Investment **Research**

Can Investors Still Believe in the Value Premium?

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After a decade of underperformance, it is increasingly well understood that value stocks are currently historically cheap relative to growth stocks. What is less understood is whether the divergence reflects a permanent, structural shift, driven by aging populations, technological disruption, and ultra-low interest rates, or whether the elastic band has stretched so far toward growth that it is bound to snap back in favor of value.

Predicting when a sustained value rally may occur has proved in the last few years to be a fool's errand, not that that has stopped many market participants from trying. However, as an increasing number of investors question whether value investing is "dead," we do think it is worthwhile to re-examine the reason why people liked value in the first place: the value premium, or the historical tendency of value stocks to outperform growth stocks over time. Dissecting what the value premium is, why it exists, and the risks associated with value investing brings us closer to an answer about whether this time is really different—whether the value premium is gone for good. We end by outlining the factors that we believe have been holding the premium back and the catalysts that might just revive it.

The Makings of a Value Investment ... and a Value Investor

The value premium is the reward stock investors have historically enjoyed from targeting stocks with low prices compared to the cash flow and earnings the businesses generate. Typically, these low prices reflect the market's belief that the businesses will either struggle to grow their future earnings or, in extremis, that their future outlook is one of sharp or persistent decline given the myriad pressures facing the company. These may be mature, established businesses that lack obvious growth catalysts, or they may operate in a commoditized industry, and as such are thought to lack dynamism and carry the weight of inefficiencies that have accumulated over a number of years.

In practice, companies start to trade at depressed valuations when existing investors become unwilling to stake their savings in a business with a low growth outlook or, even worse, an existential threat looming over it, and sell the stock. When those investors outnumber those that are willing to step in and provide liquidity for the existing equity owners, the price gets driven lower and lower until new owners are willing to own the shares. The liquidity provider, or value investor, has historically been rewarded for being willing to accept near-term uncertainty—or merely a dull growth outlook—when the grim expectations that caused investors to start selling in the first place turn out to have been an *overreaction*. Value investors believe these overreactions occur because people have an innate behavioural bias that causes them to extrapolate short-term weakness too far into the future. Patient investors who buy at a bargain price and bide their time through the short-term headwinds can potentially earn a premium when the company steers itself out of its weak patch and starts to improve.

It follows, then, that value investors often share an innate character trait: They often are contrarians. They are willing to disagree with the widely held market narrative driving a stock's price lower and are willing to appear to be wrong, potentially for a long time. Successful value investors are also typically prepared to move into a position over many months, or even a year or two, even as the share price relentlessly moves lower. Taking an unpopular view and justifying it through periods of poor performance requires an individualistic, skeptical personality that instinctively questions the widely accepted consensus views of other investment professionals. Ultimately, value investors have succeeded by identifying when the view of the herd has become so one-sided that even a moderate shift in potential future outcomes for either the specific business or the industry as a whole can set off a dramatic share price move. However, value investors must guard against falling in love with their own narratives: They must be humble, self-questioning, and ready to sell out of a position at a loss if their thesis of turnaround and revaluation weakens sufficiently.

A kink to the above characterization of value investing as a one-investor-against-the-market mindset is that entire sectors are often considered "value sectors." These typically include the telecommunications, mining, utilities, energy, and financials sectors, and they tend to have one or more of the following characteristics.

- Highly commoditized products
- Reliance on exogenous factors such as favourable regulations, currency valuations, commodity prices, or simply the economic cycle for growth
- Significant real assets, or physical capital, on their books. These assets tend to make companies look cheap compared to companies in sectors that are more oriented toward intangible assets, or knowledge capital, such as health care or technology.

While value investors might be instinctively drawn to the cheap-looking opportunities in value sectors, we believe they can only construct an effectively diversified portfolio by accounting for structural differences in valuations across sectors. Otherwise, they may risk overly favoring value sectors and missing potentially attractive value investment opportunities across the whole market.

Why Do Some Stocks Trade at a Significant Discount to the Market?

A number of factors can prompt investors to de-rate the value of a business and open up potential opportunities for a value investor. (Whether a particular investment is, in fact, an opportunity depends on whether the market has been too harsh in assessing a company's prevailing market value, and that assessment is the crux of a value investor's job.) The most common factors include:

Structural/Existential Risks

Structural concerns arise when customer preferences and behaviors change, or end markets evolve in a way that renders the existing business less relevant to its industry. At worst, if the market perceives the company to be too inflexible to adapt to changing conditions, the company risks entering a death spiral: As its financial situation—the ratio of price to cash—deteriorates, it becomes increasingly difficult to muster the financial resources to invest in adapting or restructuring the business. Many retail businesses, for example, have struggled for more than a decade to adapt to the rise of e-commerce. Having failed to create a compelling online sales channel, they were stuck with badly located real estate, declining foot traffic, and expensive lease agreements even before COVID-19 forced lockdowns in many places and pushed many customers out of work.

Cyclical Risks

Fluctuations in the economic cycle can severely impair the equity value of a business. Businesses that are most exposed to a retrenchment of business and consumer spending may de-rate sharply when the market anticipates recessionary economic conditions. The companies most at risk of significant declines in equity values are those that have both high fixed costs and revenue streams that fluctuate with the economic cycle, making for immediate and substantial losses during a cyclical downturn. Airlines are a classic example. The end of an economic cycle—which, of course, is difficult to pinpoint except in hindsight—can be a tempting smokescreen for even seasoned value investors: Cyclical businesses typically generate strong cash flow, have lower debt levels, and produce higher returns on equity during these periods, but often see all three metrics reverse themselves quickly when a downturn hits.

Operational and Financial Risk

The profitability of a business with high operational leverage is highly sensitive to changes in either revenues or costs. Financially leveraged businesses, on the other hand, carry high levels of financial debt (bank loans or corporate bonds) compared to the size of the business, as measured by assets or cash flow. Investors will typically ascribe a lower valuation to businesses that are operationally and financially leveraged, as they have limited funds for reinvestment and are more susceptible to changes in economic activity. A key risk equity owners face from highly leveraged businesses is that the company will need to issue new shares at a depressed price. If a company experiences a downturn and is in danger of breaching its debt covenants, it will likely look to shareholders to raise new capital priced at a discount to the already low prevailing share price. At best, an ill-timed issue of shares caps the future upside when and if headwinds subside. At worst, if the equity created is substantial compared to the prevailing market capitalization, it locks in heavy losses.

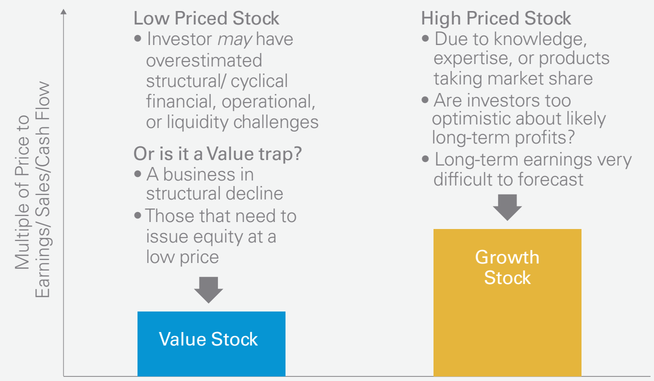
Liquidity Risks

A company has high liquidity risk if it would struggle to maintain its cost base and positive cash flow if the operating environment changed suddenly for the worse. If the company cannot maintain positive cash flow by managing costs, investors must ask whether it has the equity reserves or borrowing headroom to avoid asking shareholders for more capital at a temporarily depressed share price. To effectively assess both liquidity and leverage risks, we believe a value investor needs to understand the balance sheet to ensure that short-term business pressures won't force the company to create new equity at precisely the wrong point. For an example of the most dramatic historical example of the pain liquidity-driven equity issuance can create, investors can look to the fate of investors in many global financial firms at the nadir of the global financial crisis.

Growth vs. Value: Past and Recent Performance Trends

The polar opposite of value investing is growth investing. With a long-term view similar to that of a value investor, a growth investor seeks to identify businesses that can redefine how an industry operates. By definition, these businesses have knowledge, expertise, or a product that can enable them to take significant market share, often disrupting the way an industry has previously operated. That disruption leads in turn to a significant growth in the profits, sales, and overall size of the business. Typically, these are younger businesses—dynamic, exciting, but less battle-tested, their relative youth having likely precluded them from experiencing an array of different economic environments. There is an expectation of enormous growth embedded in their valuations, but that expectation is riddled with uncertainty about how and when earnings will grow—assuming, of course, that the company itself grows as expected. However, the excitement of being part of a disruptive business is alluring, and investors tend to put a premium—often a sizable premium—on growth businesses considering their current levels of sales, cash flows, and profits (Exhibit 1).

Exhibit 1
Typical Value Stocks vs. Typical Growth Stock

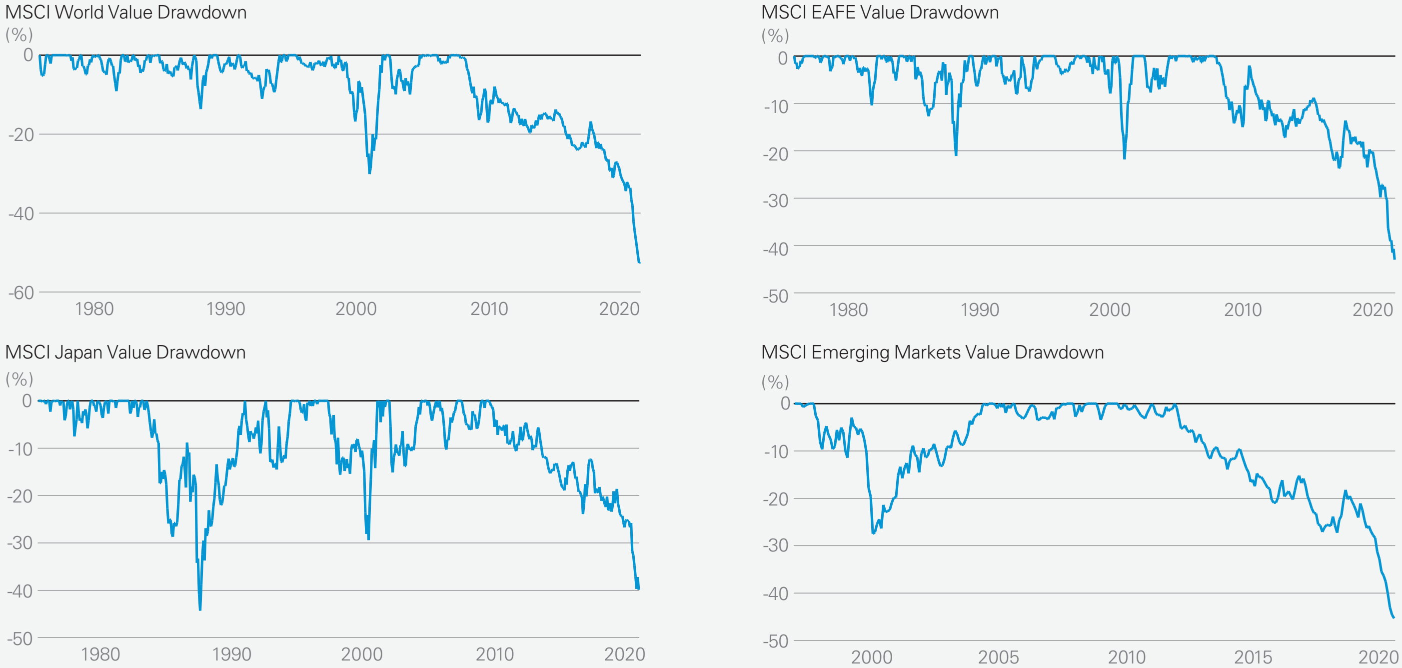


As of 31 October 2018
This information is for illustrative purposes only.
Source: FactSet, MSCI

Historically, growth investors have been rewarded only sporadically for consistently favoring growth stocks, most notably during the Nifty Fifty growth bull market of the late 1960s and early 1970s and the dot-com bubble of the late 1990s. The MSCI World Value Index outperformed the MSCI World Growth Index in 75% of the individual years from 1975 until 2006 by an average of 3.5%. The trend reversed after 2006, and the growth index has outperformed in 71% of the years since, by 5.7% on average. The acceleration of this shift since the end of 2016 has been quite extraordinary, with the MSCI World Growth Index outperforming the MSCI World Value Index by a factor of nearly 8 (92% total return to 12%). Even during the dot-com bubble, growth outperformed "only" by a factor of three (72.1% versus 23.5%). Exhibit 2 shows the drawdown of value versus growth since the Global Financial Crisis, as well as the acceleration of the trend in 2020.

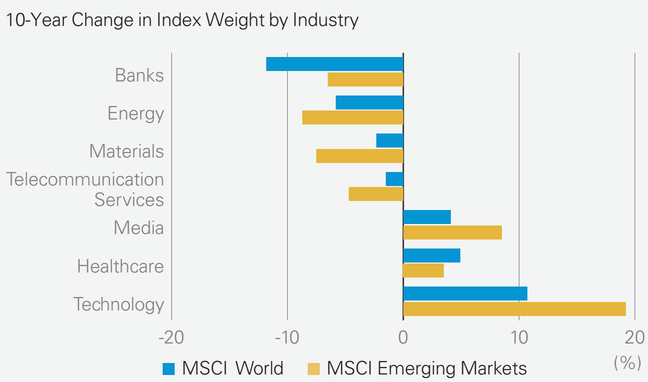
The enormous difference in return between traditional value sectors and traditional growth sectors has created some extraordinary sector shifts in the composition of global stock indices. The composition of the MSCI World Index has undergone a 21% shift over the last decade from traditional value sectors and industries (energy, banks, materials, and telecommunications) to traditional growth sectors and industries (healthcare, media, and technology), and the figure is even higher for the MSCI Emerging Markets Index (Exhibit 3). Furthermore, those figures do not account for intra-sector shifts due to disruption, such as the move from traditional brick-and-mortar retail to Amazon, traditional automakers such as Ford to Tesla, and traditional utilities such as Engie to solar provider Orsted. The total style shift determining the composition of the MSCI World Index and MSCI Emerging Markets Index would be an order of magnitude greater if the abovementioned sector changes were incorporated.

Exhibit 2
The Value-Growth Divergence in Freefall



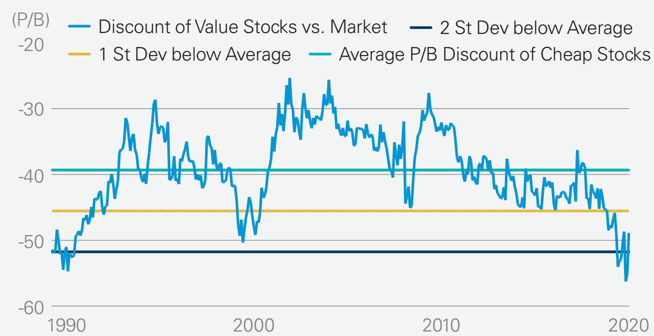
As of 30 September 2020
This chart reflects the cumulative underperformance of the MSCI Value Index from its previous high water mark versus the MSCI Growth Index for respective regions and countries
Source: Lazard, S&P Global BMI, FactSet

Exhibit 3
The Changing Face of Global Stock Indices



As of 30 September 2020
Source: MSCI

Exhibit 4
Value Implodes: Where to from Here?



As of 30 September 2020
Discount of value chart is comparing the valuation of the median ranked low P/B in quintile 1 versus the median P/B of the market. The universe is S&P Developed PMI of approximately 1800 companies. Value stocks are determined using an equal weighted combination of low P/E, P/B, and high dividend yield.
Source: Lazard, S&P

While substantial differences in the performance of growth and value sectors and the extraordinary performance of several very large US technology firms go a long way to explain the extraordinary divergence between value and growth, the divergence has taken place right down the capitalization spectrum. To illustrate this, we ranked all developed market stocks with a capitalization above $200 million on a monthly basis by their average sales growth over the preceding three years going back to 1989. We then compared how the top 20% of stocks performed in the subsequent month compared to the bottom 20% of stocks. From 1989 to 2016, high growth underperformed low growth by 1% per year on average. Since 2016, however, high growth outperformed low growth by an average of 8% a year. In the same vein, while stocks with low price-to-book (P/B) and price-to-earnings (P/E) values outperformed those with high P/B and P/E values by 13.7% a year between 1989 and 2016, cheap stocks have *underperformed* by 5.7% since 2016.

Today, the value discount is at a historic level. In exhibit 4, we illustrate the value discount over time compared to the broader market. Using our monthly stock rankings, we divided the median P/B of the 20% of stocks with the lowest P/B by the median P/B of the entire universe. Cheap stocks have traded at an average discount of 40% over the last three decades; however, that discount is currently more than 55%, its lowest level over the period.

Does the Value Premium Have a Structural Problem?

After such an extended period of underperformance, it is understandable that an increasing number of investors are questioning whether traditional value approaches and the inherent sectoral biases associated with them are now structurally impaired.

Inflation has been persistently low around the world for many years, and many worry that it may be so permanently. At the moment, inflation is caught in a feedback loop. The persistence of low inflation has encouraged central banks to maintain exceptionally low interest rates and quantitative easing policies, which has in turn put downward pressure on long-term inflation expectations and, in turn, long-term interest rates. In a world of elevated sovereign, corporate, and personal debt, policymakers place a heavy emphasis on making sure debt remains serviceable, and many feel that central banks will keep interest rates low for years to come to further that goal.

Low long-term interest rates mean a flatter yield curve and downward pressure on net interest margins for banks, a principal value industry. (Banks make money by making long-term loans at higher interest rates.) Persistent deflationary forces have also come via many commodity prices, including in energy, another key value sector. Arguably, it was easy monetary policy itself that encouraged massive investment in shale oil and gas, which ultimately resulted in a supply glut that led to a wave of bankruptcies and defaults in the industry between 2015 and 2017.

Demographics have also contributed to deflationary pressure. As the average age of the population rises, as it continues to do in most developed and many emerging economies, the tax base narrows, liabilities grow, and governments have less leeway to invest in their economies, which in turn leads to lower long-term growth potential.

Technology is another disruptive force that has been blamed for holding down inflation, typically through one of three channels: the automation of a service or method of manufacturing, the migration of services and sales online, and innovations in communication. "The disruptors" compete with the "the disrupted" in most sectors, with new, agile companies upending the existing way in which a market operates and traditional companies either investing and adapting or falling behind. Typically, the disrupting businesses are able to radically reduce their operating costs, provide lower prices to the consumer, or provide a consumer experience that is significantly more convenient or appealing. The US is the epicentre of disruptive technology, with Netflix providing a more flexible and appealing way to consume video content, Tesla advancing the integration of technology and driving, and of course, Amazon thoroughly upending the way retail operates.

The COVID-19 pandemic has further ingrained the idea that disruptive businesses represent not only the economy of the future, but the economy of today, and that the reweighting of major investment indices from old economy (value) sectors to new economy (growth) sectors is justified. Businesses have had to invest time and technology to ensure that millions of employees with "office jobs" could work from home indefinitely and find ways to measure productivity. The results are clearly preliminary, but many companies have reported a surprisingly smooth transition. Large corporations around the world will be questioning their real estate needs with a sharpened scalpel, which is sure to have an impact on real estate stocks and real estate investment trusts that were already battling what is arguably a structural downward shift in brick-and-mortar retail traffic due to e-commerce.

All of these deflationary forces have pushed investors to question the real value of the assets on the balance sheets of "old economy" companies. Instead, they are interested in the value of brands, superior technological processes, sticky product ecosystems a la Apple, and the intellectual capital necessary for continued innovation. The question is: Are these new priorities the right ones? In the end, the answer comes down to what the long-term cash flows of any given business will be. Predicting long-term cash flows is an inherently uncertain business, and right now, low discount rates inflate the value of long-term cash flow estimates. In the absence of a meaningful risk-free rate of return to fall back on, investors have been encouraged to ignore the fact that forecasting cash flows well into the future is a dicey proposition and believe rosy predictions based on current growth rates.

Deflationary forces have also forced value investors to evaluate whether traditional value industries have a future of any kind. Will policymakers be able to maintain low interest rates for the foreseeable future to balance a highly leveraged global financial system? Banks are increasingly seen as vessels of sovereign states, as demonstrated during the most difficult moments of the pandemic. Will they remain low return-on-equity businesses hamstrung by low inflation and the ever-present anvil of bad debts? Are insurers now perpetually recycling capital into low coupon bond assets and thus doomed to ever-lower returns on equity? Will automobile and energy companies be stuck with stranded assets and technology as governments act more aggressively to reduce carbon emissions? As digital services provide free audio, video, and text communication, will the cash flows of telecommunications companies remain persistently under pressure?

Most importantly: Are the prevailing high prices of today's growth businesses a testament not only to the extent of their disruption, but to the fact that investors simply have nowhere else to put their capital without seeing value destruction either by stealth, through low interest rates, or by outright losses from businesses in decline? These difficult questions are beyond the scope of this paper, but their urgency shows why the market value of growth and value businesses has diverged so dramatically and for so long.

The Return of the Value Premium: How It Could Happen

To fully accept the above narrative is to forget that stock markets represent nothing more than investors' assessments of how future cash flows will be distributed. Arguably, the kind of divergence we have seen between value and growth can only be possible if market participants deeply believe that traditional value businesses are structurally disadvantaged. When this has occurred in the past, it has historically proved to be the most dangerous time for investors who seek comfort in the safety and agreement of the crowd.

But what exactly might prompt the prevailing market narrative shift in favor of value businesses? To understand what might make investors question the price they are paying to own the most highly favored businesses, it's important to first understand which growth businesses the market has favored so enthusiastically and why.

The first growth darling is the so-called "moat" business: an established company that typically built up its market dominance over several decades through competent management; the establishment of a recognizable, world-leading brand; and the creation of ever more innovative production processes. Due to these deeply embedded strengths, moat businesses generally continue to enjoy strong and persistent returns on capital. The market understands the strengths of these businesses and values the profits and cash flows they produce more than that of other companies because it believes them to be extraordinarily durable and possibly permanent.

The second type of well-loved growth business is the "disrupter." This younger business is characterized by its rapid sales growth and acquisition of market share, often from inflexible, bureaucratic operators. Typically, these businesses produce little or no profit, but investors are happy to support and finance them because they reinvest heavily in their businesses in order to continue innovating or strengthening their positions within their industries. The companies tend to argue that they could pull back on reinvestment at any moment and send cash flows soaring, but they aim to achieve the aforementioned moat status first. Understanding what investors favor now and why, what might make them change their minds?

- **Rubber meets the road of economic reality:** Few disruptors and businesses with strong moats are immune to the profound economic shock of COVID-19. Indeed, many of them have seen earnings expectations sharply downgraded even as their stock prices have recovered and valuations soared. Visa, for example, is up 4% year to date, yet its forecast September 2021 earnings per share estimate has come down 18% since December. As a result, its P/E ratio has jumped 22% this year to a 12-year high. This lofty valuation comes even though Visa's business has no doubt been impacted by travel restrictions, which depress high-margin cross-border transactions. Many other travel-dependent businesses have experienced profound weakness in their share prices, and the trend begs the question of what lies ahead for Visa.
- **Unprecedented strain on government debt and deficit dynamics triggers currency debasement:** According to the Congressional Budget Office, the US budget deficit is projected to reach 16% of GDP in 2020 as of mid-October. Even assuming a strong economic recovery, the deficit is forecast at 8.6% of GDP in 2021, within range of the previous post-war record deficit of 9.8% in 2009. In the UK, the deficit is projected to hit 15%, and the government debt-to-GDP ratio is expected to soar past 100% in both nations. France, Italy, and Spain also exhibit troubling debt and deficit dynamics that will require the collective support of the euro area as a whole. Japan tops all other developed countries, with the debt-to-GDP ratio expected to hit 250% in the coming years. Only the UK has hit these kind of debt-to-GDP levels in the past—260% during World War II.

  These trends suggest to us that we are approaching the point at which only outright currency debasement, rather than productivity enhancements and economic growth, can bring down these ratios. In short, the crisis has severely compromised financial sustainability, and the likelihood of currency volatility and reversals has increased considerably. We believe a sustained or multi-year depreciation of the US dollar or the Japanese yen would support equities in regions that are cheap compared to the rest of the world — namely, emerging markets and Japan. In emerging markets, the cheaper dollar would boost the value of local currencies and inflate (USD priced) commodity prices. This improved local currency stability could then encourage foreign direct investment into emerging market countries. In Japan, a cheaper yen would help exporters such as industrial and mining companies, which are exceptionally unloved by the market. It would also likely raise longer-term inflation expectations, which would increase net interest margins for financial companies (given the steepening yield curves). With record low net interest margins and P/B ratios, Japanese banks would be sensitive to a shift in investor expectations on this front.
- **Inflation boosts commodity prices:** Mining and energy companies are a key component of the value investment complex and fit the textbook definition of a value company: The outlook for their capital-intensive businesses largely depends on exogenous macro factors that affect the performance of the underlying mixture of commodities they extract and sell. During this period of extended value underperformance, commodity price inflation has been absent or even declining. In many areas, particularly oil and gas, economic growth concerns have been a headwind for a number of years while supply growth has been strong.

  However, commodity price inflation was evident in the aftermath of the financial crisis, when easy monetary policy weakened the US dollar. As discussed above, the aggressive monetary and fiscal easing in the US recently might not only support commodity prices but prompt sustained inflation as aggressive currency debasement takes place. Should that happen, extractive industries could have a dramatic turnaround. The price of precious metals such as gold has already started to rise, and that increase could feed through to more economically sensitive industrial commodities. One potential caveat: In the longer term, supply disruptions may take place as nation-states encourage miners to decarbonize their businesses—further exacerbating inflationary pressures.

- **Government intervention rains on the parade:** Value sectors are typically well established, highly commoditized, and heavily regulated, but growth segments are constantly changing and consolidating by nature. Their relationships with the governments of countries in which they operate are not as well-formed as that of value sectors, and they can run into conflicts with sovereign states that try to ensure that they do not turn into monopolies as they gobble up market share or abuse regulatory and tax regimes. The actual changes that governments demand of these up-and-coming businesses are hugely sensitive to the degree of social and economic stress in a country and the amount of pressure from constituents to act on perceived excesses of power, special treatment, and rule-bending. While it is unpredictable, the threat of taxation, antitrust, and regulatory action on newer growth segments of the economy is real.
- **We don't know what we don't know:** It is worth mentioning again that growth companies and industries tend to be relatively new compared to value companies and industries, without the same experience of navigating through changing economic conditions.

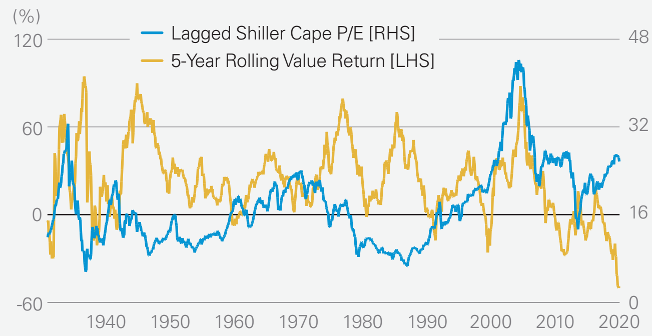
The potential catalysts we have outlined here would in most cases initially affect only a subset of value or growth stocks. However, such catalysts typically create a waterfall effect and end up boosting the performance of value assets globally, especially given how deeply entrenched the shift from value to growth assets has become at this point. Ultimately, the valuation multiple that any given stock trades on is in part determined by market sentiment, momentum trading flows, behavioral biases, and highly uncertain expectations about future cash flow expectations. Thus, any change to the thesis that underlies investors' views can be enough to trigger substantial de-ratings or re-ratings, even if the overall outlook for a given business does not change much at first.

What Will the Value Premium Look Like When It Returns?

When a growth market has shifted to value in the past, it has often done so quite suddenly. When we compared the rolling 5-year performance of low P/B stocks and high P/B stocks in the US, we found that the outperformance of value stocks has sometimes been explosive.

We then attempted to find out why. By comparing the rolling 5-year performance to the 5-year *lagged* Shiller cyclically adjusted P/E ratio (Exhibit 5), we found that one of two conditions existed before the most explosive value rallies. Either the overall market was trading at exceptionally low cyclically adjusted valuations, as in 1932, 1940, and 1980, or a significant polarisation had opened between growth and value stocks, as in the Nifty Fifty period of the late 1960s or the dot-com bubble in the late 1990s. In each of these five instances, investors had written off value stocks as casualties either of desperately weak economies or as "old economy" stocks doomed to fail in a new

Exhibit 5
Exceptionally Low Market Valuations Preceded Several Historical Value Rallies



As of 31 August 2020
Source: Kenneth French via the Tuck School of Business, Robert Shiller via Yale School of Management

economic paradigm, only to see them defy expectations. Today, we have a combination of both characteristics. Value stocks are pricing in an extremely weak economic outlook, and the continued strong performance of growth stocks in a few disruptive sectors, such as technology, are holding up the overall market.

The enormous returns to value have tended historically to manifest in three phases: investors benefit from base effects due to the low price of a stock, profits recover, and the stock re-rates. It is instructive to examine how this process works in one individual stock to start. As we've already mentioned, we believe investors must be willing to continue adding capital when short-term price movements go against them in order to benefit from the value premium. Adding capital into short-term weakness can improve the average price of the investment and put investors in a position to take advantage of the base effect of a low price–the supercharged return that occurs when headwinds subside, and a very low valuation begins to unwind. Next comes the previously unthinkable development: an improvement in the profitability outlook for a company. When that happens, a market that has grown accustomed to disappointment suddenly receives a report that earnings will be "better than expected." Analysts upgrade their outlooks to align with the improved valuation. After the initial solid earnings report, the company goes on to report earnings that are either much more consistent or that beat expectations again, in which case *the valuation improves further*.

During the five periods of large historic value returns, all three developments in this sequence occurred for a large number of stocks. Regardless of one's view on the outlook for the value premium, the unusually depressed prices for value securities have the makings for substantial returns in the years ahead.

Conclusion—The Role of Active Investing

We have defined the position value stocks and sectors inhabit in listed equity markets, their typical characteristics and risks to investors, and how investment professionals can adapt to effectively harness the value premium. We have also explained how the recent phenomenon of ultra-low inflation, shifting demographics, and an explosion of disruptive technology have conspired to drive investor interest away from traditional value businesses and toward the excitement of supposedly forward-thinking growth businesses.

There has been an enormous shift in how our equity markets are composed and weighted, and perhaps that shift is a fair reflection of how economic structures have changed. However, in the past, when the pace of such shifts has accelerated as they have since 2018, dramatic reversals in which value assets enjoy extraordinary outperformance have typically followed. Today's growth concentration at the top of widely followed indices—the top 10 stocks comprise 31.8% of the index in emerging markets and 18% of the index in developed as of mid-October—raise the risk that investors could be disappointed with the equity risk premium they ultimately receive should the boat tip back the other way. Put a bit more bluntly, if the stocks that are carrying today's market fall into a sustained slump, it could hamstring the equity risk premium for years to come. We believe active investment is one of the few ways to not only manage the risks associated with tectonic market shifts, but also to be reactive as events unfold and ensure index risks don't manifest themselves in performance.