Are Financial Stocks Value or Growth?
Your classification has mattered a lot in the past three years

By Ron Surz
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Financial stocks have been hit hard by the current economic crisis, causing most index providers to categorize them as deep value. But this categorization is arbitrary, potentially misleading and can distort reported performance calculations.

Most providers use price/book as the style differentiator. As prices declined book values have not because underwater mortgages remain on the books near their origination value. Book values of distressed banks are grossly overstated. Consequently price/book ratios are grossly understated.

By contrast, earnings have fallen even faster than the prices of these companies, so a price/earnings classification places these financials well into the growth category.

In other words, style classifications have become debatable. Are financials now cheap (value) or speculative (growth)? What do you think? Here's a clue: The president of Bank of America recently declared that he runs a growth company.

Russell and others use price/book while Surz Style Pure® uses price/earnings. This disagreement has caused the performance of style indexes to differ dramatically, so it's become very important to know how these style sausages are made. The following two graphs provide some insights and details.

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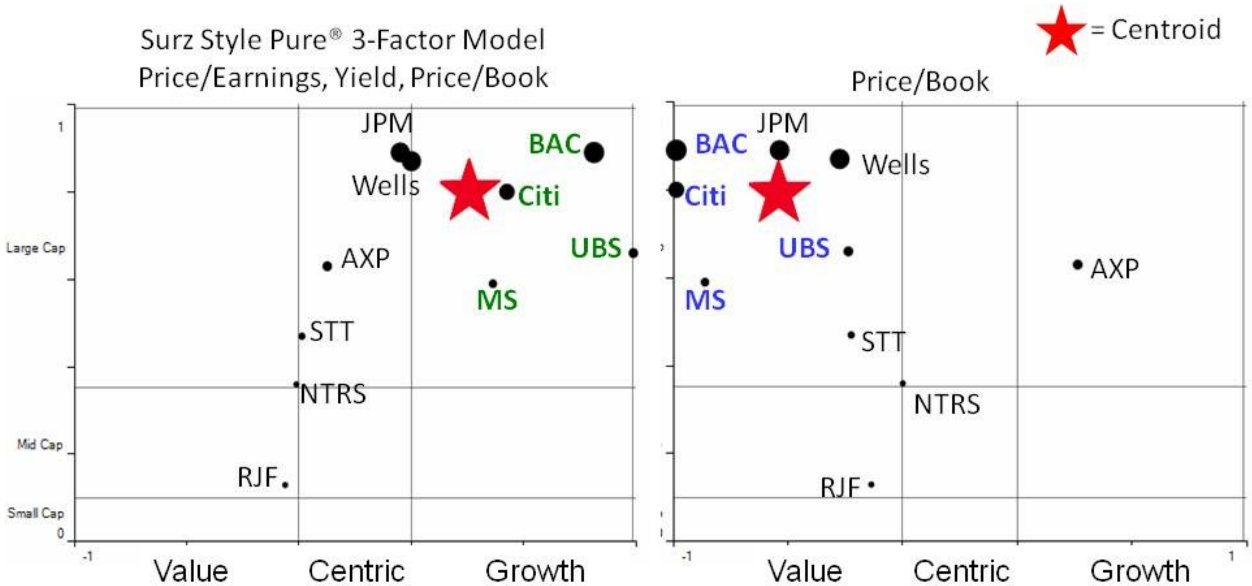
Whose Style is it Anyway?

Becoming Style Conscious: Classifying Financials in Q2, 2010



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Value or Growth?

Your Style Definition Makes a Big Difference for
Bank of America, Citigroup, UBS, and Morgan Stanley

The price/book definition views Citigroup and Bank of America as deep value, whereas the price/earnings definition sees just the opposite, locating these companies as aggressive growth. Please visit Style Classifications for a detailed discussion of the different style classification methodologies.

Here's why earnings are the better classification choice, especially in this economic environment:

- **Book Value** is a stock (accumulation) variable that reflects the history of what the company paid for assets. It is a historical accounting artifact. Some believe that most, if not all of the book value of this country's largest banks would be destroyed if the current bad debt overhang were to be recognized. That is, book values are grossly overstated.

- **Earnings** are a flow variable that reflects the company's current operating success. Earnings can be affected by accounting, but not nearly as much as book value.

	Price/Earnings	Price/Book	Yield
Bank of America	Negative	.78	0.2
Citigroup	49	.83	0
UBS	50	1.40	0
Morgan Stanley	57	.90	0.7

The X-Y style chart above uses 21st century style analysis called Style Scan. Literally "see" the styles of your favorite indexes and portfolios as they've never been seen before at **Style Scan**. Every stock, and the total portfolio, is plotted in style space (large-small, value-growth). My gift to you is FREE access to this invaluable tool. Please use it. Feed-back appreciated.

Please note the way "Centric" is defined in the chart above. Surz Style Pure® Indexes define a Centric Core that is the stuff in between value and growth, as opposed to the common definition of "blend", which enters into the next discussion. You can learn more about these indexes at Surz Style Pure.

The financial crisis has caused a significant departure in style index returns over the past three years. For example, the large-cap Russell value index lost 6.5% per year from 2008-2010, significantly trailing the 1% loss on its growth index. By contrast, the Surz Style Pure (SSP) large growth lost 8% annually, far underperforming its value index return of -2.4%. The SSP large core outperformed both value and growth with a positive 0.6% per year return.

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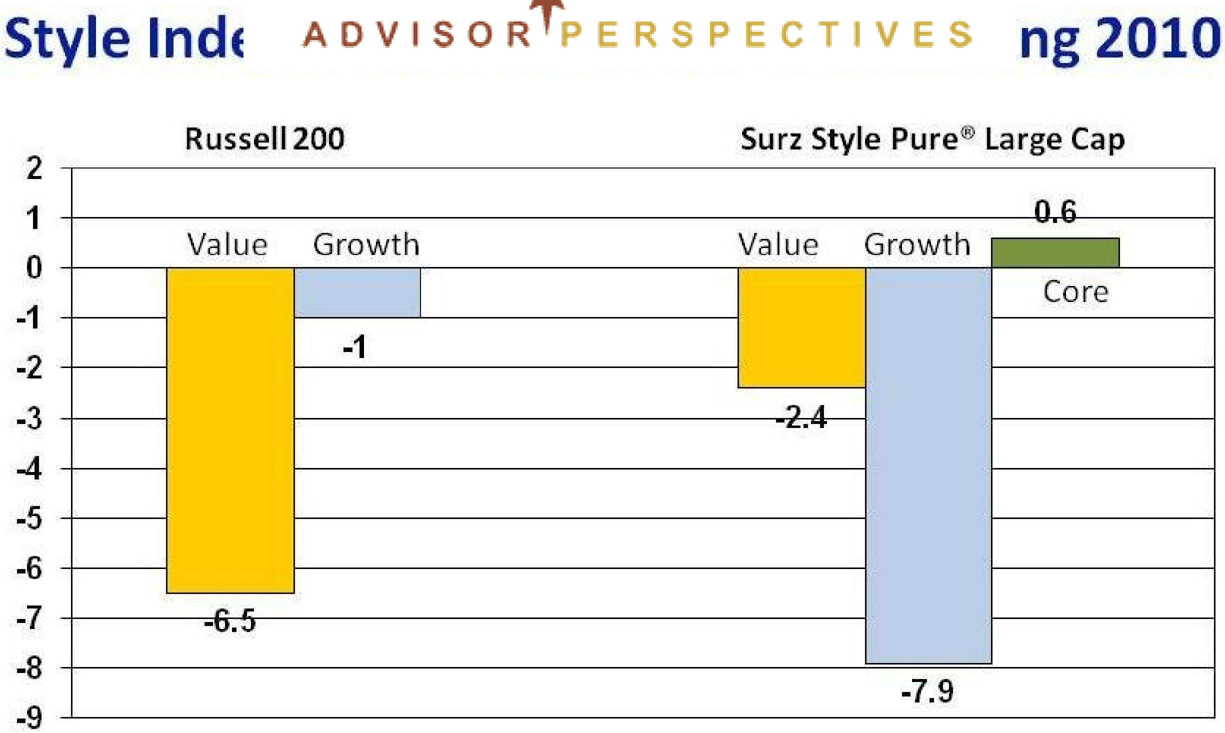

So why do we care? Investment performance is evaluated against these indexes. Has a growth stock manager performed well with a loss of less than 8% over the past 3 years, or is the hurdle a 1% loss? Is the winning loss for value managers anything above -6.5% or is it above -2.4%? You are the judge. Where do you draw the lines?

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