



The Case for Value

JUNE 2013

Some people think value investing is a defensive tactic used to weather bear markets; an approach that will protect against steep losses but won't provide much gain over a long time frame. However, from a historical perspective, long-term returns for value stocks have been strong.

Multiples and Metrics

A key aspect of value investing is digging into a given company's fundamental characteristics and examining the relationship between what you would pay for its stock (the price) and what you estimate that stock to really be worth (its value). To help make this comparison, value investors often use multiples, or metrics. One widely used metric, the "Price to Trailing 12 Months Earnings ratio," or P/E, compares a company's current share price to its per-share earnings. Think of this as a price tag on \$1 of a company's earnings. For example, a P/E of 7.8 means a stock buyer will pay \$7.80 for every \$1 the company earns. In general, a relatively low P/E, as compared to the P/E of an industry, or broad-based market, is often associated with companies that are undervalued, whereas a high P/E is often associated with companies that are expensive.

The table on the next page breaks the components of the U.S. equity market into deciles, based on their yearly P/E ratio. The lowest decile contains stocks with the lowest P/E. The highest P/E are in the 10th decile. The table shows that the average subsequent annualized return for decile 1 between December 1975 and December 2010 was 17.7%, versus a return of 8.7% for decile 10. Over the same period, the average annualized return for the S&P 500 was 11.2%, indicating that the lowest decile of stocks (value stocks) outperformed by 6.5%.

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	Lowest Decile P/E Return %	2nd Decile P/E Return %	3rd Decile P/E Return %	4th Decile P/E Return %	5th Decile P/E Return %	6th Decile P/E Return %	7th Decile P/E Return %	8th Decile P/E Return %	9th Decile P/E Return %	Highest Decile P/E Return %	S&P 500 % Return %
1975	54.25	64.47	57.1	46.23	49.89	46.57	48.3	42.26	37.64	26.01	37.23
1976	46.95	54.82	47.33	37.73	38.03	35.47	30.04	22.8	16.95	10.35	23.93
1977	5.53	10.24	-0.28	5.22	3.27	2.8	-0.28	-5.24	-5.35	-7.23	-7.16
1978	12.19	11.57	7.51	7.18	4.49	3.53	8.43	7.49	12.37	10.72	6.57
1979	30.69	23.58	27.75	20.46	17.89	25.71	26.24	30.97	36.82	44.61	18.61
1980	21.35	19.23	15.31	22.9	17.14	21.33	34.02	32.62	46.76	61.05	32.5
1981	11.61	16.04	12.32	15.05	-3.59	-2.21	1.24	-1.1	-11.78	-14.54	-4.92
1982	24.52	24.02	28.91	25.59	21.37	24.28	18.21	23.8	35.38	15.07	21.55
1983	29.33	25.11	28.82	28.9	26.29	28.22	26.89	27.77	18.7	27.76	22.56
1984	21.04	16.54	9.70	7.78	-0.16	-0.35	-0.94	-8.43	-17.86	-14.30	6.27
1985	35.85	36.7	33.97	35.45	33.27	30.32	25.56	30.42	26.35	22.66	31.73
1986	22.2	19.97	22.88	12.48	19.35	19.1	12.11	11.81	8.83	8.85	18.67
1987	-6.48	-4.29	-7.14	-1.82	-1.95	-0.66	3.2	5.02	5.06	-0.35	5.25
1988	22.74	25.29	24.79	23.96	24.99	17.77	18.98	15.73	13.05	12.56	16.61
1989	24.56	19.98	22.82	24.08	19.82	26.74	21.08	22.07	22.07	23.37	31.69
1990	-26.79	-13.39	-13.87	-12.42	-9.13	-5.86	-3.83	-10.65	-7.95	-17.78	-3.10
1991	56.04	49.41	42.84	38.41	34.64	32.06	34.78	36.57	37.27	44.25	30.47
1992	29.58	21.86	17.32	16.98	14.61	11.51	17.59	10.67	16.81	10.98	7.62
1993	18.63	14.1	9.83	12.92	18.52	17.6	11.79	15.63	27.89	19.86	10.08
1994	-4.79	-0.85	0.03	0.45	-0.84	-1.03	3.46	-2.88	-3.35	-2.00	1.32
1995	45.48	35.69	28.88	27.02	25.75	22.2	29.66	27.72	28.51	32.57	37.58
1996	20.63	26.51	21.31	24.79	24.1	18.55	17.98	20.91	14.72	19.35	22.96
1997	40.76	29.11	39.07	32.25	30.62	27.06	27.43	16.56	17.72	8.68	33.36
1998	-4.59	-4.16	-0.56	1.02	-2.19	0.40	6.8	9.94	13.48	6.14	28.58
1999	9.91	-3.4	-0.18	0.70	-2.01	4.15	12.51	13.70	21.84	16.93	21.04
2000	24.3	21.5	17.2	22.37	18.44	10.03	6.84	5.59	-5.13	-11.18	-9.1
2001	24.5	22.72	16.23	12.87	12.66	6.59	5.53	-2.99	-3.28	-21.7	-11.89
2002	-2.76	-0.58	-3.01	-2.46	-3.66	-12.76	-9.66	-13.21	-21.76	-30.42	-22.1
2003	57.48	39.17	39.99	31.49	35.19	38.28	36.95	36.3	33.66	47.89	28.68
2004	29.62	25.09	22.37	23.03	19.45	22.57	17.97	16.03	17.43	15.83	10.88
2005	11.31	11.15	9.1	5.71	8.75	7.27	7.7	9.28	9.64	11.9	4.9
2006	16.39	19.13	14.96	17.4	19.39	16.56	15.56	13.48	12.9	17.09	15.79
2007	0.47	-2.96	-4.24	0.32	2.03	3.69	8.51	13.83	8.28	2.4	5.49
2008	-43.62	-35.88	-33.28	-31.3	-32.74	-39.7	-36.08	-40.63	-41.79	-42.51	-37
2009	75.26	59.62	49.74	40.89	35.27	23.83	20.32	28.47	23.32	31.46	26.46
2010	24.21	18.27	23.3	21.04	19.07	24.21	27.17	27.69	27.07	27.84	15.06
35 year Average Annualized Rate of Return	17.73	16.41	14.86	14.54	12.81	11.88	12.77	11.45	10.69	8.71	11.18

Lowest decile less than Index 

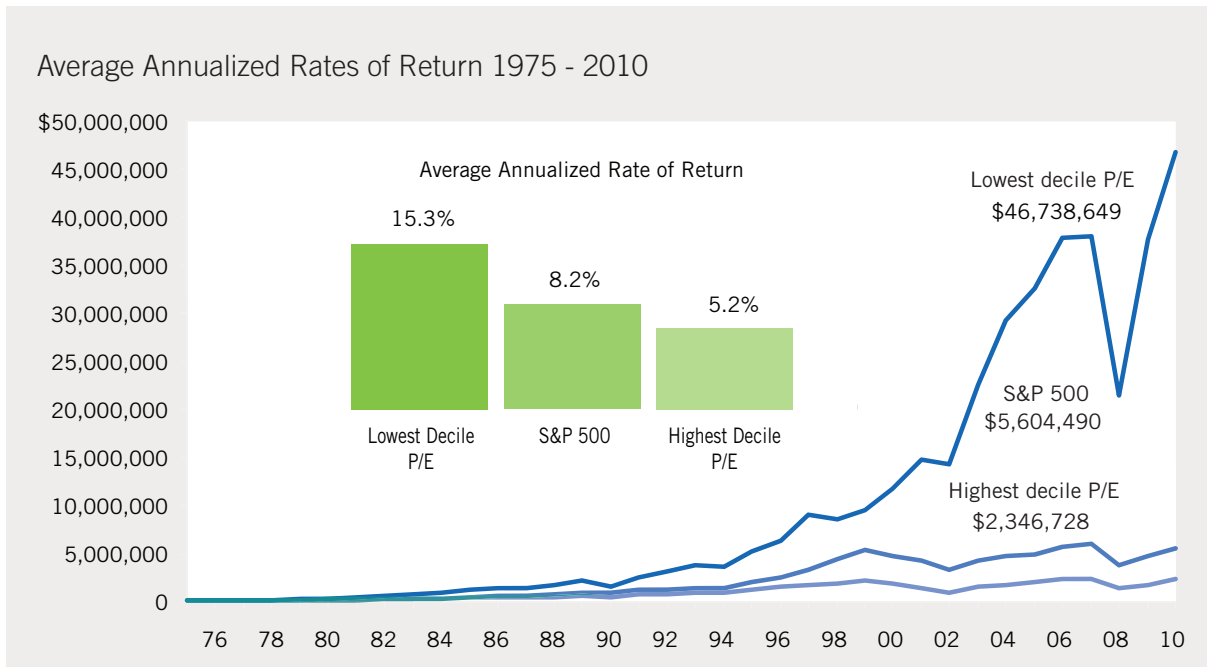
Source: Compustat via Facenet. Deciles are rebalanced annually. Data as at 12/31/10. Decile returns are equal-weighted

*Universe contains the largest 50% of the NYSE, AMEX, and Nasdaq-listed stocks with PEs greater than or equal to zero at the beginning of each period. Performance is historical and should not be considered a prediction for future results. Dividend and capital gains are assumed reinvested with no fees or tax included. Individual results may vary.

In Dollar Terms

The graph below shows how \$100,000 would have grown based on the returns of the lowest decile, highest decile, and the S&P 500. Based on returns of the lowest decile, \$100,000 would have grown to \$46.7 million; the highest decile to \$2.3 million; and the S&P 500 to \$5.6 million.

In other words, the value decile would have returned \$20 million more than the highest P/E decile, or growth decile.



Source: Compustat via Faciset. Deciles are rebalanced annually. Data as at 12/31/10.

In Short

Over the 36-year period reviewed, U.S. companies that sold for a low price relative to their past year's earnings provided a substantially higher return than those whose price exceeded earnings by a large margin.

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Published June 2013