Year to date, US mega-cap stocks drove global market performance. Equal-weighted indices lagged cap-weighted ones by a near-historic amount, and market sensitivity to earnings reports reached a 30-year high, emphasizing the short-term focus.

The first half of 2024 witnessed a significant performance disparity in the global stock market, driven primarily by US trends and characterized by several key factors:

- A small number of expensive mega-cap US stocks continued to drive US and global market performance, with the 10 largest ACWI stocks averaging a 47% year-to-date increase.
- Globally, value stocks underperformed growth stocks by over 1,000 basis points, a rare occurrence seen in less than 5% of rolling six-month periods.
- Equal-weighted (EW) US indices, which have historically outperformed cap-weighted (CW) indices, experienced a significant reversal, underperforming by 11.3% in the first half of the year.
- US market performance has been driven by near-term earnings reports to an unusually high degree.

CONCENTRATED PERFORMANCE

Relatively few mega-cap US stocks have driven US and global market performance year to date, continuing the trend of the past few years. The 10 largest ACWI stocks are up an average of 47% year to date, representing 61% of the total return of the MSCI ACWI Index. Eight of those stocks are US-based companies.

This greatly impacted value stocks globally, which trailed growth stocks by more than 1,000 basis points in the year's first half. This fairly rare occurrence happens in less than 5% of rolling six-month periods. The disparity between growth and value was largely a US phenomenon, as EAFE and emerging markets value indices trailed growth by a more modest amount (Exhibit 1).

Exhibit 1: US Centric YTD Performance Disparity

	Value	Growth
ACWI	6.2%	16.3%
Russell 1000	6.6%	20.7%
EAFE	4.5%	6.2%
EM	6.5%	8.5%

Source: FactSet, Pzena analysis
Value and Growth indices: MSCI ACWI, Russell 1000, MSCI EAFE, and MSCI EM.
Total return data in US dollars December 31, 2023 – June 30, 2024. Past performance is not indicative of future returns.

This has led to a decade in which the US value universe has performed roughly in line with its history, generating an 11.1% annual return versus the 11.3% it returned for nearly a century. Meanwhile, over the same period, expensive stocks returned 14.4% versus their 9.2% historical return.

DISPARITY BETWEEN EQUAL-WEIGHT AND CAP-WEIGHT INDICES

Equal-weighted (EW) indices in the US have outperformed cap-weighted (CW) indices by 150 basis points per year over the past 65 years. This occurs because EW indices benefit from exposure to two key investing approaches, each with a superior long-term track record. First, EW indices systematically sell positions, as they get bigger and often overvalued, rebalancing into cheaper stocks. Second, EW indices invest more in stocks with smaller market capitalizations, benefitting from the small-cap effect.

However, that has reversed in the past couple of years, as mega-cap stocks have had an outsized impact on highly concentrated indices. That reached a crescendo in the first half of the year, as the CW index beat the EW index by 11.3% (Exhibit 2).

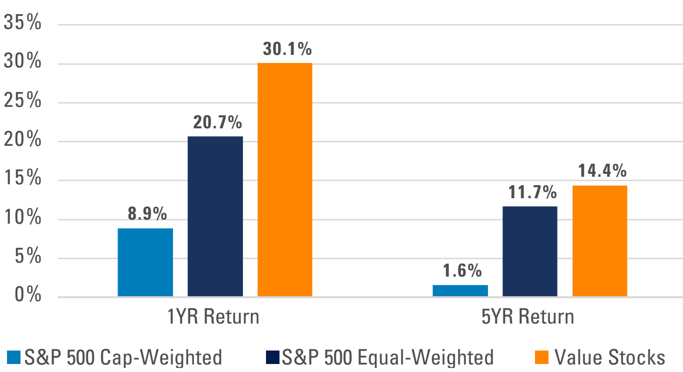
Exhibit 2: An Equal-Weighted Basket of Stocks Has Outperformed the Cap-Weighted Market Historically

	S&P 500 Cap-Weighted	S&P 500 Equal-Weighted
Recent 6M Return	16.5%	5.3%
Avg. 6M Return Since 1960	5.9%	6.9%
Annualized Return Since 1960	11.0%	12.5%

Source: FactSet, Sanford C. Bernstein & Co., Pzena analysis
Both S&P universes created by Bernstein. Total return US dollar data from January 1, 1960 – June 30, 2024.
Does not represent any specific Pzena product or service. Past performance is not indicative of future returns.

Over the past 65 years, CW beat the EW index by more than 10% in just 15 six-month periods out of more than 750 rolling six-month periods. Highlighting the concentration of performance of the past few years, four of those occurrences have happened since March 2020. In the past, the bounce back for EW following these 12 extreme periods has tended to be dramatic and happens fairly quickly, as EW has, on average, significantly outperformed CW in one- and five-year time frames, and value outperformed both by a wide margin (Exhibit 3).

Exhibit 3: Equal-Weighted And Value Outperform Following Extreme Periods
Average Return Following 6 Months
of Cap-Weighted Extreme Outperformance

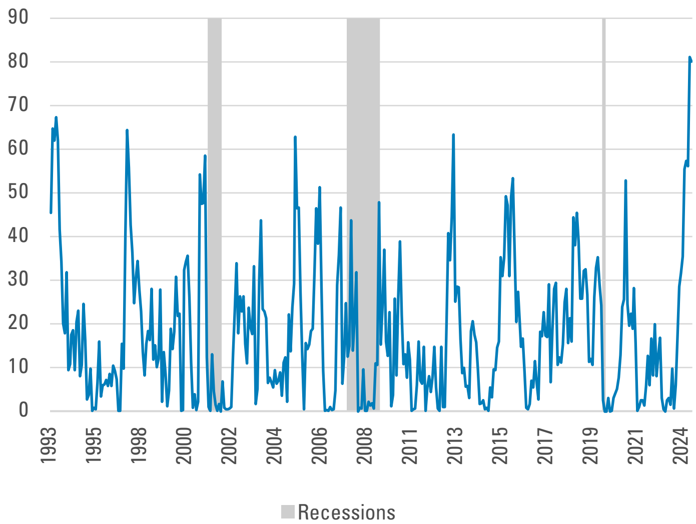


Source: FactSet, Sanford C. Bernstein & Co., Pzena analysis
Both S&P universes created by Bernstein. Value stocks defined as cheapest quintile price to book of the ~500 largest US stock universe (equal-weighted data).
For this analysis we look at the average forward one- and five-year return after extreme outperformance of the S&P 500 cap-weighted universe vs. the S&P 500 equal-weighted universe during the trailing six months since 1960. We define extreme as a minimum of 1000 basis points of outperformance. Data is calculated on a monthly rolling basis. Total return US dollar data from January 1, 1960 – June 30, 2024. Five-year returns are annualized.
Does not represent any specific Pzena product or service. Past performance is not indicative of future returns.

HEIGHTENED MARKET SENSITIVITY TO EARNINGS FAVORING GROWTH STOCKS

The US market has been highly sensitive to earnings beats and misses over the past several quarters, with the stocks that beat earnings richly rewarded, and the stocks that missed earnings severely punished. The stock price impact of these beats and misses is at a 30-year high (Exhibit 4). While we believe long-term normalized earnings are the ultimate driver of valuation, a market that is so sensitive to a single quarter's earnings results seems unusually short-term focused.

Exhibit 4: Performance Explained by Earnings
US Large-Cap Stocks
Share of Return Dispersion Explained By Earnings Surprises
1993 - June 2024



Source: Empirical Research Partners
Universe is the largest ~750 US stocks. Return dispersion (the squared deviations of individual stock returns relative to the cap-weighted market return) is aggregated on a capitalization-weighted basis at any given point in time. The aggregated measure is then regressed against the dispersion in earnings surprise rates over the trailing nine months. The chart displays the share of explanation by the independent variable, indicating the extent to which variability in large-cap market returns can be explained by differing earnings surprises across the market. Data through June 30, 2024.
Does not represent any specific Pzena product or service. Past performance is not indicative of future returns.

True value stocks have not participated in this EPS-driven performance in quite the same way as the broader value index. While cheap stocks have beaten earnings by almost the same rate as the broader value index, their stock performance has trailed by 1,000 basis points (Exhibit 5).

Exhibit 5: Market Driven by Short Term Earnings

1H 2024	% EPS Beaters[2]	Stock Price Return[3] EPS Beaters	Stock Price Return[3] EPS Missers
Russell 1000 Value Index	76%	6%	2%
Value Stocks[1]	69%	-4%	-1%

Source: FactSet, Pzena analysis
1The cheapest 20% of stocks based on Pzena's estimates of their price-to-normal earnings valuations, measured on an equally weighted basis within the largest US ~1,000 stock universe. 2Defined as the percentage of companies that beat earnings expectations on an aggregate EPS US dollar amount during the last six months. 3Market cap weighted.
All data in US dollars December 31, 2023 – June 30, 2024. Past performance is not indicative of future returns.

INDEX CONFUSION

We believe the performance disparity between a true value portfolio and value indices is at least partially driven by the vagaries of index formation, which we have previously written about. Value indices are currently filled with stocks that we would not consider value names. Since value and growth indices match cumulative market caps, expensive mega-caps have caused many growth names to fall into the value index. For example, the Russell 1000 Value Index currently has nearly twice as many stocks in it as the Russell 1000 Growth. Bizarrely, some stocks wind up with a portion of their weighting in both the value and the growth series. We are firm believers that a stock is either cheap or not, and the value indices are currently poor proxies for value.

NO SIGNIFICANT EARNINGS IMPAIRMENT IN OUR PORTFOLIOS

Importantly, we have not seen any significant impairment of earnings in the companies we own across our portfolios. Consensus estimates for our Global Focused Value portfolio remain extremely attractive at less than 9x next year's earnings, with consensus estimating a healthy 11% EPS growth.

CONCLUSION

The first half of 2024 has witnessed significant performance disparities in the global stock market, primarily driven by the success of US mega-cap growth stocks. There has been an unusual performance gap between growth and value indices, a stark difference between CW and EW indices, and a heightened market sensitivity to earnings reports.

While true value stocks have underperformed value indices despite comparable earnings beats, this discrepancy may be influenced by index construction rather than fundamental weaknesses. We believe the underlying business fundamentals and earnings power of the companies we own is not reflected in the valuations seen in the market today. On the other hand, historically elevated valuations in other parts of the market have distorted near term returns. Extrapolating the continuation of these elevated returns for highfliers runs in the face of history.

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