John’s Take 1-16-24

A Simple way to make a 100% Return in the Market, Part 2

Last week, I discussed historical spreads between value stocks and the broader market that could lead to huge gains *when* that spread closes.

These extremes are *always* close.

Why is that?

Eventually, the return potential is too high to ignore, and money begins to flow into the underappreciated segment of the market. That flow of funds creates a new trend of the unloved asset outperforming the other side of the trade (in this case, the broader market), and it becomes a self-reinforcing positive cycle.

We see this over and over again.

Markets change. Human nature does not.

People assume Nvidia, Apple, or Tesla will be the dominant companies for as far as the eye can see.

But, the leaders of one market cycle are seldom the leaders of the next.

Where were the "Nifty 50" stocks from the 1970s? Where are the "Four Horsemen of the Internet" from the end of the last century?

A lot of them are dead money

I used this chart from last week to show we are at 40-year extremes in the value spread!

The latest string of losses has pushed the total return ratio between value and growth stocks to a 23-year low. It would only take a few more bad days for value and good ones for growth to send the ratio to its lowest level in more than 40 years.

We know we are at extremes, and we don't know when the spread will become *too* extreme. The spread could widen further.

I've not developed an indicator that tells me precisely when I should make a trade. That said, 40-year extremes interest me.

I didn't discuss how to invest in this trade last week. Readers asked a few questions, so I wanted to address them this week.

My preference is for exchange-traded funds (ETFs).

ETFs are easy to trade and contain an entire portfolio based on a specific methodology, such as the S&P 500, small-cap stocks, or value stocks.

The issue with individual stocks is that companies can have all sorts of problems specific to the company regardless of whether the stock is a "value" play or "cheap."

That said, if you picked individual companies and chose wisely, you'd likely outperform owning an ETF by a massive margin.

This type of trade calls for a shotgun approach instead of sniper precision though.

Surprisingly, the ETF options are not great. There are more indexes out there than individual stocks. You can buy an index to replicate almost anything.

One good, free resource is the ETF Database. You can go to etdb.com to analyze investable options for various strategies.

That’s what I use.

Here's a list of some of these value ETFs ranked by assets.

VettaFi ETF Database Channels Tools

Symbol	ETF Name	Asset Class	Total Assets ($MM)
VTV	Vanguard Value ETF	Equity	$127,397
XLE	Energy Select Sector SPDR Fund	Equity	$33,713
VBR	Vanguard Small Cap Value ETF	Equity	$30,539
DVY	iShares Select Dividend ETF	Equity	$19,569
EFV	iShares MSCI EAFE Value ETF	Equity	$19,003
XLU	Utilities Select Sector SPDR Fund	Equity	$16,400
AVUV	Avantis U.S. Small Cap Value ETF	Equity	$15,066
IWS	iShares Russell Mid-Cap Value ETF	Equity	$13,453
CGDV	Capital Group Dividend Value ETF	Equity	$12,342
DFUV	Dimensional US Marketwide Value ETF	Equity	$11,071
DFAT	Dimensional U.S. Targeted Value ETF	Equity	$10,554

The S&P Value indexes are crude. They carve out a piece of the S&P 500 using the cheapest metrics for book value, earnings, and sales.

I wrote an award-winning and best-selling book called *What's Behind the Numbers?* on the ways that companies can pull the wool over investors' eyes when it comes to book value, earnings, and sales.

Having written the book on these deceptions, you can understand why I'm not excited about the S&P methodology.

The best I can find from the list of ETFs is from Dimensional Fund Advisors. They've been around for over 40 years and have hundreds of billions of dollars under management.

Their strategies are built around market anomalies. Dimensional still uses relative price ratios like the S&P strategies, but they cast a wider net. You clearly get some benefit from smaller companies. They also use profitability; however, I caution again that earnings can be highly manipulated.

Anyway, you play the hand you're dealt. Dimensional appears to be the best option. It's just not perfect.

Below is a list of ETFs that Dimensional manages. The value ones clearly say "value" in the name:

Equity ETFs	Ticker	Inception Year	Expense Ratio[1] Gross	Net
US EQUITY				
ALL CAP				
US Equity Market ETF	DFUS	2001	0.09	0.09
US Core Equity Market ETF[2]	DFAU	2020	0.12	0.12
US Core Equity 1 ETF	DCOR	2023	0.17	0.14
US Core Equity 2 ETF	DFAC	2007	0.17	0.17
US Sustainability Core 1 ETF	DFSU	2022	0.20	0.18
US Vector Equity ETF[3]	DXUV	2024	0.30	0.28
US Marketwide Value ETF	DFUV	1998	0.21	0.21
LARGE CAP				
US Large Cap Vector ETF	DFVX	2023	0.23	0.22
US Large Cap Value ETF	DFLV	2022	0.24	0.22
US High Profitability ETF	DUHP	2022	0.22	0.22
SMID CAP				
US Targeted Value ETF[4]	DFAT	1998	0.28	0.28
SMALL CAP				
US Small Cap ETF[4]	DFAS	1998	0.26	0.26
US Small Cap Value ETF	DFSV	2022	0.31	0.31

The spread will close at some point, and the returns will be outsized. It's more important to be in the game than to slice and dice the investments too much.

If I were to make a prediction—which I don't like to do—we may see the spread close in a bear market for the key drivers of the S&P 500. As Apple, Nvidia, Tesla, and Amazon

fall into a bear market, money will flow elsewhere, and "value" bargains will be snapped up.

We may be getting close!

I always like to hear from readers. Questions, comments, and snide remarks will reach me at jd@unboundedwealth.com

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