Style Investing

Kari E. Bayer
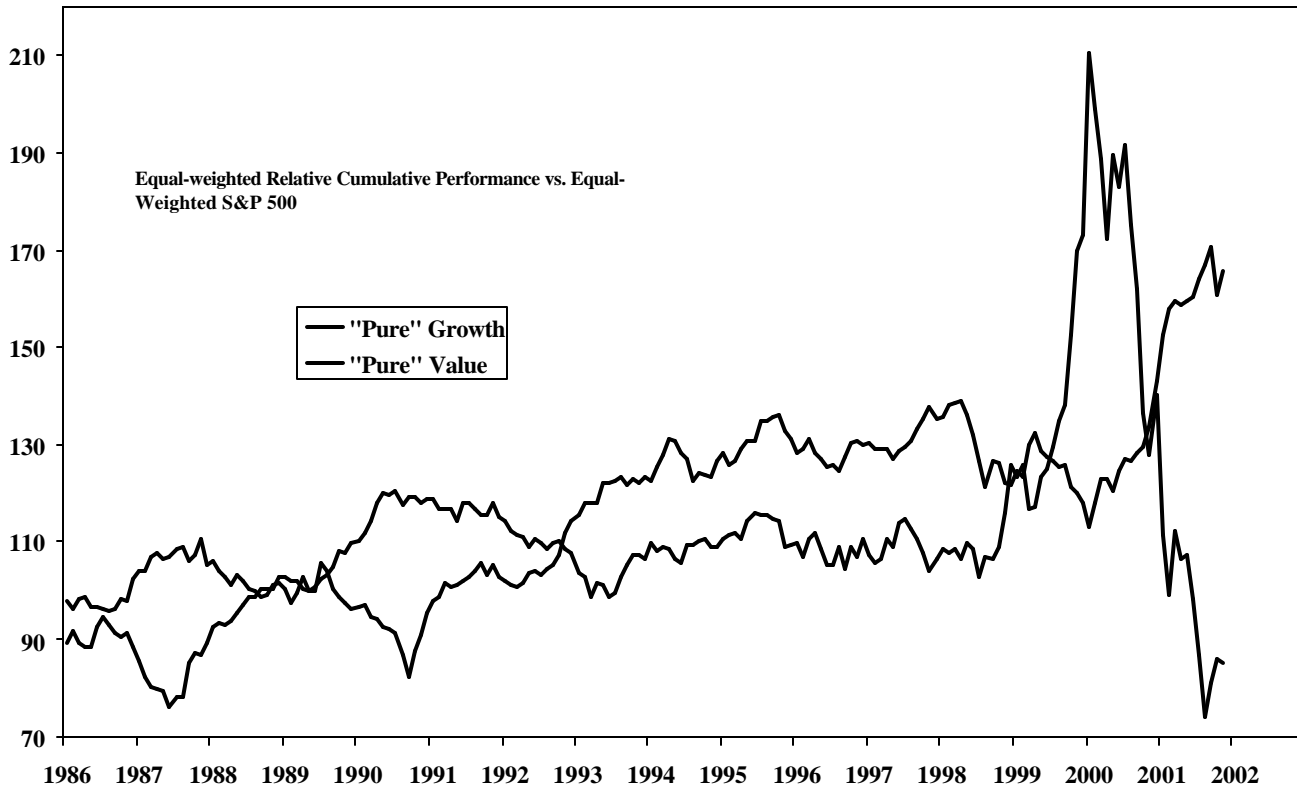
Director

Senior U.S. Strategist

Defining Growth and Value

→ **Each month we monitor approximately forty different stock selection strategies.**

→ **Two of the forty strategies are "pure" growth and "pure" value portfolios.**

→ **The "pure" growth portfolio is the fifty stocks in the S&P 500 with the highest five-year projected EPS growth rates.**

→ **The "pure" value portfolio is the fifty stocks in the S&P 500 with the highest earnings yield.**

→ **The term "pure" is used because the portfolios are those stocks in the S&P 500 that are made up of the companies that show the most extreme values of the particular characteristic.**
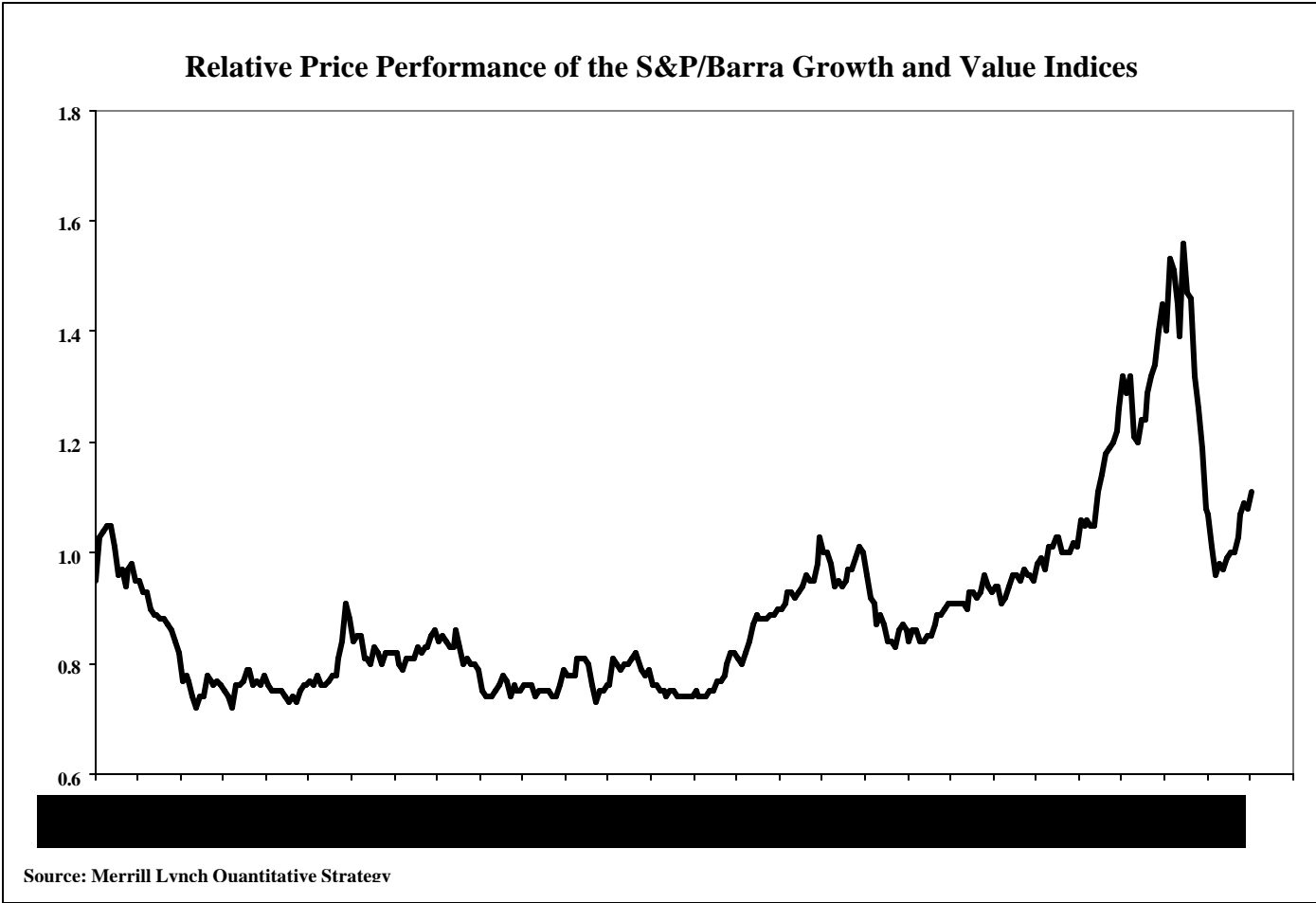
"Pure" Growth and Value Portfolios

Equal-weighted Relative Cumulative Performance vs. Equal-Weighted S&P 500

Legend: "Pure" Growth / "Pure" Value

Source: Merrill Lynch Quantitative Strategy

When Growth outperforms, Value tends to underperform and vice versa.

Relative Performance of S&P/Barra Growth and Value Indices

Relative Price Performance of the S&P/Barra Growth and Value Indices

Source: Merrill Lynch Quantitative Strategy

Merrill Lynch

Relative Performance of MLQS Growth and Value Indices

**Relative Performance of the Growth Mutual Fund Index
versus the Value Mutual Fund Index**

Source: Merrill Lynch Quantitative Strategy

Merrill Lynch
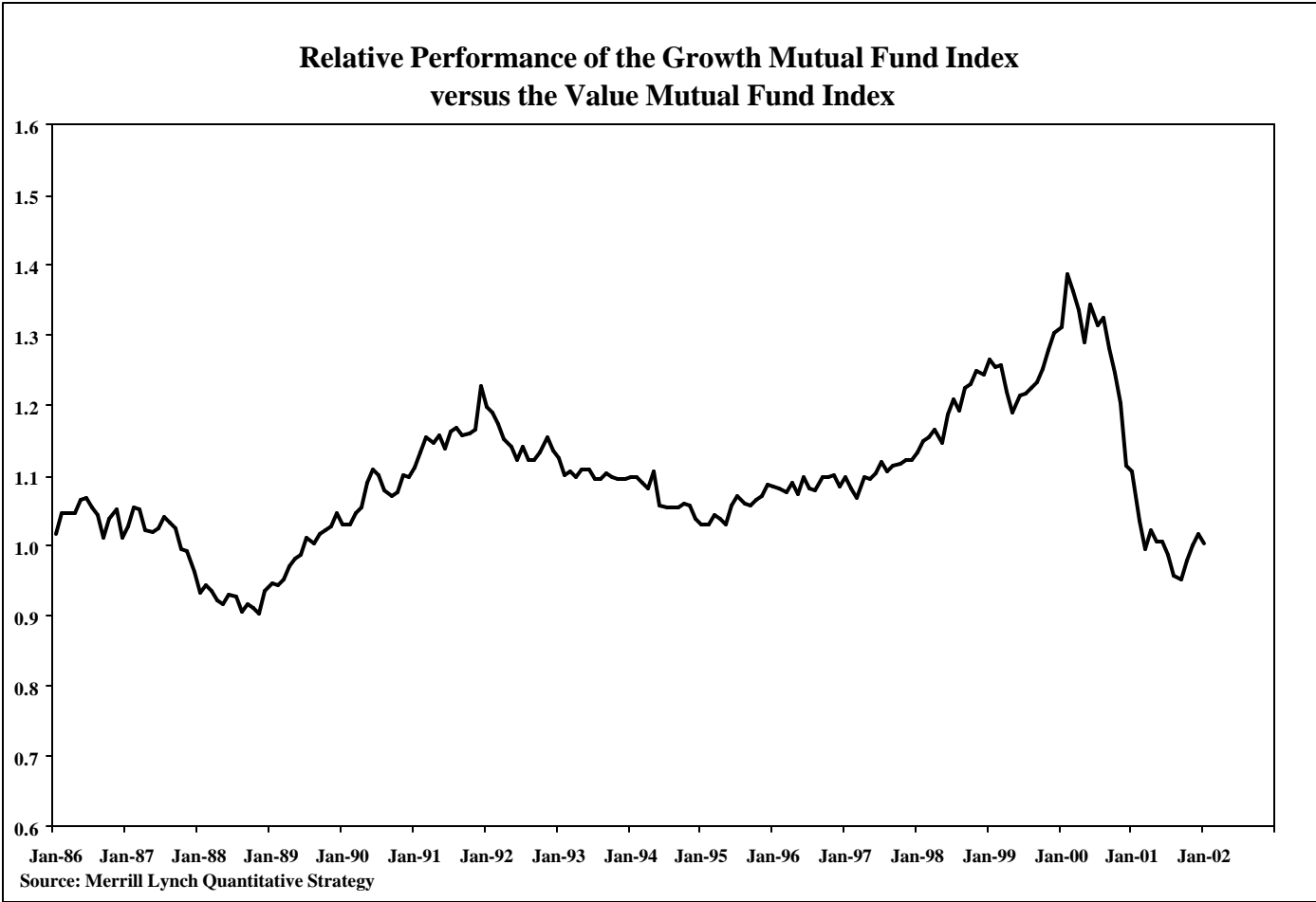
Growth Managers

➜ **Growth managers are typically defined as high expectations managers who prefer to search for investments among stocks that have a proven superior track record of earnings growth.**

➜ **Growth stock investors usually pay a high premium to hold such stocks because the market realizes the superior qualities of the company.**

➜ **The assumption behind growth stock investing is that the market will continue to reward the superior grower.**

Value Managers

➜ **Value managers are typically defined as low-expectations managers because they tend to search for investments among stocks that are out of favor.**

➜ **The assumption behind value investing is that the consensus views a company overly pessimistically, and that the stock's valuation will improve once the consensus realizes its mistake.**

➜ **Value managers, therefore, usually search for stocks that sell below the worth of a company's assets or below the value of its future growth prospects.**

Good and Bad Managers

Growth: **CONTRARIAN SELLERS**
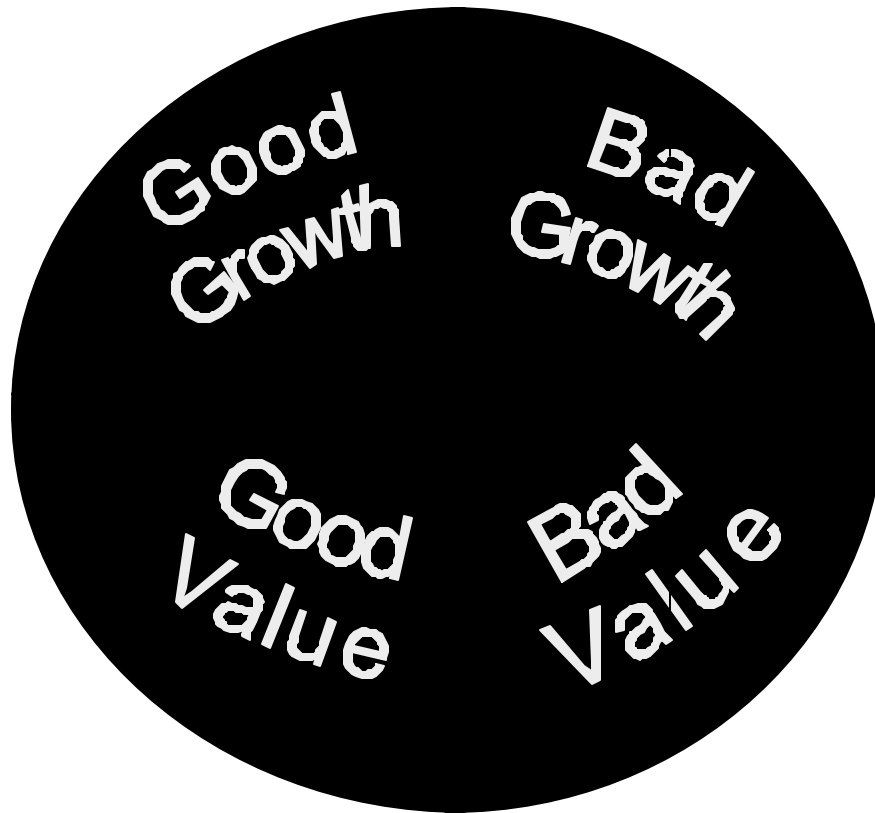

Value: **CONTRARIAN BUYERS**

Defining Quality

→ **We use the S&P Common Stock Rankings to define quality.**

→ **S&P ranks approximately 1500 companies based on their stability in earnings and dividends growth over the last ten years.**

→ **A company with extremely stable earnings and dividends growth would be rated an A+ whereas a company in bankruptcy or reorganization would be rated a D.**

→ **The rankings are A+, A, A-, B+, B, B- and C/D.**

Relative Performance by Quality

Relative Performance MLQS "A+" vs. "C&D"

Relative Performance
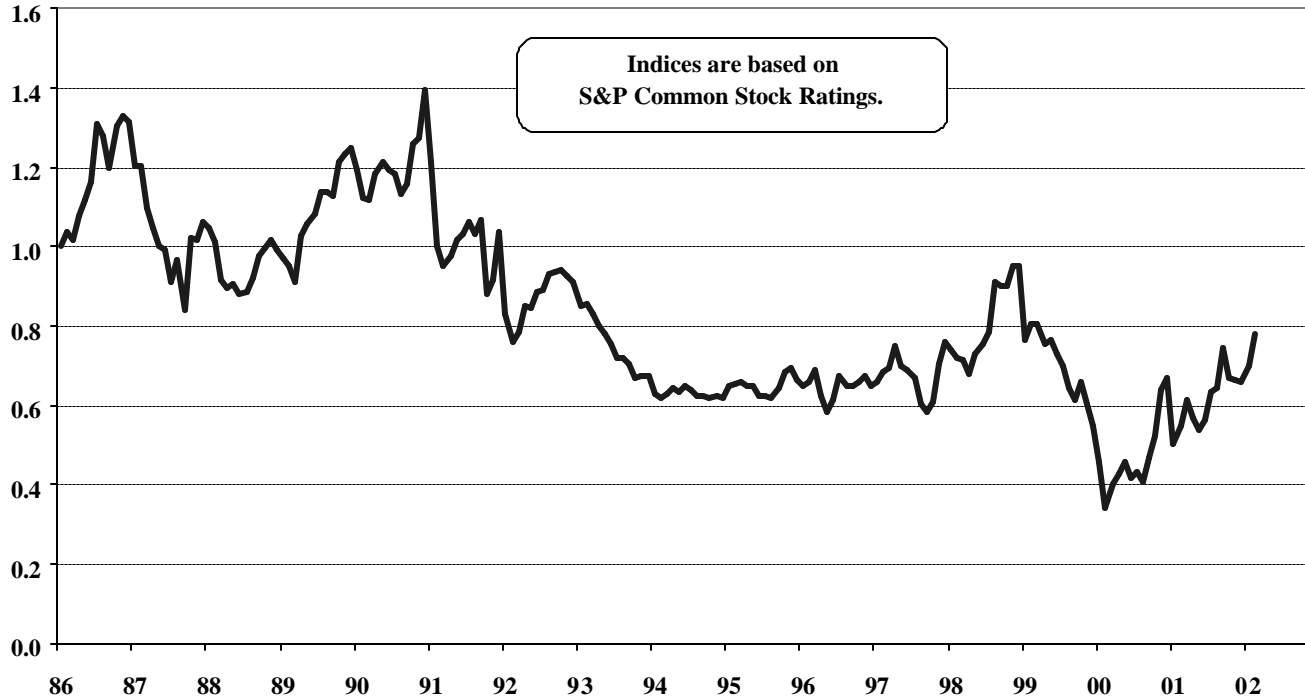
Indices are based on
S&P Common Stock Ratings.

Source: Merrill Lynch Quantitative Strategy

*Similar to Growth and
Value, High vs. Low
Quality goes through
cycles of out- and
under-performance.*

Relative Performance by Size

Relative Performance of S&P 500 and Russell 2000
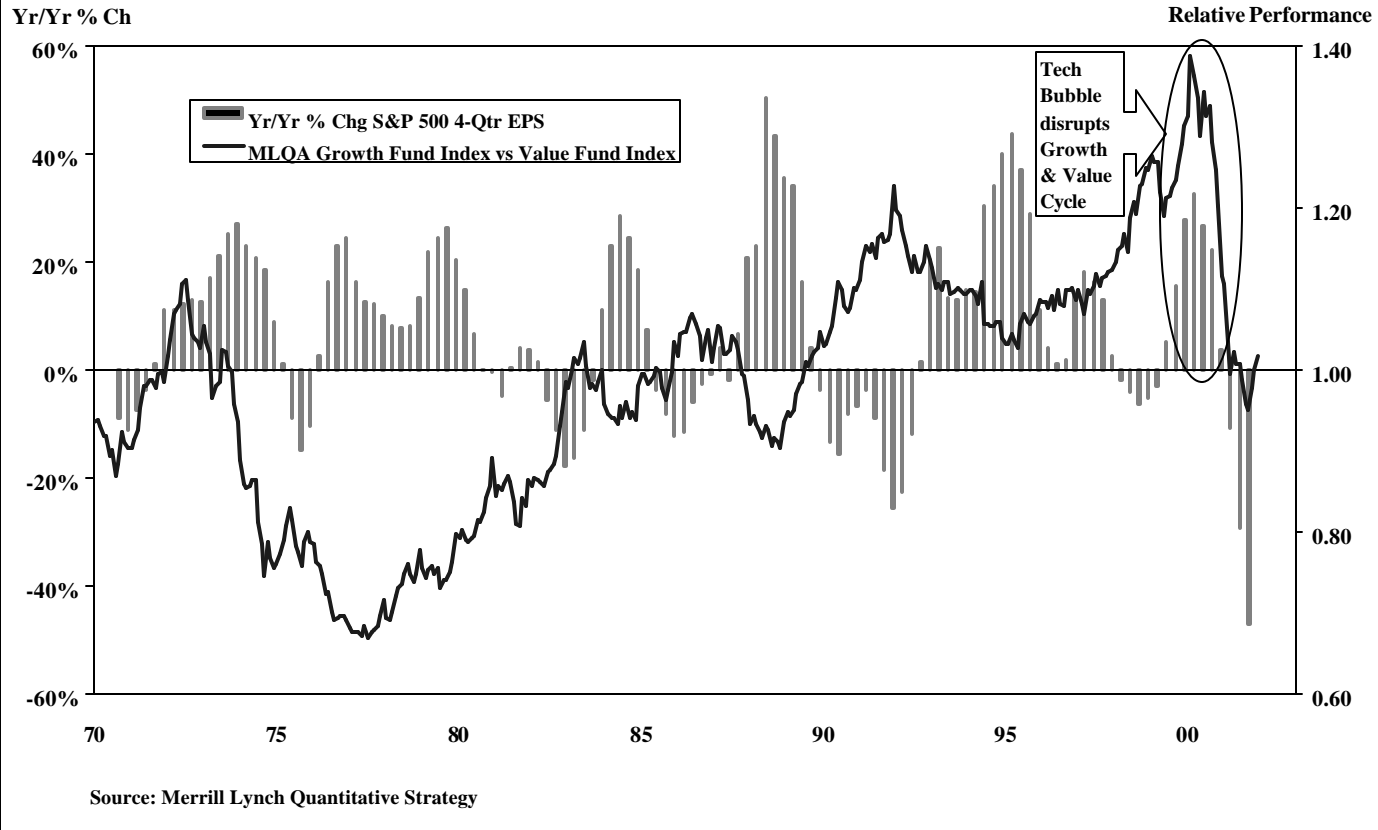
Source: Merrill Lynch Quantitative Strategy
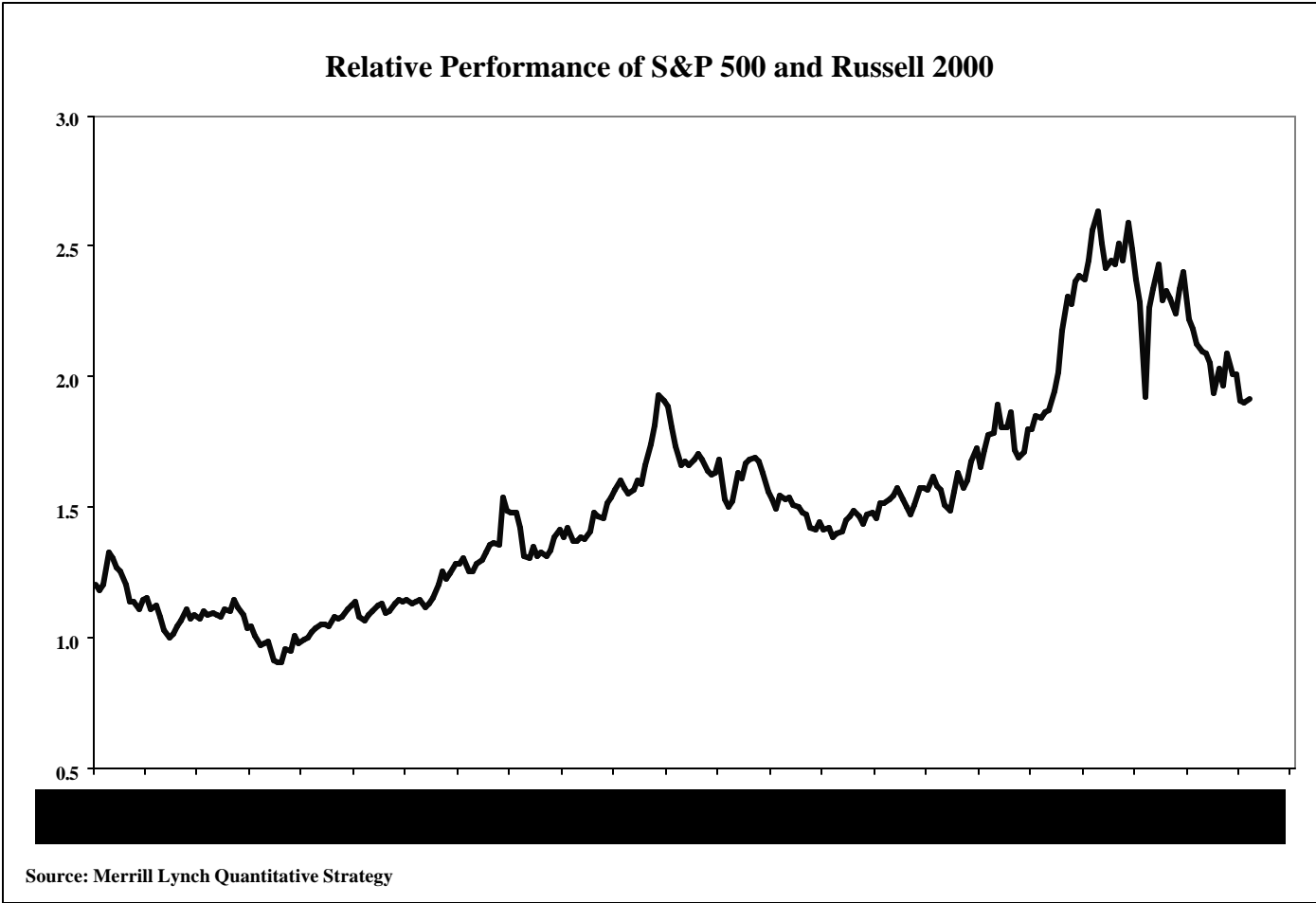
The Importance of Profits

GROWTH vs. VALUE - RELATIVE PERFORMANCE
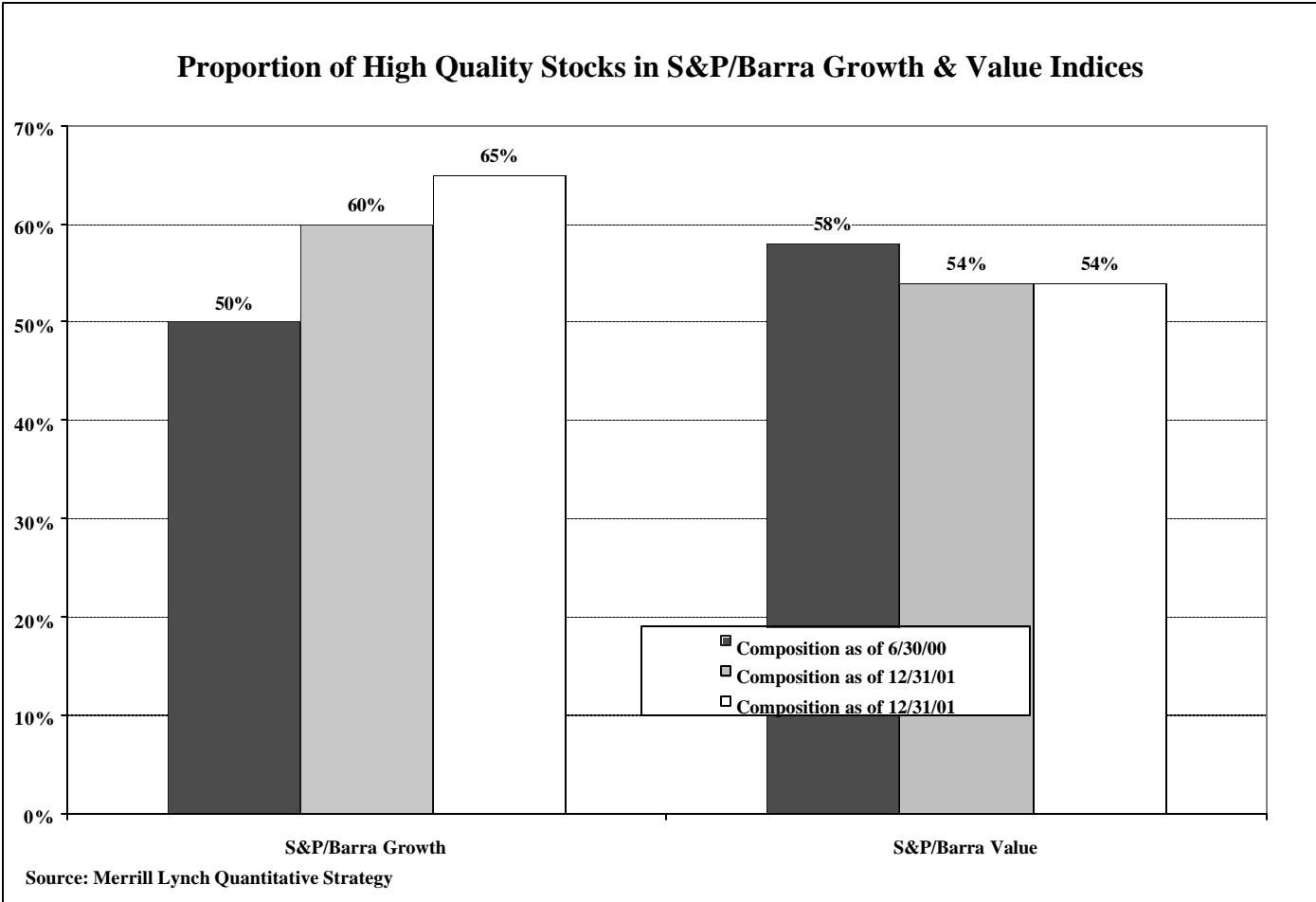AND S&P 500 EPS MOMENTUM

The scarcity or abundance of earnings growth drives style rotation.

The Tech Bubble Distorts Growth versus Value Investing

	2000	**2001**
"Pure" Growth	-22.4%	-33.2%
"Pure" Value	20.7%	24.5%
MLQS Growth	-12.7%	-15.8%
MLQS Value	-4.2%	-1.7%
A+ Index	22.4%	2.4%
C/D Index	0.1%	3.8%

High Quality Value?

Proportion of High Quality Stocks in S&P/Barra Growth & Value Indices

- Composition as of 6/30/00
- Composition as of 12/31/01
- Composition as of 12/31/01

S&P/Barra Growth: 50%, 60%, 65%

S&P/Barra Value: 58%, 54%, 54%

Source: Merrill Lynch Quantitative Strategy

Sector Concentration of S&P/Barra Growth Index

S&P Barra Growth Index By Sector
(December 2001)

Other 4%

Financials 7%

Industrials 12%

Technology 23%

Consumer Staples 15%

Healthcare 21%

Consumer Discretionary 18%

Change in Composition of SGX

Change in Composition of S&P/Barra Growth Index

Legend:
- Composition as of 6/30/00
- Composition as of 12/31/01

Categories: Technology, Healthcare, Consumer Staples, Consumer Discretionary, Industrials, Financials, Other

Merrill Lynch
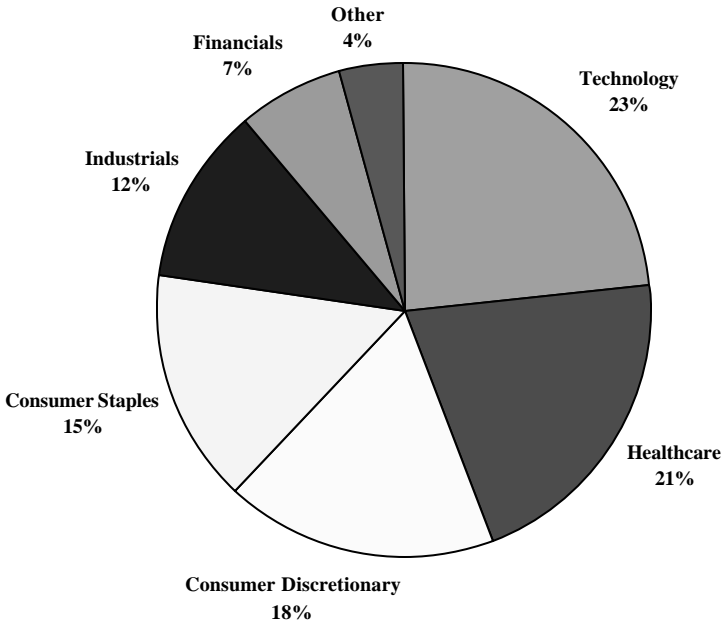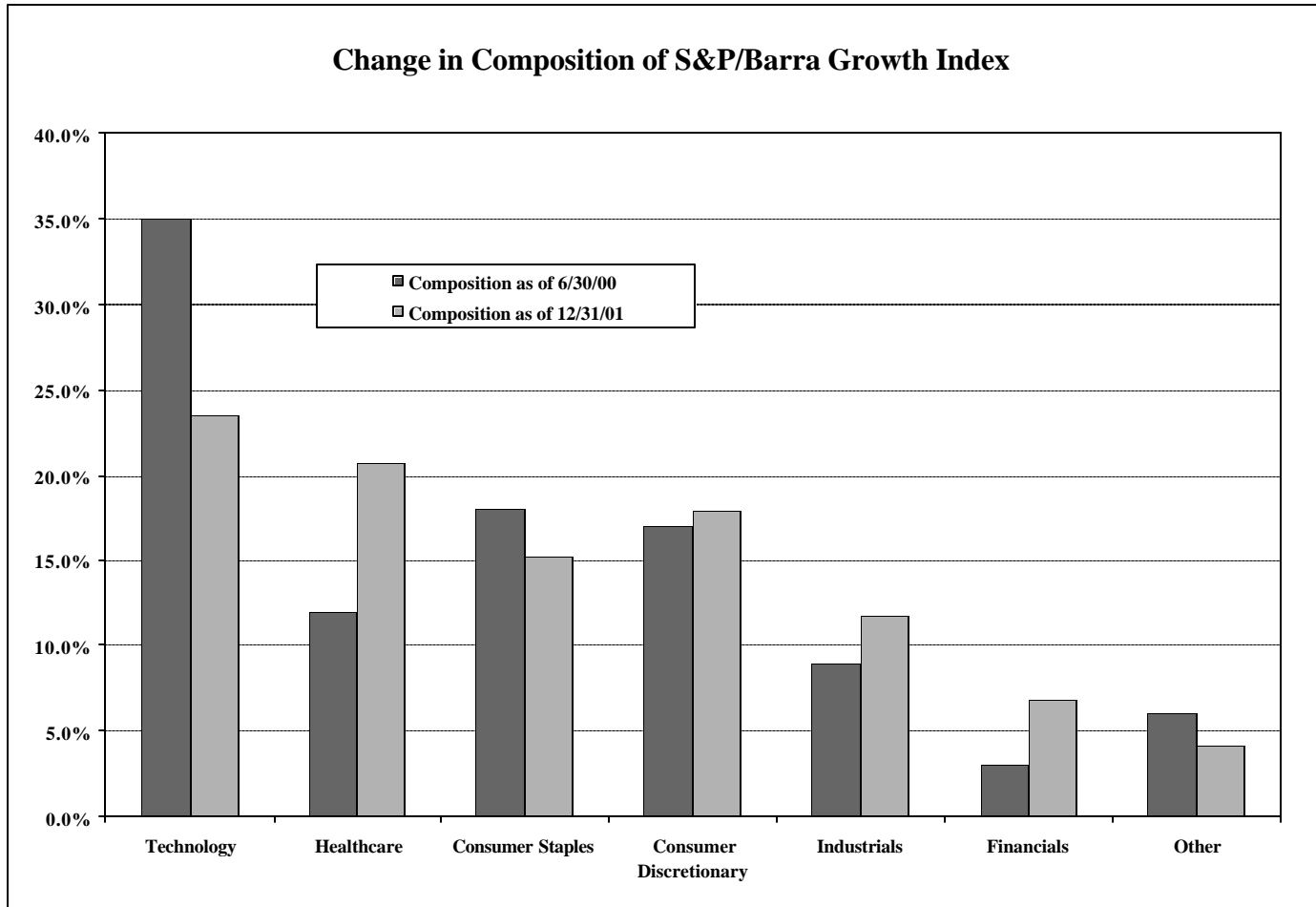
Sector Concentration of S&P/Barra Value Index

S&P/Barra Value Index By Sector

- Telecom 3%
- Staples 3%
- Healthcare 4%
- Energy 7%
- Utilities 11%
- Materials 11%
- Technology 13%
- Industrials 14%
- Financials 16%
- Discretionary 18%
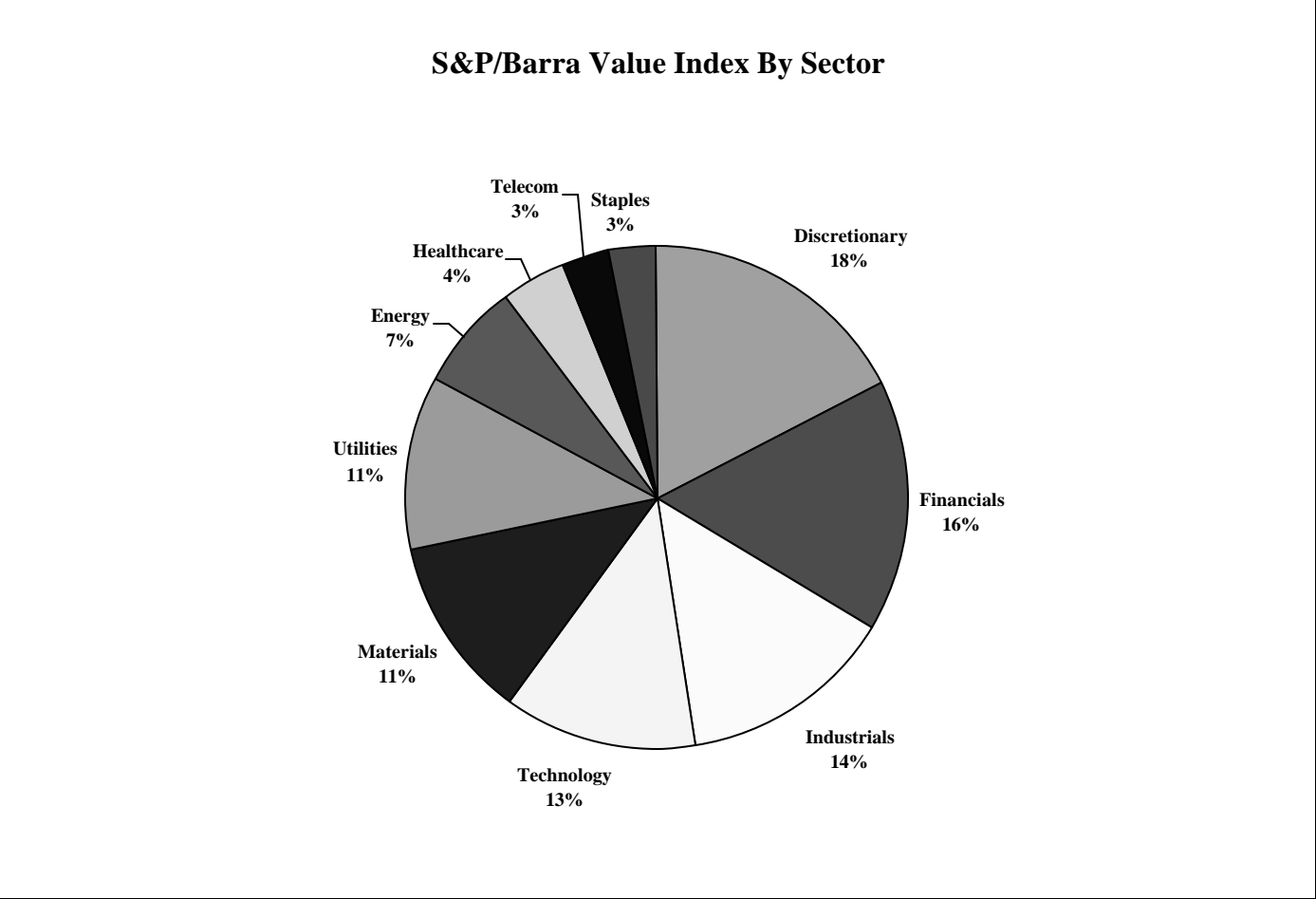
Proportion of Sector in S&P/Barra Growth Index

Proportion of Sector Residing in S&P Barra Growth Index
(Data as of 12/31/01)

Sector	Proportion
Staples	64.7%
Healthcare	66.7%
Technology	43.6%
Industrials	25.0%
Discretionary	29.5%
Telecom	15.4%
Financials	13.9%
Energy	0.0%
Utilities	0.3%
Materials	7.5%
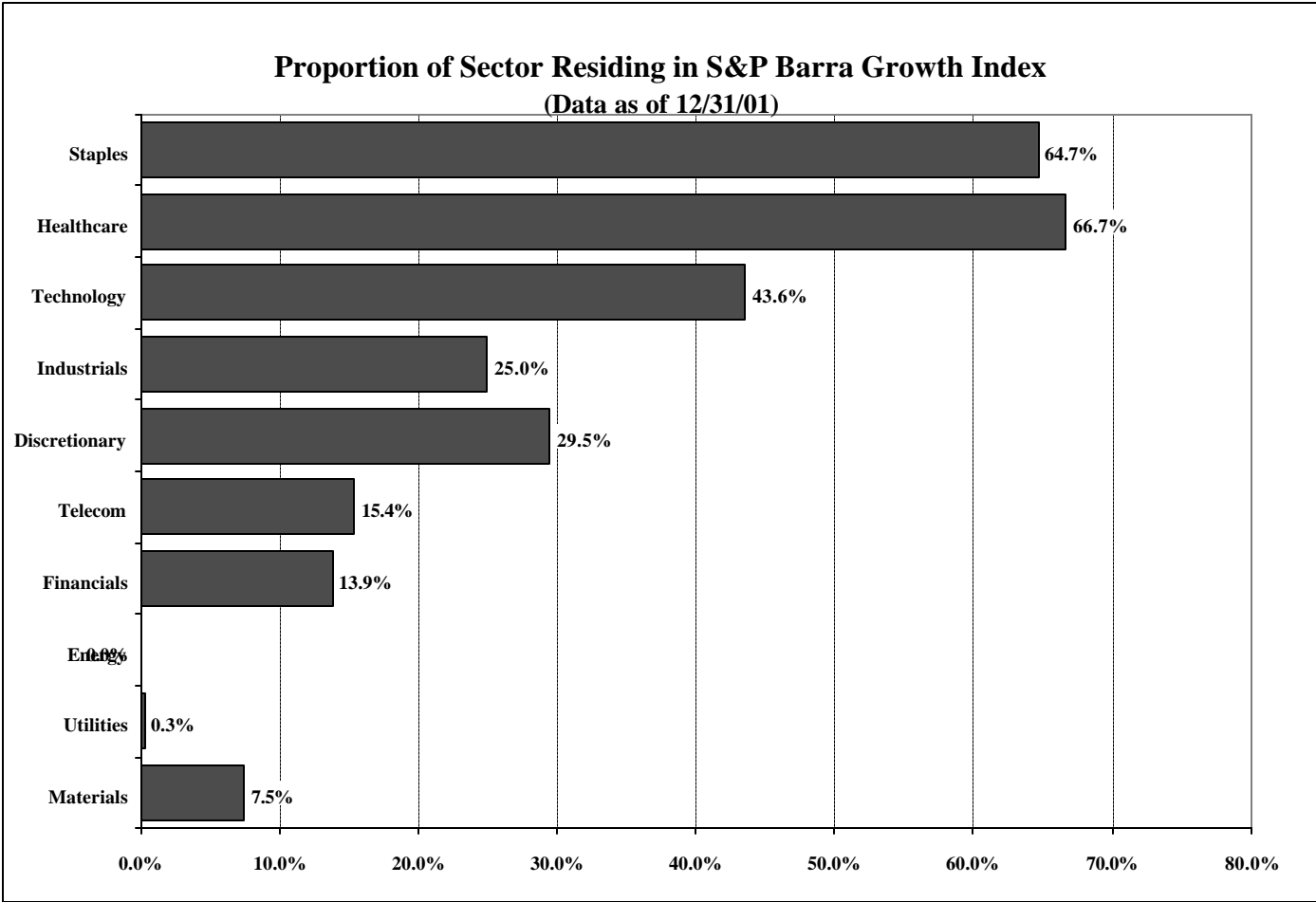
Style Allocation Benchmarks (2/28/02)

	USPC Equity Allocation	Large Cap Growth	Large Cap Value	Small Cap Growth	Small Cap Value	International
Capital Preservation	15%	5%	10%			
Current Income	30%	5%	25%			
Income & Growth	45%	15%	20%		5%	5%
Long-Term Growth	65%	15%	20%	10%	10%	10%
Aggressive Growth	80%	20%	20%	15%	15%	10%
U.S. Strategy Asset Allocation	**50%**	**10%**	**15%**	**10%**	**10%**	**5%**