Index Insights | Russell US Indexes

Trends in growth and value: Cycles and market regimes

A four-part analysis

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Overview

The enduring appeal of style investing lies in its intuitive nature and ease of use. Even with the rise of more intricate factor strategies, the original Russell style methodology creates clear segmentation of the market along meaningful and powerful lines[1]. Growth and value in particular created an almost Shakespearean dialogue, where subsequent generations of investors have debated, measured market risks, and allocated towards their investment objectives through the lens of these two contrasting, yet complementary, investment styles.

This paper is the first in a series of four analyses to further this generational understanding of growth and value style methodologies, along with their practical implications. The intension is not only to explore how these frameworks can decompose market risks, but, more importantly, inform evidence-based investment outcomes. These papers examine four critical questions on the evolution of U.S. growth and value style market regimes, namely:

1. How long do growth and value market cycles typically last?
2. How impactful are oscillations between growth and value?
3. How do style regimes transition? Are shifts slow or sudden?
4. What factors motivate performance disparities between growth and value?

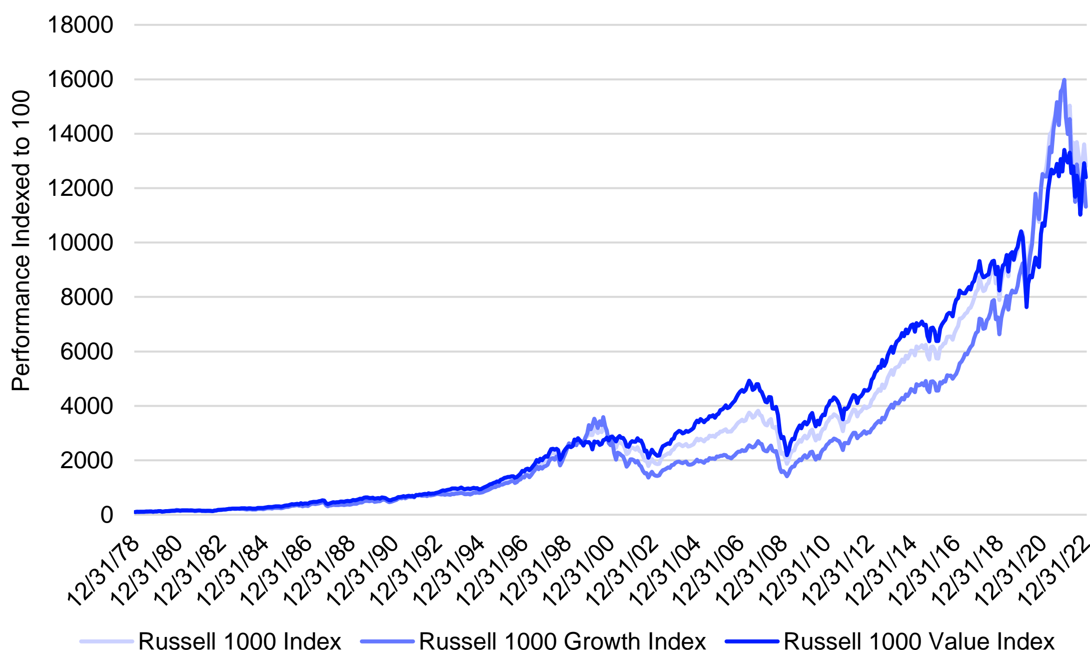
The recent shift to value lends a renewed credence to these cycles within the growth and value paradigm, especially following the unprecedented Great Growth Regime of the last decade plus. This analysis will focus on the initial question, introducing a methodology to compare different growth and value regimes so as to quantify their length and consistency. Here, we leverage over four decades of Russell 1000 Growth and Value data to not only understand historical patterns and behaviors, but to better contextualize our current market positioning. Ultimately, we find style regimes are not transitory phenomena measured in months, but durable trends measured on multi-year horizons.

[1] Russell growth and value style methodologies implement a simple ranking technique to achieve separation in a starting universe, such as the Russell 1000 Index, for instance. For value, stocks are ranked by their Book to Price ratios, and for growth a composite is used of a stock's five-year historical revenue growth and two-year IBES revenue growth forecast. For a full overview of Russell Style Indices construction, please refer to the Russell methodology guide here.

The long view of growth and value

From an inception point in December 1978, 43 years of history of Russell 1000 Growth and Value indices have produced surprisingly coincident total returns, differing by only 8.7% as of December 31, 2022. As Figure 1 depicts, however, these indices have taken remarkably different trajectories to arrive at their current positioning (this outcome is a simply a curiosity; there is little reason to expect growth and value returns to align over any long-term history, quite to the contrary in fact). Recognizing these periods where one style manifestly outperforms its counterpart, and deciphering patterns as to their longevity, is our primary focus.

Figure 1: The long view of market and style total returns

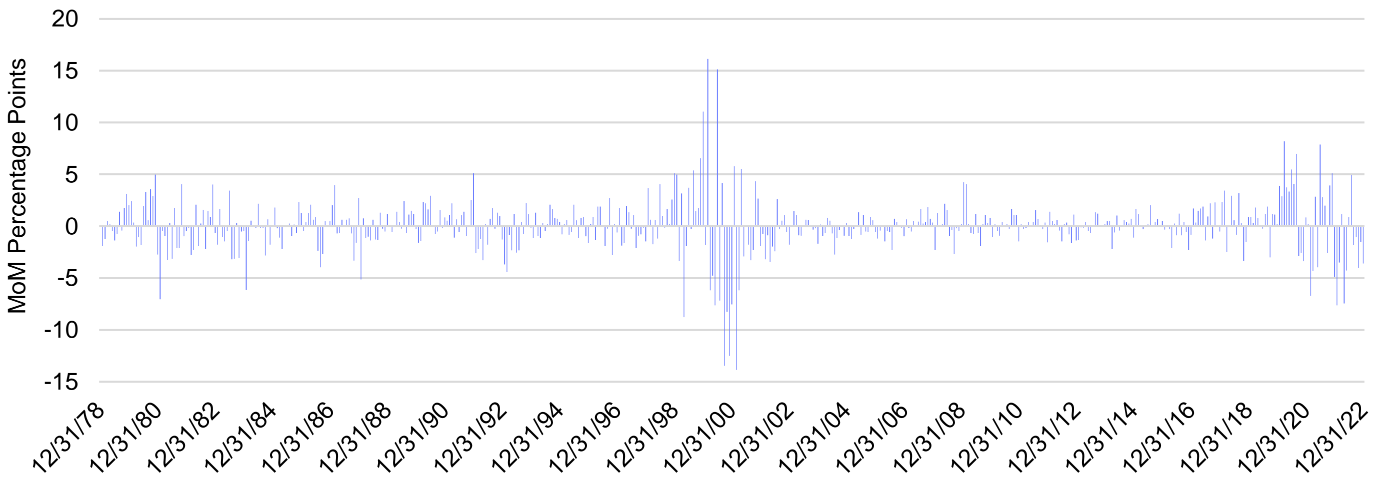


Source: FTSE Russell, December 2022.

Both optically and from a data analysis standpoint, raw total returns make a poor filter through which to interpret growth and value trends. While giving a sense of scale to 140-fold returns, the compounding of equity returns renders any fluctuations before 1998 completely indistinct, and deviations thereafter are also lost in the overall upward arc in asset prices. Moreover, the observed trends are highly dependent on chosen starting date; an analysis beginning in 1988 or 2008 would produce substantially different outcomes from one beginning in 1978.

A further challenge in assessing growth versus value regimes is that these trends are far from clear cut—rather the style premia involve a fair degree of noise. Contrast this inconsistency with other familiar market cycles, such as interest rates regimes or business cycles with well-pronounced trends, and the distinction is quite clear. Figure 2 illustrates this point concretely by referencing the month-over-month change in the ratio of growth and value total returns, expressed in percentage points. For example, a positive value of five would signify that growth outperformed value in a given month so as to increase the ratio of total returns by five percentage points. The challenge remains however, that unless your eye is extraordinarily perceptive, clear trends remain elusive amid the month-to-month reversals. In fact, in only 51.9% of occasions do style trends continue in the same direction over consecutive months—indistinguishable statistically from a coin toss.

Figure 2: Monthly change in style total return ratio: 1979–2022



Change in the ratio featured in Figure 2, units in percentage points. Positive values indicate positive returns to growth, negative returns to value. While style returns are impactful, their behavior is noisy month to month.

Source: FTSE Russell, December 2022.

To create consistency and cross comparability over such an extended time period, this analysis concentrates on the relationships exhibited in Figure 3, which depicts the ratio of growth to value total returns rebased to 100. In other words, it aggregates all the month-to-month changes from Figure 2, and immediately patterns emerge that can be measured and compared across expansive time periods. Upward surges in the graph reflect the dominance of growth performance, while downward trends indicate a rotation towards value. As an alternative reference point, Figure 3 can be interpreted as diving the orange line by the grey line from Figure 1. Notable is how much chart real estate is occupied by values below 100 which indicate strength in value returns; in 85% of time periods, investors were better served allocating to value starting from December 1978.

Figure 3: Ratio of growth to value total returns: 1979–2022

Depiction of Russell 1000 Growth Index total returns divided by Russell 1000 Value Index total returns, parity set to 100 with an inception date of December 31st, 1978. Upward trends indicate strong growth performance, downward trends reveal strength in value. In total we observe nine distinct cycles of styles returns. Source: FTSE Russell, December 2022.

Time is money, but for how long and in what direction?

In spite of these challenges, connecting local highs and lows in the ratio of growth to value returns can identify discrete style regimes, where one strategy is clearly favored over the other. Overall, nine distinct cycles emerge over the 43-year history, beginning with (1) a late 70's growth tilt, followed by (2) the long 80's value regime, (3) the late 80's growth rebound following the '87 crash, (4) the early 90's value reversion, (5) the mid 90's slight tilt to growth, (6) the dot.com bubble formation and (7) subsequent bursting, leading to (8) the Great Growth Regime and finally (9) the present value resurgence starting late 2021.

Table 1: Breakdown of nine growth and value market cycles

Regime	Start	End	G/V	Duration	PP Change
1	7/31/1979	11/30/1980	94.90	16	23.13
2	11/30/1980	8/31/1988	118.00	93	-44.01
3	8/31/1988	12/31/1991	74.00	40	27.25
4	12/31/1991	9/30/1993	101.30	21	-22.96
5	9/30/1993	5/30/1998	78.30	56	6.41
6	5/30/1998	2/29/2000	84.70	21	52.68
7	2/29/2000	7/31/2006	137.40	77	-86.24
8	7/31/2006	11/30/2021	51.20	184	72.91
9	11/30/2021	-	124.10	13	-32.75

Column G/V denotes the ratio of total returns of Russell 1000 Growth and Value Style indices since 12/31/1978 at the *start date* of a new regime, scaled to 100 at inception. PP Change describes the percentage point change in the aforementioned ratio. Source: FTSE Russell, December 2022.

Even with this ratio of total returns methodology, some judgement calls remain. For instance, while cycles five and six are both growth regimes, the period from 1998–2000 exhibited a 22-fold more intense tilt to growth than that from 1993–1998; a separation is warranted. Moreover, determining the end date, the Great Growth Regime is likewise ambiguous. While the absolute peak return to growth occurred in August 2020, the November 2021 local peak sees a 96% reversal of the intervening trend towards value. This case excellently illustrates the artform in interpreting these style trends; which point marks the decisive turn towards value? The stronger argument is that the first peak reflects extraordinary volatility in the market overall—style returns in particular—and the second peak reflects the true changing of the guard to from growth to value.

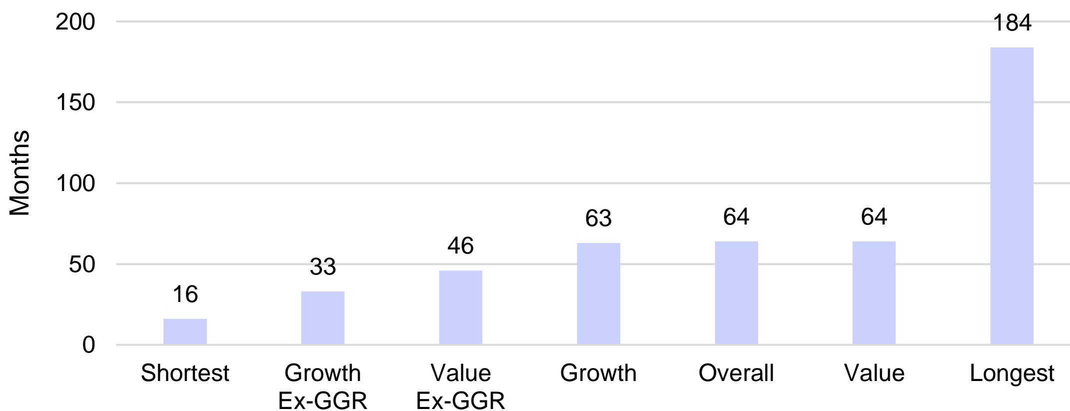
By identifying these distinct periods of market performance, we can now examine patterns in the duration of style regimes. On average, growth and value cycles have lasted just over five years at 63 months in duration, but the dispersion in regime length is substantial. For instance, while the shortest regime was only 16 months, the longest cycle persisted for an astounding 184 months, an 11.5-fold increase in duration! This extreme range, and indeed inconsistency, with respect to regime length, is a central finding of this analysis, but further context can illuminate more useful relationships.

The growth elephant in the room

Isolating the impact of the Great Growth Regime (GGR), which spanned over 15 years from 2006 through the end of 2021, leads to a more precise understanding of typical style regime length. It simply cannot be underscored how much of an outlier the GGR was, a truly unique event in financial history. Figure 3 depicts the dominance of the GGR, which stands 2.3 standard deviations from the mean regime length overall, and 4.6 standard deviations out if the GGR is excluded from the overall sample. For those who require more convincing, the GGR is a staggering 8.2 standard deviations out from the mean duration of the mainline growth cycles—indeed it is nearly twice the size of the next largest observation!

If statistical evidence alone is not persuasive, consider the macroeconomic context behind the GGR. Foremost, a banking collapse facilitated a low interest rate and low inflation environment to endure for over a decade, and the rise of digital platforms enabled a small cohort of companies with similar commercial and market risk profiles to dominate asset returns. Moreover, the GGR was unique to the U.S. market, a phenomenon not paralleled in the asset returns of European or other developed markets. These quantitative and qualitative characteristics both categorically distinguish the GGR from conventional growth and value cycles—it is simply far too divergent from any other style cycle on record.

Figure 4: Distribution of style regime lengths



The Great Growth Regime (GGR) is the clear outlier in cycle duration. Source: FTSE Russell, December 2022.

Being such an aberration, this latest growth regime does not lend itself to predicting future cycle behavior, and expectations are better formed by analyzing the remaining historical cycles. By eliminating the GGR from sample, the overall average cycle duration falls from 63 months to 46 months as displayed in Figure 4. Furthermore, the average length of growth cycles decreases from 63 months to 33 months duration.

Two key observations follow, foremost that value cycles have historically persisted for twice as long on average as growth cycles (64 versus 33 months). Second, such is the influence of the GGR that its exclusion alone is responsible for striking the observed parity between overall, growth and value cycle averages. While each cycle is varied, by recognizing the Great Growth Regime as *sui generis*, discernible patterns can be uncovered in the lifecycles of growth and value regimes.

Conclusion and market implications

Examining the last 43 years of Russell 1000 Growth and Value Index data reveals nine distinct periods of style performance in terms of growth and value. Using a ratio of index total returns, the average cycle length when excluding the Great Growth Regime stands at 3.8 years, and value cycles have typically lasted nearly twice as long as their growth counterparts. Noteworthy is that growth cycles have overrepresented themselves in the observation history, constituting 60.1% of the total time duration. With trends in cycle length established, subsequent analysis will focus on the relative impacts of style performance, how regimes transition from growth to value and vice versa, as well as the factors that motivate overall style returns.

Given the recent and impactful turn towards value style premia, how long can this current regime be expected to continue? The substantial variability in cycle length, however, both on the growth and value sides, confounds forward-looking expectations. Nonetheless, style regimes are conclusively long-term trends that persist for multiple years; these cycles are not "flavor of the month" phenomena, nor do they fluctuate on an annual basis. With the present value regime celebrating its one-year anniversary, past data indicates this new market direction may still be in the early innings.

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