Can Individual Investors Capture The Value Premium?

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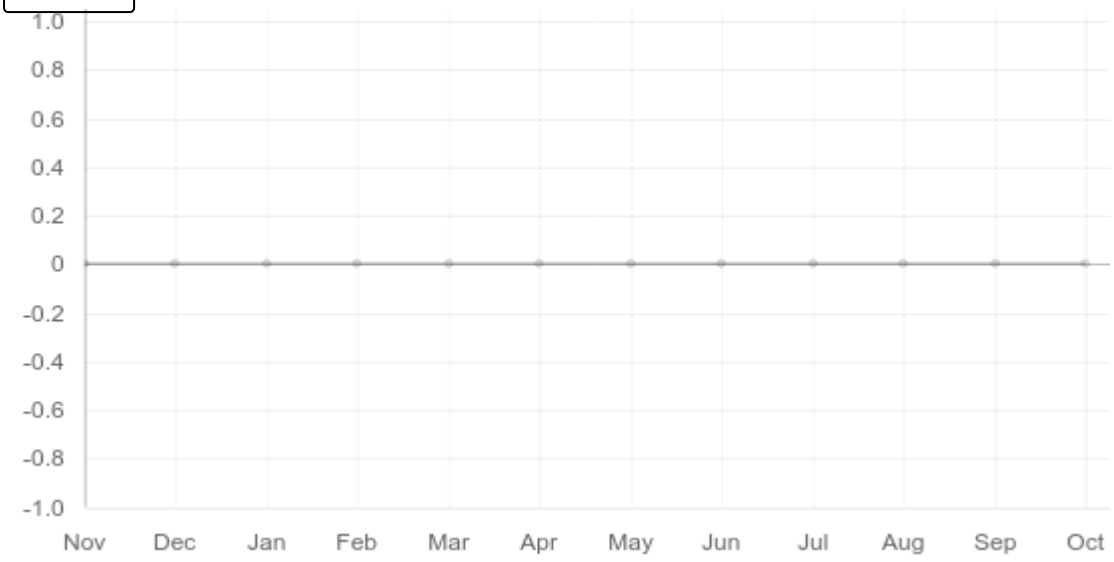
Keywords

value premium, individual investors, value investing

Abstract

I test the performance of several simple one and two-factor mechanical GARP and value investment strategies against a value-weighted market portfolio for the period 1998-2006, focusing on the suitability of the strategies for individual investors. All of the GARP and value strategies produce substantially higher average returns than the market portfolio over the 97 rolling one-year holding periods included in the study. The strategies have a higher standard deviation of returns across the 97 start months, but are less likely than the market portfolio to experience negative returns over any three or five-year time period. Overall, the best performing strategies are EBIT to enterprise value and return on capital, EBIT to enterprise value alone, and earnings yield (the inverse of the P/E ratio). Adding a profitability factor to form a GARP strategy from a simple one-factor value strategy does not appear boost performance, though it does reduce risk in the EBIT to enterprise value and return on capital strategy. My results indicate that individual investors who are able to tolerate occasional underperformance should consider using a GARP or value strategy in at least a portion of the portion of their portfolio that is allocated to U.S. equities.

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