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CONTENTS

Feature Articles

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

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.

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.

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