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The Case for Value: why Equity Income may be the best approach

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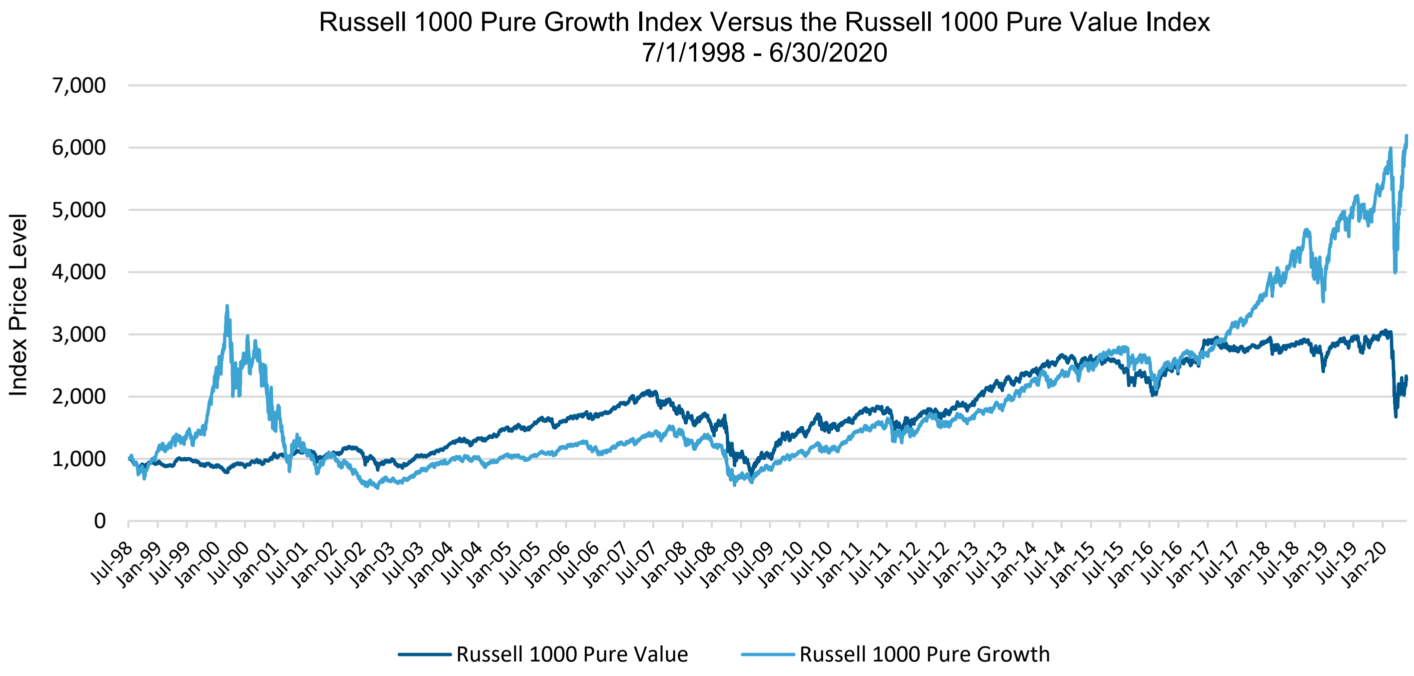
At Cadence Capital, we believe the case for investing in value has never been stronger. Our approach to value is dividend yield and total return, better known as Equity Income. During times of uncertainty, Equity Income has proved to be a resilient strategy. Presently, there are a confluence of concerns at play in the market: there is a wide dispersion between growth and value not seen since the dot.com bubble burst; certain indexes are dominated by mega-cap companies causing a high concentration in Top Ten names; the valuation of value is below historical ranges, especially for cyclical stocks; and many fixed income investments are low-yielding. In this paper, we address these areas of worry and make our case for value via an Equity Income strategy.

DISPERSION

One of the main reasons we believe the case for value has never been stronger is due to growth's relative outperformance over value, especially since late 2016. The chart below shows over 20 years of data where there has only been one other instance where the performance dispersion between growth and value has been this extreme. Given the current gap, which mirrors the dot.com bubble time period, we believe it points to an attractive opportunity for value investors.

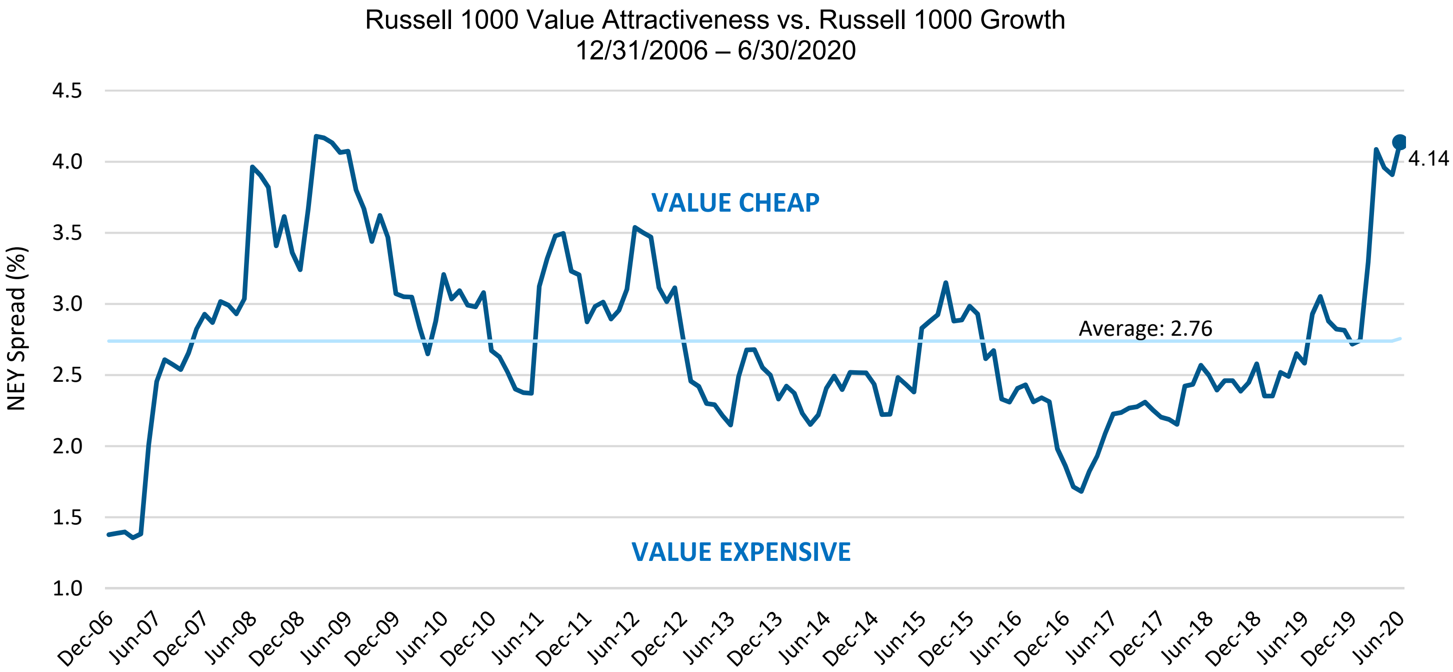


Source: Bloomberg Finance; Cadence. This hypothetical example is for illustrative purposes and does not represent the results of the actual trading of investable assets. An investment cannot be made directly into an index. The "Pure" style indices include only those stocks that are considered fully value or growth as defined by Russell. Results in USD. Past performance does not guarantee future results.

VALUATION

Since we use premium yield and valuation as tools to form our portfolios at Cadence Capital, we have stayed diligent and consistent throughout the most recent period of market volatility. Historically, our valuation tools have proven to be helpful in identifying opportunities and keeping people invested in times like this. And, this valuation work is embedded in many of the things we do.

From a valuation standpoint, our normalized earnings yields are stationary with respect to underlying assumptions, so they are free from cognitive and unconscious behavioral biases. As evidenced by our most recent normalized earnings valuation chart below comparing the Russell 1000 Value Index to the Russell 1000 Growth Index, value continues to look attractive. We believe this high-quality form of value investing can provide a premium and growing income stream and is now priced to deliver an attractive total return.

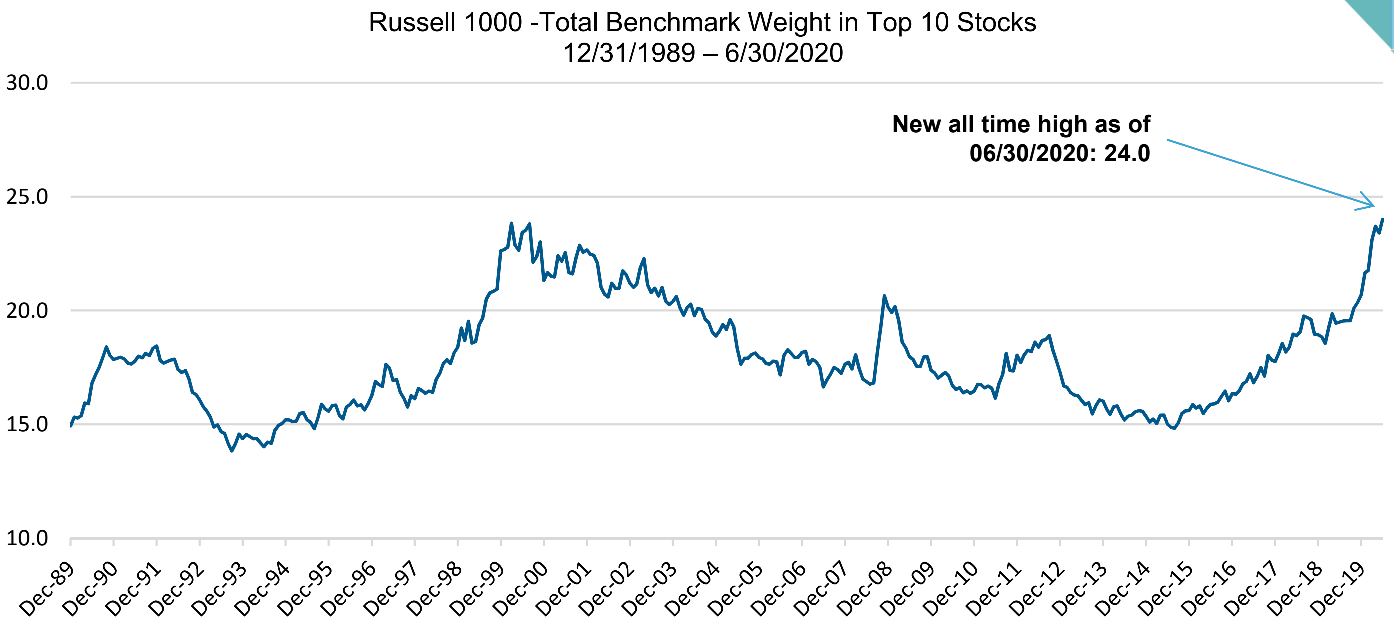


Source: Factset, Cadence. Past performance is no guarantee of future results.

CONCENTRATION

Following a similar pattern of growth versus value since 2016, markets have come to be dominated by numerous mega-cap companies. This trend shows up in indexes as a high concentration in Top Ten names, which have been commanded by growth companies (e.g. Apple, Microsoft, Facebook, Amazon, and Google). These highly profitable tech companies have grown to mega-capitalizations through technological innovation, highly scalable business models, and strategic buyouts.

In addition, the pendulum swing toward indexed investing has provided an additional tailwind for these companies. During the current crisis, these mega-cap companies have served as a haven, adding even more concentration to many indexes. As the popular proverb goes, 'trees don't grow to the sky'. History shows that these trends have eventually reversed themselves as their advantages wane either through competition, anti-trust intervention, or sector rotation.

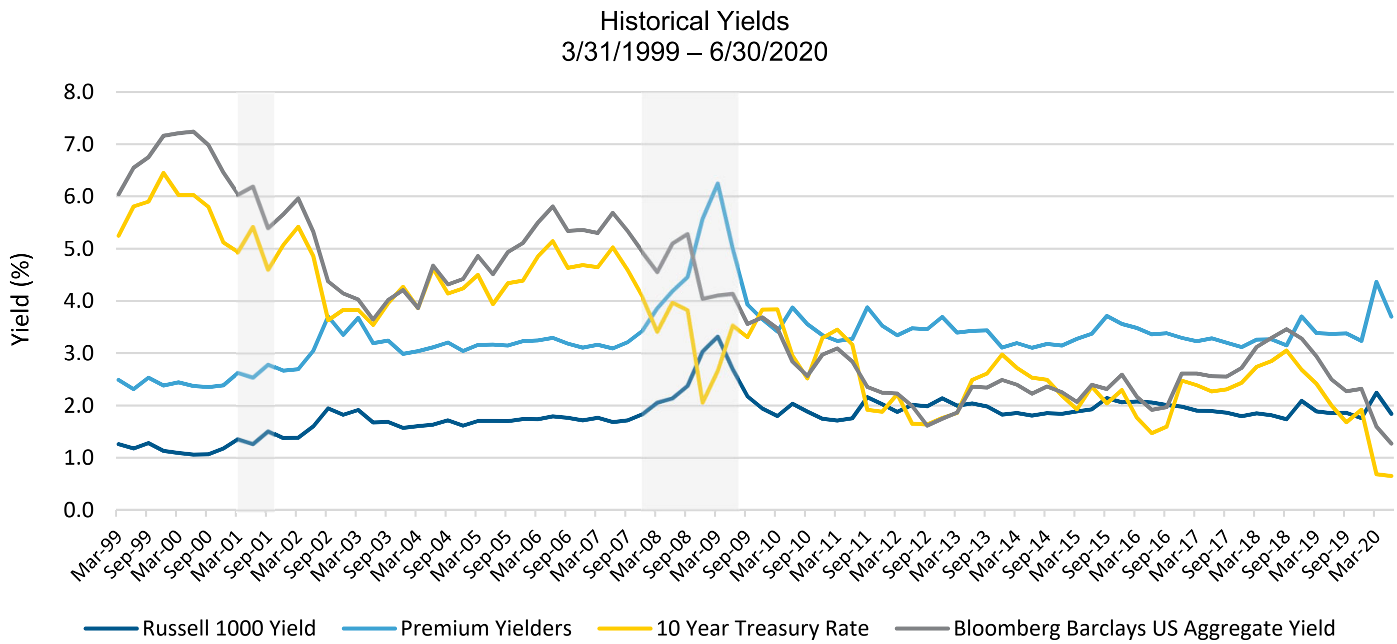


Source: Bloomberg Finance; Russell Index; Cadence. Using the Russell 1000 index, chart represents a sum of the benchmark weight in the top 10 largest benchmark-weight stocks, monthly from 12/31/1989 through 03/31/2020 and for 04/15/2020. Calculations done in Factset by Cadence. Past performance does not guarantee future results.

Over reasonable investment horizons, Cadence Capital believes investors do not get paid for concentration risk or idiosyncratic risk. Therefore, minimizing these risks is a benefit and allows for better risk management to avoid any unintended risks that can overwhelm a subset of stocks.

YIELD

Over more than two decades, a portfolio of premium dividend-focused equity securities has provided a more stable and secure yield relative to many other yield-focused instruments (see chart below). This has been especially true during times of crisis. When the dot.com bubble burst in 2000, the yield for the premium-yielding equities cohort increased throughout the proceeding recession while many fixed-income classes fell. During the Great Recession, premium dividends again outperformed most fixed-income classes. In today's economic downturn, those premium-yielding equities are following this same pattern.



Source: Russell Index; Cadence. Past performance does not guarantee future results.

In addition, given the current record-high spread between equities and fixed income, we believe it is prudent to remain invested in a portfolio of companies that make responsible capital-allocation decisions. Higher-yielding companies are usually financially sound with attractive cash flows, and the stocks of those firms have historically tended to have above-average returns with lower-than-average volatility than the overall market.*

CONCLUSION

Even in these challenging times, income-producing securities continue to look attractive. At Cadence Capital, we focus on quality dividend companies that exhibit balance-sheet strength, profitability, and earnings stability. We believe quality dividend companies can ultimately maximize return potential, minimize volatility, and provide steady cash flow, even in down markets.

Our evergreen strategies are dynamic-in-nature and are constantly assessing premium yielding stocks. We believe there is an infinite horizon for what we do as our strategies are designed to maximize cash flows and minimize the prices we pay for those cash flows. Regardless of what the market throws at us, we believe there will always be a premium income yield level, and we think current market valuations will create ample opportunities to be exploited within Equity Income.

Cadence Capital Management has three flagship strategies designed for income, value and growth: US Equity Income, International Equity Income and Emerging Companies. For more information, visit CadenceCapital.com.

*Data Source: Kenneth R. French "Portfolios Formed on Dividend Yield" and CRSP data, 1/1/1928 to 12/31/2019. Includes all equity securities listed on NYSE, Amex, NASDAQ and NYSE Arca during the time period. Performance results are annualized value-weighted total returns with dividends reinvested. Volatility is measured by annualized standard deviation. Past performance does not guarantee future results.

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