

Questioning Conventional Wisdom on Risk and Return

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Value investing is a long-term proposition.

So why measure long-term returns (at a single point in time) against monthly volatility?

What if we modify the Sharpe ratio to measure *average* long-term returns against *long-term* volatility?

Risk

Volatility Declines and Converges Over Long Time Periods

Annualized Volatility of Returns

	S&P 500 Index	Russell 1000 Value Index	Pzena ¹
Monthly*	15.2%	15.3%	20.0%
3YR*	10.5%	9.3%	10.4%
5YR*	6.9%	6.3%	8.5%
10YR*	4.3%	3.3%	3.5%

Investors typically use short-term metrics for evaluating risk. Monthly volatility is used in the Sharpe ratio.

*Based on the standard deviation of their relative holding periods assembled on a monthly basis.

Return

What if We Remove End-Point Dependency?

Total Annualized Return

	S&P 500 Index	Russell 1000 Value Index	Pzena ¹
Best*	16.7%	15.4%	17.1%
Worst*	-3.4%	-1.2%	3.4%
Most Recent	14.0%	10.4%	8.3%
Average	6.5%	6.9%	8.5%

Investors almost always use long-term metrics for evaluating returns. And the metric of choice typically ends with a recent data point. So, even when we look at a 10-year record, that record is highly endpoint (and beginning-point) biased. Using the average return eliminates this issue.

*The best 10-year period ended February 2019. The worst 10-year period ended February 2009. Average is of all 10-year periods, rolling monthly.

Risk-Adjusted Return

Results can be Startlingly Different

Long-Term Risk-Return Metrics

	S&P 500 Index	Russell 1000 Value Index	Pzena ¹
Return	6.5%	6.9%	8.5%
Volatility	4.3%	3.3%	3.5%
Sharpe-Type Ratio*	1.5	2.1	2.4

*Average 10-year return divided by the volatility of 10-year returns.

Point in Time Return/Short-Term Risk Metric

	S&P 500 Index	Russell 1000 Value Index	Pzena ¹
Return	14.0%	10.4%	8.3%
Volatility	15.2%	15.3%	20.0%
Sharpe-Type Ratio*	0.9	0.7	0.4

*Most recent 10-year return divided by the volatility of monthly returns.

Source: FTSE Russell, S&P Global, Pzena analysis. January 1, 1996 – June 30, 2020. ¹Based on gross performance of our Pzena Focused Value Composite. Past performance is not indicative of future results. The S&P500 Index and the Russell 1000 Value Index are used for comparative purposes only. Indexes cannot be invested in directly.

Measuring **average** long-term returns against **long-term volatility** provides a more accurate reflection of a manager's true investment capability.

Risk, after all, isn't buying stocks that are facing price volatility; risk is paying too much for them.

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The Pzena Focused Value Composite:

	Annualized Returns						
	2Q 2020	YTD	One Year	Three Year	Five Year	Ten Year	Since Inception 1/1/96
Pzena Focused Value Composite — Gross	22.6%	-27.9%	-22.2%	-6.3%	-0.1%	8.3%	8.8%
Pzena Focused Value Composite — Net	22.4%	-28.2%	-22.7%	-6.8%	-0.7%	7.7%	8.0%
Russell 1000® Value Index	14.3%	-16.3%	-8.8%	1.8%	4.6%	10.4%	8.0%

Past performance is not indicative of future results. The Russell 1000 Value Index is used for comparative purposes only. Indexes cannot be invested in directly.