

CONTENTS

Feature Articles

This month's focus: **Value Investment and Its Future**

Overview *Yasuyuki Kato, CMA* 2

Articles

A Comparison of Value Factor Performance in Global Markets
..... *Hikomichi Tamura, CMA / Alex Chen* 6

In recent years, the value factor has been stagnating in global markets. In this paper, we reexamine the overall picture and make global comparisons by region and time period. In order to take a closer look at the sources of value performance, we observed 'pure' value factor return using a method that completely neutralizes the influence of sectors and other factors (referred to as 'off-targets'). As a result, we found that (1) over the past two decades, conventional value has shown positive premiums in five regions, while the US has almost zero returns when observed in terms of pure value; (2) comparing conventional value and pure value, the returns of conventional value are higher in the US and Japan because non-value factors such as industry and off-targets contribute more to conventional value in these regions; and (3) comparing pre-global financial crisis (GFC) and post-GFC periods, performance of the conventional value factor declined in all five regions, but, in terms of pure value, the decline in performance in the US, the epicenter of the financial crisis, was minimal.

Revisiting Value Investing: Evaluation under Perfect Foresight
..... *Hideaki Kudoh, CMA / Daisuke Katayama, CMA / Kentaro Takayanagi, CMA* 17

Value investing in Japanese equities used to be known for its stable investment return that was rarely observed elsewhere in the world. However, investing in value stocks has continued to perform poorly in recent years not only in Japan, but also in other parts of the world. We review the status of value investing so far, and examine the reduction in the value effect from the perspective of corporate performance. First, it is confirmed that from 2010 onward, even if expected profit and ex-post realized profit were undervalued, the undervaluation does not disappear in the Japanese stock market. Second, price formation in accordance with the change in ex-post realized profit was functioning throughout each period. However, from 2018 onward, both the Japanese and US stock markets have fallen into a situation in which investors have not been able to obtain excess returns even if stock prices are undervalued ex post facto or in the future. Although market pricing for value stocks has been functioning properly over the long term, the price discovery function has not been functioning in recent years, and the stock market may have become dysfunctional.

Alpha or Beta? Understanding the Value Effect with Machine Learning	
..... Makoto Naito / Tomonori Uchiyama, CMA / Yasuhiro Shimizu, CMA / Sho Nishiuchi, CMA CIIA	29

Is the value effect alpha or beta? The answer from this study is beta. We construct a five-factor model with neural networks based on the Japanese equity market while avoiding data-snooping bias. Our out-of-sample tests show that the predictable component of stock returns by the value characteristic is captured by factor premiums, and also that excess returns on value stocks can be explained by factor premiums. It is important to consider time-varying exposures in addition to identifying factors when estimating expected returns on stocks.

Three Blunders That Affect Factor Investing	
..... Rob Arnott / Campbell R. Harvey / Vitali Kalesnik / Juhani Linnainmaa / Noritaka Tamura, CMA / Kohei Ando, CMA	41

Factor investing has failed to live up to its many promises. Its success is compromised by three problems that are often underappreciated by investors. We explore these three problems using evidence on factor performance from the US, Europe, and Japan. First, many investors believe their own backtests, embracing exaggerated expectations about factor performance as a result of, for example, data mining, crowding, and unrealistic—or ignored—trading costs. Second, for investors using naïve risk management tools, factor returns can experience downside shocks far larger than would be expected. Finally, investors are often led to believe their factor portfolio is diversified. In certain economic conditions in which factor returns become much more correlated, the benefits of diversification disappear. Factor investing is a powerful tool, but understanding the risks involved is essential before adopting this investment framework.

Prospects

Amendments to Lease Accounting Standard	Satoshi Komiyama	51
--	------------------	----

Economic and Industrial Analysis

Fiduciary Duty of Asset Managers in the US	Yoshinobu Tomomatsu	57
---	---------------------	----

Point of View	Tsutomu Watanabe	70
----------------------------	------------------	----

Book Reviews

.....	Katsuhiko Okada / Satoshi Sakamaki, CMA / Tetsuo Kitagawa	75
-------	---	----

SAAJ News		82
------------------------	--	----