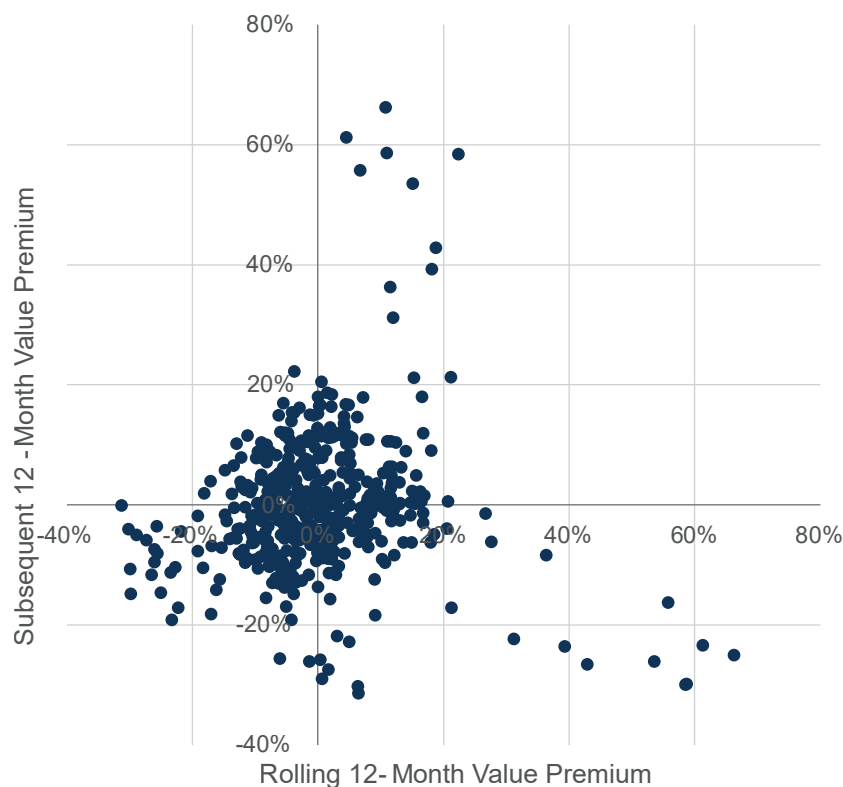
Does recent value performance predict future value performance?

Cognitive biases often interrupt our ability to make objective judgments about future events. One such bias, the gambler's fallacy, refers to the mistaken belief that recent events occurring more frequently, or in larger magnitudes, have a lower probability of occurring in the future. Have you ever been to a roulette table that has spun red five times in a row? If you have, you probably will have noticed other gamblers making statements suggesting that black is 'due' to occur. Investors make similar mistakes, often pointing to recent events as evidence for why something recently occu-

ring will not continue to occur into the future.

In the value premium's case, investors should expect a positive value premium every day, week, month, year, etc. However, this is not the case in practice. There are plenty of periods when value will outperform, but also periods when value underperforms. It is important to recognize that the recent performance of value has no power in predicting the future performance of value.

Exhibit 2. 12-month Value Premium and Subsequent 12-Month Value Premium



Value premium is defined as the performance of Russell 3000 Value Total Return Index minus the performance of Russell 3000 Growth Total Return Index. Source: Innealta Capital, using monthly data from 1/1979 to 2/2023.

As you can see, there is no discernible relationship between rolling 12-month value premiums and the subsequent 12-month premium. There are many periods of strong positive value premiums followed by a subsequent

period of continued strength. Instead of falling into the same trap as gamblers at the roulette table, value investors should remain steadfast in their value conviction, even after a run of success.

What can current valuation spreads tell us about what to expect going forward?

Valuation ratios, like the price-to-book ratio, provide useful insights into the relative prices investors are willing to pay for companies. By comparing the valuation ratios between two sets of securities, creating a valuation spread, we can understand the relative price difference between them. In observing the valuation

spread between value and growth stocks, we are directly comparing the relative 'expensiveness' of the two. Buoyed by record low interest rates, growth companies have consistently become more and more expensive relative to value stocks over the last decade, with this bubble beginning to pop in 2021.

Exhibit 3. Valuation (P/B) Spread Between Growth and Value S tocks, 5/1995 to 2/2023



P/B Spread is defined as the difference in P/B ratio between Russell Value 3000 Total Return Index and Russell Growth Total Return 3000 Index. Source: Innealta Capital, using monthly data from 5/1995 to 2/2023.

While we have observed a contraction in the valuation spread between growth and value stocks, the current reading remains in the 89th percentile of historical observations. Further contraction in this ratio, as it reverts towards its historical mean, would mean continued outperformance for value stocks. In other words, this

value rally still seemingly has a lot of room to run. Furthermore, there is evidence indicating higher valuation spreads predict higher future returns, albeit with considerable uncertainty¹. This suggests it's best to maintain consistent focus on the value premium moving forward.

¹ Cohen, R. B., Polk, C., & Vuolteenaho, T. (2003). The Value Spread. *The Journal of Finance*, 58(2), 609–641. <http://www.jstor.org/stable/3094552>

Conclusion

For value investors, the trailing decade has not been an easy one. Despite the value premiums strong return in 2022, we feel it is important for investors to recognize that a swift, strong premium is not a reason to expect a reversion back to the growth regime. Instead, investors should expect a value premium continuously and should position their portfolios to capture premiums when they do appear, as it can happen quickly and in large magnitudes. Systematic strategies rooted in empirical evidence

are the best tools investors can deploy to do this. Furthermore, two months of strong relative growth performance in 2023, doesn't overcome the fact that the valuation spreads between value and growth stocks suggest that the value premium still has considerable room for outperformance before spreads revert to historical averages. For investors willing to continue to be patient, value seems to still have a lot to give.



Acclivity noun

ac·cliv·i·ty | \ ə-ˈkli-və-tē

plural acclivities

Definition: an ascending slope

Synonyms: ascent, elevate, rise, upgrade

Index Descriptions

The **Russell 3000 Growth TR Index** is a market-capitalization weighted equity index and measures the performance of the Russell 3000 companies with higher price-to-book ratios and forecasted growth values. Total return indexes reinvest dividends. The **Russell 3000 Value TR Index** is a market-capitalization weighted equity index and measures the performance of the Russell 3000 companies with lower price-to-book ratios and forecasted growth values. Total return indexes reinvest dividends.

Disclosures

This material is for informational purposes and is intended to be used for educational and illustrative purposes only. It is not designed to cover every aspect of the relevant markets and is not intended to be used as a general guide to investing or as a source of any specific investment recommendation. It is not intended as an offer or solicitation for the purchase or sale of any financial instrument, investment product or service. This material does not constitute investment advice, nor is it a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. In preparing this material we have relied upon data supplied to us by third parties. The information has been compiled from sources believed to be reliable, but no representation or warranty, express or implied, is made by Innealta Capital, LLC as to its accuracy, completeness or correctness. Innealta Capital, LLC does not guarantee that the information supplied is accurate, complete, or timely, or make any warranties with regard to the results obtained from its use. Innealta Capital, LLC has no obligations to update any such information.

Market indices are shown for illustrative purposes only and are provided for the purpose of making general market data available as a point of reference only, and do not constitute as an offer or recommendation to buy or sell securities or engage an investment manager. Such indices are unmanaged, assume reinvestment of income, do not reflect the impact of any trading commissions and costs, management and incentive fees, and have limitations when used for comparison or other purposes because they, among other reasons, may have a different trading strategy, volatility, credit or other material characteristics (such as limitations on the number and types of securities or instruments). No representation is made that any benchmark or index is an appropriate measure of comparison. Indices included are a general source of information and comparison to an index does not imply that the portfolio will be constructed in the same way as the index or achieve returns, volatility, or other results similar to the index. Potential or current [investors/clients] should not conclude that a [Innealta/Acclivity] portfolio will or will not be correlated with any such index (including those purporting to represent the trading strategies to be implemented by such product). Historical performance results for investment indexes and/or categories generally do not reflect the deduction of transaction and/or custodial charges or the deduction of an investment management fee, the incurrence of which would have the effect of decreasing historical performance results. You should not consider any comparative index shown in this document to be a performance benchmark for the a [Innealta/Acclivity] portfolio. Such indices are provided solely as an indication of the performance of various capital markets and/or investment strategies in general. However, the comparison of indices in general, and to individual managed products in particular, are subject to material inherent limitations. Economic factors, market conditions, and investment strategies will affect the performance of any portfolio and there are no assurances that it will match or outperform any particular benchmark.

Acclivity Investment Research is a division of Innealta Capital, LLC. Innealta Capital, LLC is an Investment Adviser, registered with the Securities & Exchange Commission and is subject to the rules and regulations of the Investment Advisers Act of 1940. Registration of an investment adviser does not imply any certain level of skill or training. For more information, please visit our website: innealtacapital.com. Innealta Capital, LLC only transacts business in states where it is properly registered or exempt from registration. No federal or state agency or regulatory or self-regulatory authority has approved the information contained in this material, and any representation to the contrary is unlawful. A copy of Innealta's Form ADV Part 2 is available upon request.

Investing involves a high degree of risk. Investors could lose all or a substantial amount of their investment, and there are no assurances that investment objectives will be achieved. Investors should carefully review and consider potential risks before investing. Past performance is not indicative of future results. The information herein may contain forward-looking statements and projections that are based on our current beliefs and assumptions and on information currently available that we believe to be reasonable. All statements that are not historical facts are forward-looking statements, including any statements that relate to future market conditions, results, operations, strategies or other future conditions or developments and any statements regarding objectives, opportunities, positioning or prospects. Forward-looking statements are necessarily based upon speculation, expectations, estimates and assumptions that are inherently unreliable and subject to significant business, economic and competitive uncertainties and contingencies, and prospective investors may not put undue reliance on any of these statements. Forward-looking statements are not a promise or guaranty about future events.

3133-INN-03/03/2023