John Hancock Investment Management

Watch out when value returns to favor

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"In early September of 2019, we witnessed one of the most abrupt momentum-to-value reversals in equity market leadership in the past 30 years."

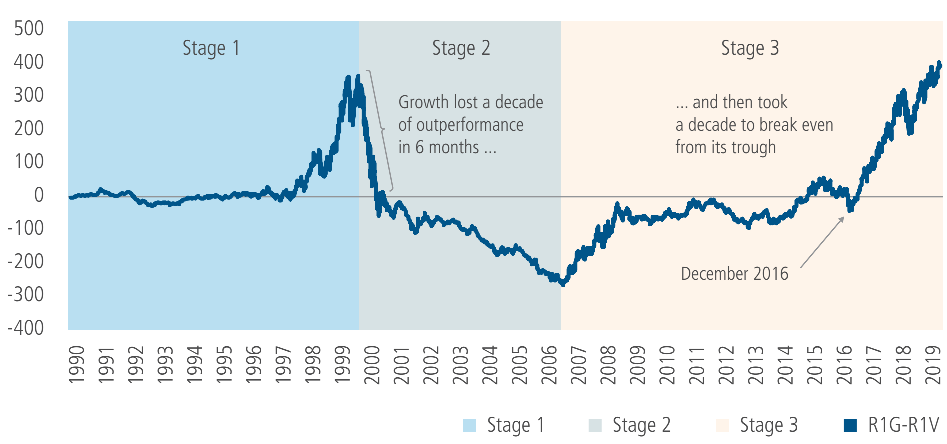
Key takeaways

- Growth has outperformed value for most of the past 10 years, but a recent reversal in leadership could mark a lasting shift.
- In 2000, an abrupt shift to value wiped out an entire decade of growth outperformance in only six months.
- We believe that now is the time for investors to take advantage of valuation discrepancies.

Executive summary

Growth has outperformed value for the better part of the last decade. In early September of 2019, we witnessed one of the most abrupt momentum-to-value reversals in equity market leadership in the past 30 years. Will this mark the beginning of a shift in leadership? While we don't know the exact timing, we can observe from history that when the reversal comes, we can expect it to be dramatic. While growth outperformed value for the entire decade of the 1990s, it took a mere 6 months in the year 2000 to wipe out an entire decade of growth outperformance.

The cumulative history of growth vs. value since 1990 (%)

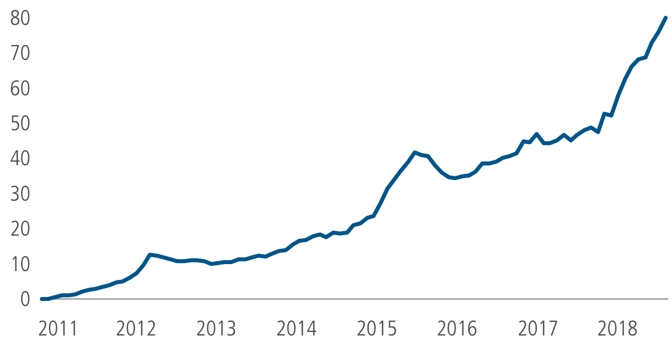


Source: yCharts, 12/31/89–12/10/19, for the Russell 1000 Growth Index (R1G) minus the Russell 1000 Value Index (R1V). Past performance does not guarantee future results.

The momentum-led market of the past couple of years has not only favored the growth darlings popularly referred to by the FAANG acronym, but also companies deemed to be stable, as macroeconomic fears surrounding the U.S.-China trade war and an inverted yield curve have caused investors to seemingly disregard two of the three key tenets in Boston Partners' three circles investment framework: attractive valuation and strong business fundamentals (high financial productivity); the third circle is a catalyst for change. Instead, investors have craved what's been perceived as safe: companies that can generate their own growth and/or companies deemed as stable with low earnings volatility. As a result, the most expensive cohorts of the value opportunity set have been bid up to unprecedented absolute and relative valuations. This reminds us of late 2015 through mid-2016, when investors bid up the valuations of bond proxies—utilities, real estate investment trusts (REITs), and consumer staples—due to Brexit, fears of a China hard landing, and a potential proliferation of energy credit defaults that never materialized. Today, investors continue to pile into low-volatility exchange-traded funds.

Due to Boston Partners' strict valuation discipline, we've maintained an underweight allocation to the most expensive cohorts of the Russell 1000 Value Index (many of which trade at a premium to the S&P 500 Index) and expect to be rewarded for this positioning as the excesses are unwound. We continue to be positioned toward financials—banks currently trade at historically low relative valuations with strong credit quality and accelerating levels of capital return—and away from many

U.S. low-volatility ETF assets ($ billions)

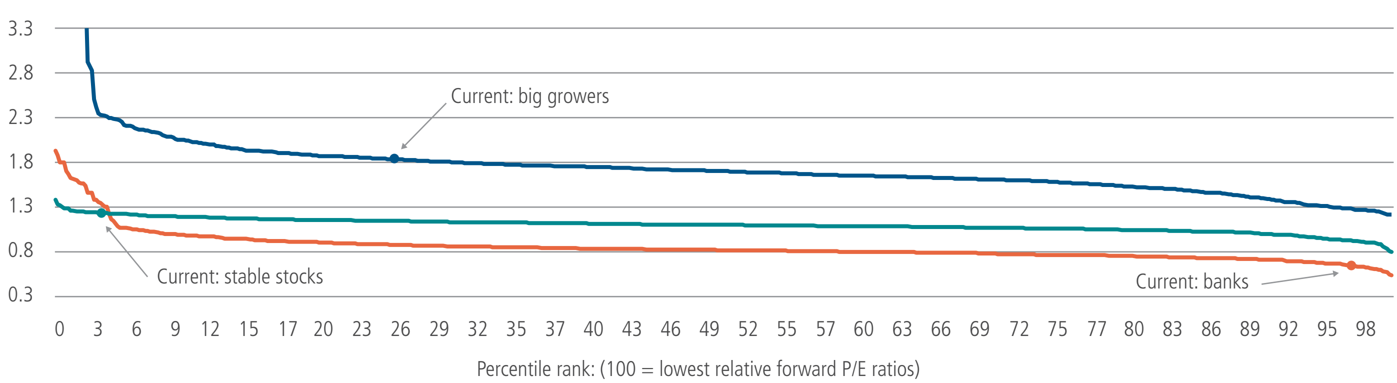


Source: ETF.com, as of 8/31/19.

expensive low beta/stable stocks, many of which trade in excess of twenty times 2020 expected earnings. Banks trade at historically low relative valuations, while high revenue growers are in the most expensive quartile of their relative valuation history, and stable stocks trade near all-time relative highs.

As previously mentioned, we experienced another low volatility/stable stock bubble during the Q4 2015/Q2 2016 period, which negatively affected relative performance. However, we never strayed from our investment discipline and were rewarded when the bubble ultimately burst. We believe that there's a strong probability for the same this time around, and the beginning of the reversal may have already begun. While our approach wasn't rewarded during the period ended June 30, 2019, we've outperformed the benchmark during the entire period.

Relative forward P/E ratios of big growers, stable stocks, and banks (1976–September 2019)



Source: Empirical Research Partners Analysis, 1976–9/30/19. Capitalization-weighted data for big growers and banks, equally weighted data for stable stocks. Big growers: top quintile of the 1,500 U.S. stock universe that has the highest revenue growth over the past 12 months. Stable stocks: The top 1,500 U.S. companies by market liquidity are evaluated by Empirical Research; a composite score for fundamental stability is generated. Factors used to evaluate fundamental stability include beta, return on equity (ROE) level, variability in ROE, earnings stability, dispersion in earnings estimates, and debt-to-total capitalization ratio. The top 20% (quintile) of companies that have the best stability score are included in the cohort of stable stocks. Past performance does not guarantee future results.

Recent performance of John Hancock Disciplined Value Fund

Date	Period	JVLIX (%)	Russell 1000 Value Index (%)
7/1/16–9/30/18 (annualized)	Recovery from low vol bubble 1	16.56	12.51
10/1/18–6/30/19	Low vol bubble 2 is formed	-3.24	2.61
7/1/19–10/31/19	Beginning of recovery?	3.08	2.77
7/1/16–10/31/19 (annualized)	Entire period	10.81	10.02

The past performance shown here for John Hancock Disciplined Value Fund Class I shares reflects reinvested distributions and the beneficial effect of any expense reductions, and does not guarantee future results. Shares will fluctuate in value and, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance cited. For the most recent month-end performance, visit jhinvestments.com.

Although avoiding the bond proxies has contributed to short-term underperformance during the extreme sentiment-driven periods of Q4 2015/Q2 2016 and Q4 2018/Q2 2019, it's worth noting that our underweight allocation to these sectors benefited relative performance during the late 2016 to late 2018 time periods. And while past performance doesn't guarantee future results, we believe it will once again benefit returns going forward, as has been the case over the last decade.

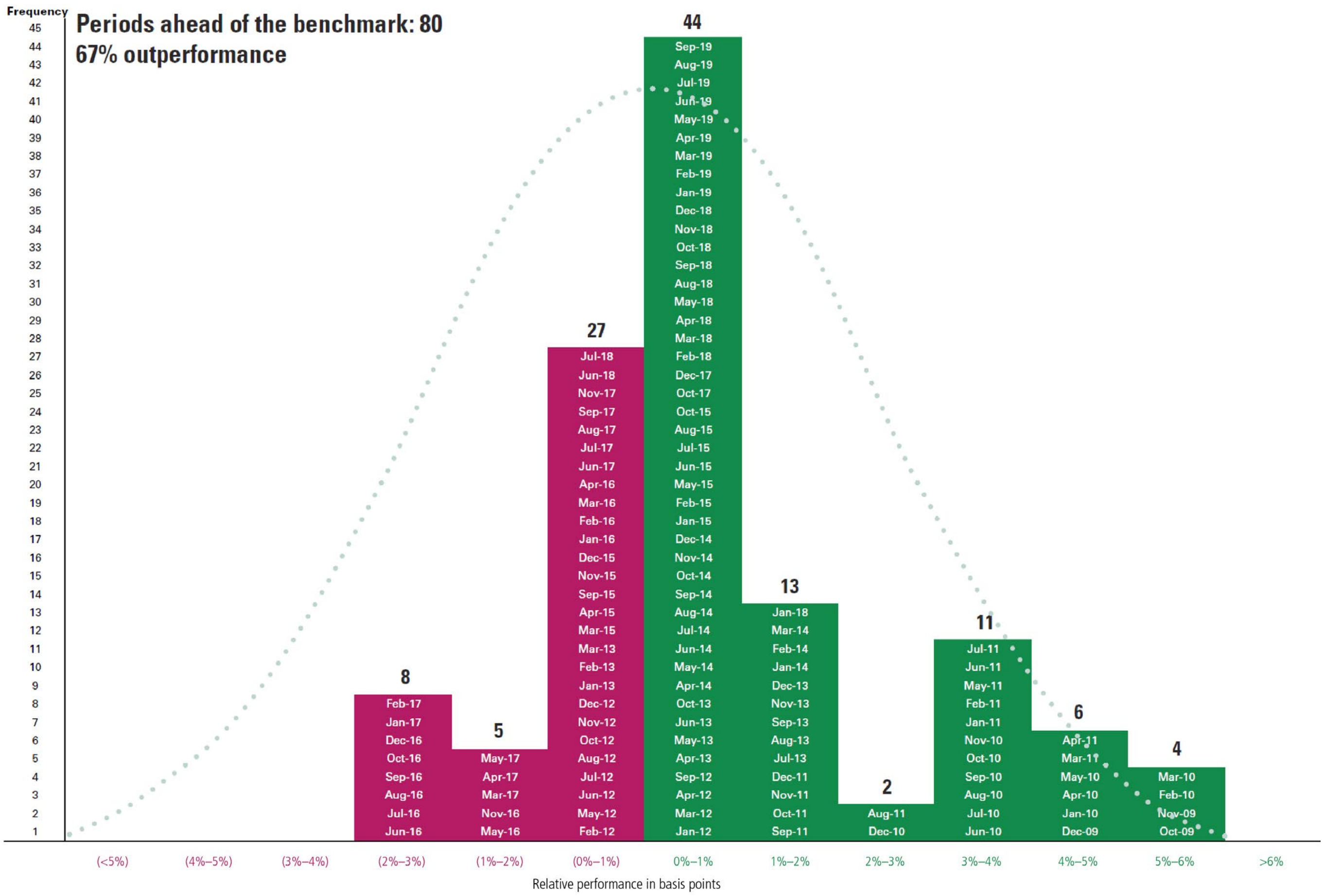
Recent outperformance from the most expensive cohort of the opportunity set has created wide valuation spreads—the difference between the price-to-earnings (P/E) discount at which the cheapest cohort trades and the P/E premium at which the most expensive cohort trades—which are the widest since the tech bubble of the late 1990s. In other words, we believe value is on sale and have been tilting our portfolio toward what we believe are attractive value opportunities. In comparing our valuation characteristics on measures such as P/E and price/free cash flow relative to the Russell 1000 Value Index and other top U.S. large-cap value strategies, we observe a valuation advantage in our portfolio coupled with favorable quality and business momentum characteristics.

Ultimately, we believe top-down noise related to trade wars, political debates, and U.S. Federal Reserve policy has created attractive bottom-up opportunities for our three circles approach. In addition to financials, we've increasingly added to healthcare, where we see many compelling opportunities. We currently believe Cigna is an excellent three circles stock, as the world's fourth largest health insurer traded as low as eight times 2019 earnings per share (EPS) earlier in 2019 despite sell-side 2019 EPS estimates rising 10% from last year and year-over-year earnings growth of 18% reported in Q3 2019. Conversely, NextEra Energy,1 the largest utility in the Russell 1000 Value Index, recently traded at twenty-six times 2019 EPS, with no year-over-year improvement in 2019 EPS estimates and negative 5-year free cash flow growth due to rising capital expenditures. Meanwhile, during the trailing 12 months ended September 30, 2019, Cigna returned –27% compared with NextEra appreciating 43%, as investors fear a shift toward nationalized healthcare, and they seek out perceived safety in a large electric utility. Given the attractive valuation and growth characteristics of Cigna and the high valuation, zero growth, and weak cash flow metrics of NextEra, we believe Cigna presents a more attractive future return profile. Additionally, examples such as this are indicative of the broader market environment.

It's market environments such as this that tempt many managers to stray from their stated investment discipline because short-term underperformance feels like it lasts a long time. It's important to remind yourself not to be tempted into behavioral mistakes of market timing and performance chasing. Boston Partners has been through periods such as this before, and our experience tells us that out of such periods, we find some of our best opportunities to create long-term outperformance. When we hear market pundits proclaim that value is dead or fundamentals no longer matter, this is typically a sign that opportunities abound. Our approach is consistent regardless of the economic backdrop, as we always strive to assemble a portfolio of companies exhibiting lower-valuation characteristics, higher-quality business fundamentals, and improving business momentum.

This time-tested approach has served our clients well in the past, evidenced by John Hancock Disciplined Value Fund's rolling 3-year performance tracked each month over the past 15 years. The performance shows a distribution of returns with a clear skew to the right side of the distribution and the majority of the observations ahead of the market. More plainly stated, our approach generates positive 3-year results 86% of the time over an extended market cycle. This is how investors allow the power of compounding and active management to work on their behalf. This process has been in place for over two decades and has prospered through the ups and downs of the markets, especially when market excesses correct themselves, such as the tech bubble in 2000, during the financial crisis in 2008/2009, and the aforementioned low-volatility/Brexit bubble in 2016. We believe the time is now for investors to take advantage of valuation discrepancies.

Distribution of rolling three-year excess returns, relative performance



As of 9/30/19. The chart reflects a 10-year time period, 120 months. Inception for John Hancock Disciplined Value Fund Class I shares is 1/2/97. Relative performance of John Hancock Disciplined Value Fund is versus the Russell 1000 Value Index. Past performance does not guarantee future results.

Calendar year performance (%)

	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Disciplined Value Fund Class I	-9.58	19.20	13.97	-4.99	10.91	35.93	19.95	0.39	13.12	26.26
Russell 1000 Value Index	-8.27	13.66	17.34	-3.83	13.45	32.53	17.51	0.39	15.51	19.69

John Hancock Disciplined Value Fund performance (as of 9/30/19)

Performance (%)

	3Q 19	YTD 19	1 year	3 year	5 year	10 year	Since inception
Disciplined Value Fund Class I	1.59	14.29	-1.70	10.00	7.05	11.04	8.45
Russell 1000 Value Index	1.36	17.81	4.00	9.43	7.79	11.46	8.11

Expense ratio

	Gross	Net (what you pay)	Contractual through
Class I	0.81%	0.80%	7/31/21

Inception date is 1/2/97. "Net (what you pay)" represents the effect of a fee waiver and/or expense reimbursement and is subject to change.

The past performance shown here reflects reinvested distributions and the beneficial effect of any expense reductions, and does not guarantee future results. Sales charge figures reflect the maximum sales charge, which is 5.0%. Returns for periods shorter than one year are cumulative, and results for other share classes will vary. Shares will fluctuate in value and, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance cited. For the most recent month-end performance, visit jhinvestments.com.

Returns prior to the commencement date of Class I shares are those of Robeco Boston Partners Large Cap Value Fund (the predecessor fund) and have not been adjusted for expenses; otherwise, returns would vary.

Largest stock holdings (%)

Berkshire Hathaway, Inc.	4.59
Bank of America Corp.	3.80
Comcast Corp.	3.11
JPMorgan Chase & Co.	2.98
Procter & Gamble Company	2.72
Wells Fargo & Co.	2.57
Verizon Communications, Inc.	2.52
Citigroup, Inc.	2.32
Chubb, Ltd.	2.28
United Technologies Corp.	2.23

Listed holdings are for Class I shares and reflect the largest portions of the fund's total and may change at any time. They are not recommendations to buy or sell any security. Data is expressed as a percentage of net assets and excludes cash and cash equivalents.

1 As of 9/30/19, NextEra Energy was not a current holding of John Hancock Disciplined Value Fund.

FAANG is an acronym for five high-performing technology stocks in the market—Facebook, Apple, Amazon, Netflix, and Google (now Alphabet, Inc.). This should not be considered a solicitation to buy or an offer to sell a security. It is not known whether these securities will or will not be profitable in the future. Earnings per share (EPS) is a measure of how much profit a company has generated calculated by dividing the company's net income by its total number of outstanding shares. Free cash flow is a measure of a company's cash available for distribution to shareholders per share after capital expenditures and taxes, divided by its share price. Price to earnings (P/E) is a valuation measure comparing the ratio of a stock's price with its earnings per share.

The S&P 500 Index tracks the performance of 500 of the largest publicly traded companies in the United States. The Russell 1000 Growth Index tracks the performance of publicly traded large-cap companies in the United States with higher price-to-book ratios and higher forecasted growth values. The Russell 1000 Value Index tracks the performance of publicly traded large-cap companies in the United States with lower price-to-book ratios and lower forecasted growth values. It is not possible to invest directly in an index.

Value stocks may decline in price. Foreign investing, especially in emerging markets, has additional risks, such as currency and market volatility and political and social instability. Large company stocks could fall out of favor, and illiquid securities may be difficult to sell at a price approximating their value. Please see the fund's prospectus for additional risks.

Clients should carefully consider a fund's investment objectives, risks, charges, and expenses before investing. To request a prospectus or summary prospectus with this and other important information, call us at 866-582-2777, or visit us at jhinvestments.com.

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