Rising Rates, Inflation and Value Investing

January 2022

Value has Outperformed in Rising Yield Environments

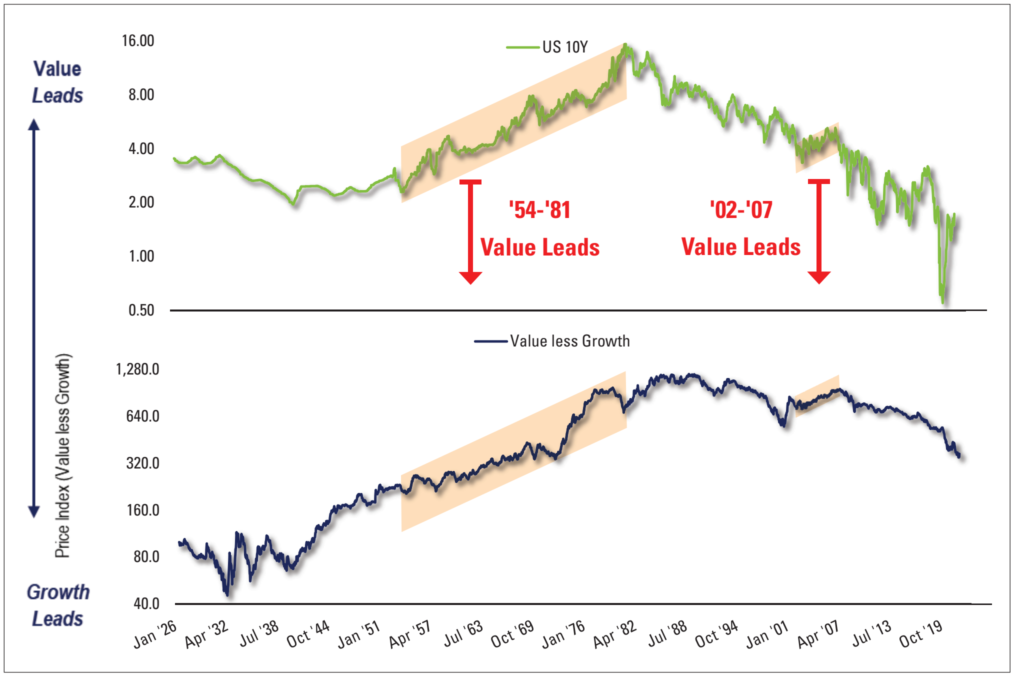
The Federal Reserve announced they will complete their bond purchasing program by March 31, 2022 and the market speculates the Fed will begin selling bonds in the latter half of the year. With inflation expectations rising and real interest rates in negative territory, we believe it is reasonable to expect interest rates to rise in 2022. Many investors are asking **what will happen to equities in a rising rate/accelerating inflation environment?**

10-year yields in the U.S. have been falling almost steadily downward for 40 years (since 1981) while inflation has not been a major concern of investors since the oil embargo in the mid-1970s. During periods of rising 10-year yields from 1954 – 1981 and from 2002 - 2007, value assumed leadership in the equity market.

Figure 1:

Value has Outperformed Growth in Rising Yield Environments

Comparison of U.S. 10-year yields and value vs. growth relative returns



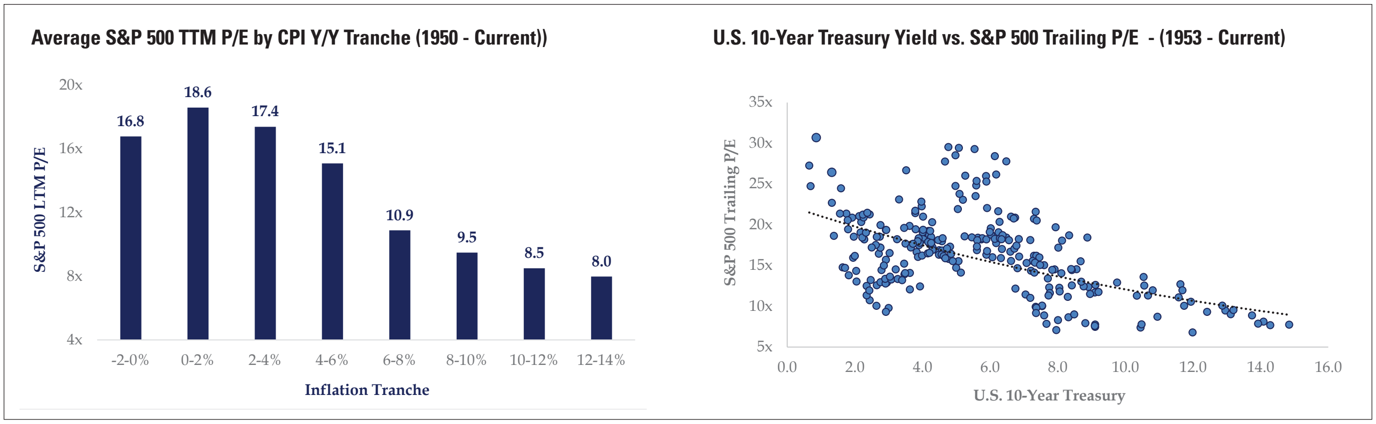
Data as of January 6, 2022.
Source: Fundstrat, Bloomberg, FAMA until 1975.
Growth and value universes are defined by FAMA database prior to 1975 and Russell Indices thereafter. Price index for Value vs. Growth is based on daily net return (value less growth) since 1926. Past performance is not an indication of future results. Please refer to the last page for other important disclosures.

Rising Inflation and 10-Year Yields have led to Price-to-Earnings Multiple Compression

Historically, when inflation accelerates above 4%, we have witnessed compressed P/E multiples in the equity market. Similarly, P/E multiples have contracted as 10-year bond yields rise. The market is a discounting mechanism. When inflation and interest rates rise, investors demand a higher rate of return to offset higher inflation and rates. We believe it is reasonable to expect the market P/E multiple to contract as inflation accelerates and 10-year yields continue their upward trajectory.

Figure 2:

Rising Inflation and 10-Year Yields Historically have led to P/E Multiple Compression



Data as of December 31, 2021.
Source: Strategas.
TTM = trailing 12 months. Past performance is not an indication of future results. Please refer to the last page for other important disclosures.

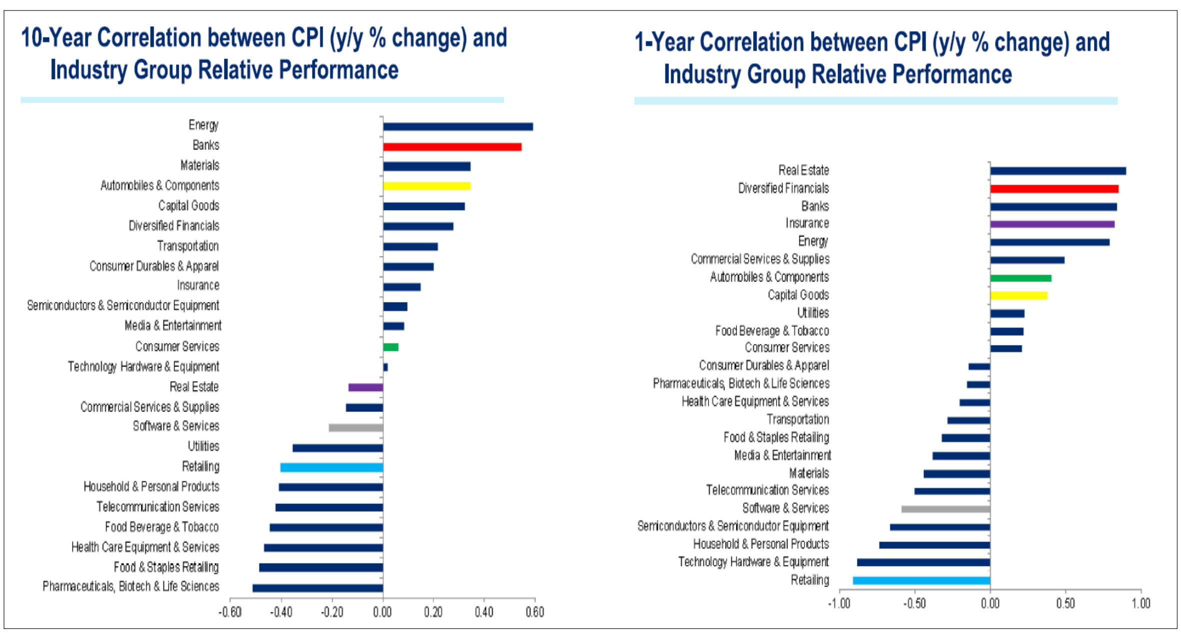
Financials, Energy, and Industrials have Outperformed in Rising Inflation Periods

Growth stocks are longer duration assets compared to their value counterparts as a significant portion of growth company cash flows are further into the future. Like the bond market where 30-year bonds will lose more value if rates rise 1% compared to 1-year notes, growth stocks will lose more value relative to shorter duration value stocks in a rising rate/inflation environment.

Historically, traditional value sectors such as Financials, Energy and Industrials have been leaders in periods of rising inflation. Bank net interest margins benefit from rising interest rates while strong commodity prices help Energy company cash flows. Leading Industrial companies can often raise prices to offset increased costs. High multiple, long duration growth sectors such as Technology and Communication Services have lagged as valuations are compressed more severely for these traditionally high P/E groups.

Figure 3:

Industry Sensitivity to Inflation



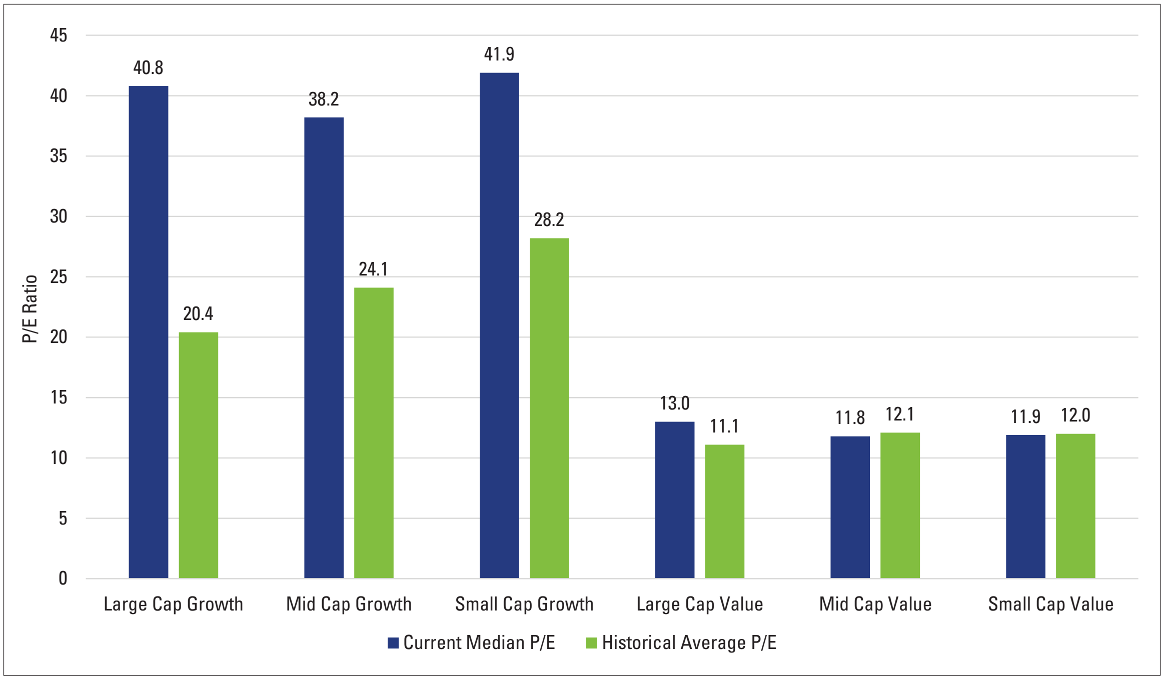
Data as of May 31, 2021
Source: Boston Partners.
Correlation shows the strength of a relationship between two variables and is expressed numerically by the correlation coefficient. The correlation coefficient's values range between -1.0 and 1.0. A perfect positive correlation means that the correlation coefficient is exactly 1. This implies that as one variable moves, either up or down, the other variable moves in lockstep, in the same direction. A perfect negative correlation means that two assets move in opposite directions, while a zero correlation implies no linear relationship at all. Please refer to the last page for other important disclosures.

Growth Stocks Appear Most Vulnerable to Valuation Re-rating

Breaking down the U.S. market by capitalization and style, growth companies are trading at 50% to 100% P/E premiums relative to historical averages dating back to 1982. Value companies are more reasonably priced, trading at a modest discount to a 17% premium relative to history. We believe it is reasonable to expect interest rates and inflation to rise in 2022, pressuring P/E multiples. The extended valuations of growth stocks make them appear much more vulnerable to significant P/E multiple contraction compared to their more reasonably priced value counterparts. **We believe a genuine value-based approach to equity investing should reward investors in 2022 and beyond.**

Figure 4:

Value Looks Attractive Relative to Growth Across all Capitalizations



Data as of December 31, 2021.
Source: The Leuthold Group.
Market caps and universes are defined by Leuthold.
Median Valuations: Largest 3,000 companies Large Cap > $39.1B; Mid Cap $5.8B - $39.1B; Small Cap $1.4B - $5.8B.
Historical average median P/E period is from January 1982 to December 2021. Past performance is not an indication of future results. Please refer to the last page for other important disclosures.

Definitions:

Inflation: A general increase in prices and fall in the purchasing value of money.

Interest Rates: The amount a lender charges for the use of assets expressed as a percentage of the principal.

10-Year Yields/Bonds: The 10-year U.S. Treasury yield is the global benchmark discount rate frequently used to calculate the present value of future cash flows of financial assets.

Price to earnings (P/E): A method of valuing stocks, calculated by dividing the closing price of a company's stock by its annual earnings per share. A higher multiple means investors have higher expectations for future growth and have bid up the stock's price.

Trailing price to earnings (P/E): A relative valuation multiple that is based on the last 12 months of actual earnings.

S&P 500 Index: The S&P 500 Index is a registered trademark of the McGraw-Hill Companies, Inc. and is an unmanaged Index of the common stocks of 500 widely held U.S. companies.

CPI (Consumer Price Index): A measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indices are available for the U.S. and various geographic areas.

About Boston Partners

Boston Partners specializes in traditional value investing, with an investment process and philosophy that was established more than 25 years ago. The source of our investment returns is security selection achieved through bottom-up fundamental analysis guided by quantitative methods. The team's process systematically blends fundamental research with quantitative screening to identify undervalued stocks throughout the capitalization spectrum.

Important Disclosure Information