

OPINION

Another reason to believe value stocks are outperformers



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Small cap value stocks outperformed small cap growth stocks, on average, by 9 percentage points a year from 1983 to 2018 in Canada.

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Value (defined as low price-to-earnings or price-to-book portfolios of stocks) does not beat growth (defined as high PE or PB portfolios of stocks) every year. There are many years in which value underperforms.

But on average, over the long run, value does outperform. In Canada, between 1983 and 2018, the average value outperformance was about 3 per cent. The average value premium (defined as the difference between value stock returns and growth stock returns) in the U.S. between 1966 and 2019 was more than 5 per cent.

Figures from the Brandes Institute show that, across various metrics of value against growth, large global value stocks outperformed large global growth stocks by about seven percentage points between 1985 and 2014. Between 2021 and 2025, value stocks in the U.S. outperformed growth by 7.2 percentage points, in Europe by 13.4 percentage points and in the global markets by 9 percentage points, according to Verdad Weekly Research. We can assume that Canadian value stocks have been notable outperformers over the last five years as well.

And value stock outperformance has been markedly higher for small cap stocks. For example, in Canada, small cap value stocks outperformed small cap growth stocks, on average, by 9 percentage points a year from 1983 to 2018. In other words, value beats growth, especially for small cap stocks.

There is, however, another lesser known, sub-genre of stocks with a value premium even better than average, according to a recent paper that will be soon published in the Financial Analysts Journal.

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Each year, many stocks move in and out of the value and growth categories. In fact, for the study's U.S. sample, half of the value and growth stocks shown in the respective categories each year were not there two years ago. The authors found that the new value stock members slightly outperform incumbent value stocks. On the other hand, new growth stocks severely underperform the incumbent growth stocks. As a result, between 1970 and 2024, the value premium for the new value and growth stocks was much higher than the incumbent value and growth stocks, and this was the case for both value and equally weighted indexes, but more so for the latter.

This aligns with my findings that the value premium is much higher for smaller cap stocks. Specifically, the mean annual value premium for new value and growth stocks, weighted according to their market capitalization, was 4.3 per cent between 1970 and 2024, and for incumbent value and growth stocks it was 1.3 per cent. Using equal weights, where the market capitalization of a stock has no impact, average returns were respectively 9.2 per cent and 7.7 per cent. Moreover, the "new value premium" was higher during recessions, monetary tightening cycles and periods of high 10-year Treasury yields. The evidence was consistent when the authors used international data, too.

So, there you have it. Value beats growth, on average, but more so for small cap stocks and for stocks recently added to value and growth portfolios. Small cap stocks tend to be more obscure than larger stocks, but at the same time tend to have higher differences in growth expectation. As far as the newly minted value and growth stocks, growth expectation differences between the two categories of stocks are more pronounced.

This finding dovetails with research I conducted a few years ago. I examined what happens to the value premium when companies announce positive versus negative earnings surprises. A positive surprise is when a company reports earnings that exceed expectations by at least 10 per cent. A negative surprise is when the company announces earnings that fall short of expectations by at least 10 per cent.

I focused on U.S. stocks (Nasdaq, NYSE and NYSE American, formerly Amex) for the period 1980-2018. I found that when companies announce positive earnings surprises, the value premium (based on price-to-book ratio) is 2.34 per cent three months after the earnings announcement and 6.69 per cent over the following year. When companies announce negative surprises, the value premium is 6.04 per cent three months after the earnings announcement and 21.51 per cent over the following year.

Growth stocks tend to overreact much more negatively vis-à-vis value stocks when news is bad. For growth stocks, investors expect good numbers. The good numbers are baked into stock prices and so there is little reaction to good (or better) news. But when numbers are bad (or not so good), there is a downward overreaction leading to a sharp increase in the value premium as growth stocks react much more negatively to bad news than value stocks (for which the markets tend to be pessimistic about growth).

A good example of this is when Nvidia Corp. announced good earnings in February of this year and gave an upbeat forecast, but its shares fell as it “failed to impress investors,” according to [Reuters](#). And the value premium has become even higher, when news is bad in recent years, because of the significant increase of high tech and fast-growth stocks in the market.

It is now clear that value beats growth in the long run, not necessarily because value does so well, but rather because in the long run growth does so poorly – and this is particularly true for small cap stocks and recently added stocks to the value and growth portfolios.

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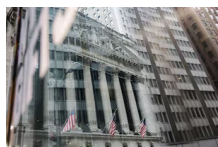
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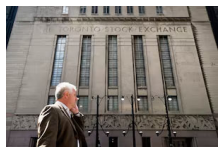
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