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THE INTELLIGENT INVESTOR | JASON ZWEIG

The Man Who Returned $10 Billion

A value investor with a once-great record is calling it quits. What does that mean for bargain hunting?

You can complain about the death of value investing, or you can do something about it.

The discipline of buying cheap stocks, and holding them until they deliver superior returns, has lagged behind the market for so long that most of its practitioners seem to do little but talk about how bad it is and speculate about when it will get better.

Then there's Ted Aronson. He is giving back $10 billion to his investors and shutting down his Philadelphia-based value-investing firm, AJO. That is after more than 30 years in which AJO's returns were often among the best in the business of managing money for pension funds, university endowments and other institutions. They aren't among the best anymore.

"Our recent performance sucks," says Mr. Aronson. "And our record over most of the last five years has been so sucky that even if we outperformed mightily over the next five, we would still have—at best—a drab return looking back over those 10 years."

He concedes that he may be getting out of the business with "the exact wrong timing" and that the exit of a firm like his might well signal that value investing's long-awaited comeback is imminent. Even so, given AJO's recent results, Mr. Aronson says he had no choice but to give clients their money back.

How unusual is that? Asset managers return their investors' capital about as often as sharks regurgitate swimmers without a scratch.

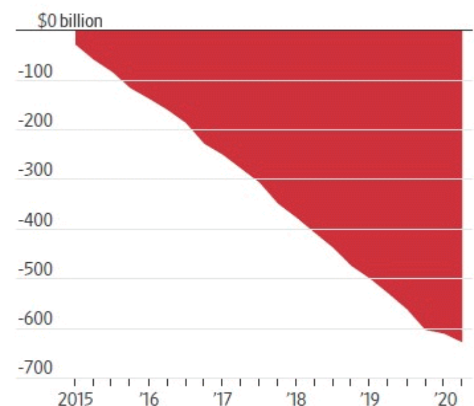
Hedge funds sometimes hand money back to their investors. In early 2000, the last time value stocks performed this poorly, Julian Robertson of Tiger Management LLC shut his main fund and returned several billion dollars to outside clients. In 1969, after speculative stocks soared, Warren Buffett shuttered his partnership, returned his investors' capital and told them, "I don't want to spoil a decent record by trying to play a game I don't understand."

RYAN STRAND GREENBERG FOR THE WALL STREET JOURNAL

'Our recent performance sucks,' says Ted Aronson, who is closing his Philadelphia-based firm, AJO.

Value investors are running out of patience. Institutional clients have pulled $76 billion more out of U.S. value portfolios than out of growth portfolios since 2015, estimates eVestment, a research firm.

For many decades, value stocks tended to earn higher average returns than the shares of growth companies. Since the late 2000s, however, growth stocks have been beating value to a pulp.



Low interest rates make investors less averse to holding assets that might not pay off for years to come. Just think of Tesla Inc.'s shares racing even as the company lost nearly $5.4 billion between 2015 and 2019. Only this week did it finally report a profit for the fifth quarter in a row.

And in this year of pandemic, growth industries like technology and health care still boomed, while such value sectors as real estate and financials have been clobbered.

So far in 2020, large U.S. growth stocks have beaten big value stocks by 36 percentage points, as measured by FTSE Russell indexes. That shatters all records: The widest such margin in a previous full year was 26 points in 1999, according to BofA Securities.

Value investors have suffered the anguish of missing out. Across all U.S. companies from large to small, $10,000 invested in growth stocks 10 years ago would have surpassed $47,000 this week. The same amount in value would be worth $25,400, according to FTSE Russell.

Mr. Aronson is a "quant," or quantitative investor, who doesn't analyze such fundamentals as the quality of a company's products, the skill of its executives, the loyalty of its customers or the strength of its competitors. Instead, he and his team look only at the numbers: more than a dozen measures of net income and asset values, profitability, earnings estimates, trading activity and other factors that decades of research has shown can identify cheap stocks.

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As recently as 2015, according to AJO, every one of its 15 strategies was outperforming its benchmark since inception—often by at least two percentage points annually for decades.

In 2016, growth stocks started to pull away, and AJO's results never caught up. "Holy shit, it was painful," says Mr. Aronson. "It was all downhill from there—or should I say uphill." By this September, only six of AJO's remaining 13 strategies were beating their benchmarks since inception—and all but two were far behind over the past five years.

"You get to think that all these machines, all this technology, all the data, are the keys to the kingdom," says Mr. Aronson. "Not!"

He pauses, then says in a rush, "It can all work for years, for decades, until or except when the not-so-invisible hand comes down and slaps you and says, 'That's what worked in the past, but it's not going to work now, nope, not anymore.'"Although he is shutting down, Mr. Aronson is convinced value investing isn't dead. When will it come back to life? "All records have been broken, so past experience is meaningless," he says—"except in knowing the drought will end." He bears down hard on the word "except."

Mr. Aronson adds, "There's a lifetime left of finding real companies that continue to produce real stuff. They will retain earnings. They will pay dividends. They will make money."

After so long a run of growth-stock outperformance, "the sheer stretching of the rubber band is bound to make value companies worth buying," he says. "It has to."