

THE VALUE PREMIUM IS NOT DEAD IN CANADA

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ABSTRACT

This study examines whether a value premium still exists in Canada. The evidence presented in this paper suggests that the Canadian value premium persists in recent years, particularly for stocks with low prices. The value premium is argued to be countercyclical so that the strength of the business cycle in causing longer expansions and deeper contractions can lead to trends and plunges in the value premium. While some declare that the value premium is dead, our evidence suggests it has not evaporated in Canada most likely due to the combined effects of a stable Canadian economy, and industries that are less growth oriented.

Keywords: value premium, value stock, growth stock, anomaly

1. INTRODUCTION

Value stocks have low price-to-book ratios, whereas growth stocks sell at high multiples of book value. Since the 1970s many researchers have documented a value premium, meaning that value stocks outperformed growth stocks (Basu, 1977; Fama and French, 1992, 1993, 1996; Lakonishock, Shleifer, and Vishny, 1994). As in the United States, Canadian value stocks have been shown to have higher returns compared to growth stocks (Athanassakos, 2009). However, Fama and French (2020) document a decline in the performance of value stocks in the United States over recent decades leading some to question the wisdom of using a value strategy.

While some evidence suggests that value investing is dead in the United States, is this purely an American phenomenon? In their recent examination of the value premium, Fama and French (2020) argue that the value premium is lower in recent years, but is this also the case for Canada? The U.S.'s closest neighbor to the North provides a test ground to address this question. Notably, some practitioners and academics argue that it is too early to write a post-mortem for value investing (Framsted, 2019; Israel, Laursen, Richardson, 2020). This paper updates the evidence provided by Athanassakos (2009) and provides new evidence on the value premium in Canada.

With a sample including all stocks in the Canadian universe from 1985-2005, Athanassakos (2009) documented a strong and consistent value premium for the full sample, as well as for bear and bull markets, recessions, and recoveries. Firms were sorted into value and growth portfolios using both the price-to book ratio (P/B) and the price-to-earnings ratio (P/E). In all conditions, value beat growth. Athanassakos (2009) concluded that the value premiums in Canada and the United States were quite similar and argued that differences in market structure and firm characteristics across the countries had no discernable impact on the observed outperformance of value stocks above growth stocks for the 1985-2005 sample period. However, there are significant differences in policy between Canada and the United States that give reason to expect differences in performance across the nations' markets.

In recent decades, debates over immigration and medical care have become heated in the United States. In Canada, these social issues have been dealt with more successfully. Furthermore, in the 1990s Canada responded to its increasing debt load by cutting spending and implementing other austerity measures that decreased its debt load. Thus, when the global recession hit in 2008, Canada's debt-to-GDP ratio was under 20%, from over 70%, and it was better able to tackle the challenges of a recession.