



The Value Anomaly – Why Dirt Cheap Stocks Outperform

Description

There is one kind of stock that has consistently out-performed other stocks over several decades.

It's not cannabis stocks, crypto stocks, or any other category of "hot" stocks.

Rather, it's beaten down value stocks that have fallen to the point that they trade below fair value. According to research by Economist Victoria Galsband, cheap stocks out-performed growth stocks from 1975 to 2010 in [every single G7 country](#). The G7 consists of Canada, the U.S., Japan and the biggest European countries – it is a pre-existing set, not a group of countries cherry-picked to make the data work.

Put simply: value outperforms, across countries and over long time periods.

The question is, why? According to the Efficient Market Hypothesis, any market anomaly that results in superior returns should be exploited by traders until it no longer exists. Galsband's research suggests that the value anomaly has been going strong for at least two decades. It seems paradoxical, but as you're about to see, there are good reasons for it to have lasted a long time.

Crowd psychology

One reason why the value anomaly persists is because of crowd psychology. Psychological studies have shown that people are strongly influenced by their peers. For example, a French study found that people became more extreme in their political positions after participating in a group discussion. With reinforcement from others, a person will have more conviction in their actions. This would seem to create social pressure against value investing – to be a value investor, you have to buy unpopular things.

Take bank stocks for example. Banks are beloved by value investors like [Warren Buffett](#), Charlie Munger, Li Lu, and others. Apart from that, though, they aren't exactly popular. There isn't a single bank in the top 10 stocks in the S&P 500, and there are even fewer of them being mentioned on memestock communities like *WallStreetBets*.

Ask yourself, have you ever seen social media posters rallying around **The Toronto-Dominion Bank** ([TSX:TD](#))([NYSE:TD](#)) stock? Most likely you haven't, because they aren't doing so. To be a value investor, you have to be able to tolerate 'boring' assets. You can know that intellectually, but still be susceptible to the psychological principles that push you in the opposite direction.

In fact, TD Bank is a well-capitalized bank that is currently significantly undervalued. The bank is trading 25.7% below its 52-week high of 86. For the 12 months ending April 2022, revenues were up 4.5% and net income 8.4% year over year to \$39.5 billion and \$11.7 billion, respectively. To boot, the Big Six Bank pays out an increasing dividend with a healthy 4% yield.

Less downside risk

Another reason why value stocks outperform is because they have less downside risk than growth stocks. In other words, they're unlikely to fall as far as growth stocks sometimes do. To return to TD Bank stock for a minute: it trades at 1.6 times book value (the value of its assets after you subtract debt). If a stock trades at book value, it shouldn't go any lower, because if it does, it's being sold for less than the business is worth. With a 1.6 price/book ratio, a stock can fall 37.5%, before its price goes below book value. It would take some very dire market conditions for something like that to happen. But if you've got a high-flying growth stock that trades at 50 or 60 times book value, it's a very different story. It's not only possible, but common, for such a stock to fall 90%.

So to sum it all up:

Value stocks outperform because they're already cheap. Those with the nerve to go against the crowd often reap big returns, because they're not waiting for a stock to get expensive before buying.

CATEGORY

1. Bank Stocks
2. Investing

TICKERS GLOBAL

1. TSX:TD (The Toronto-Dominion Bank)

PARTNER-FEEDS

1. Business Insider
2. Flipboard
3. Koyfin
4. Msn
5. Newscred
6. Quote Media

7. Sharewise
8. Smart News
9. Yahoo CA

PP NOTIFY USER

1. andrewbutton
2. cleona

Category

1. Bank Stocks
2. Investing

Date

2025/07/21

Date Created

2022/08/18

Author

andrewbutton

default watermark

default watermark