A Contrarian Case for Value Investing

Valuations are stretched, leverage is elevated, and concentration sits at historic highs. History suggests this does not persist indefinitely.

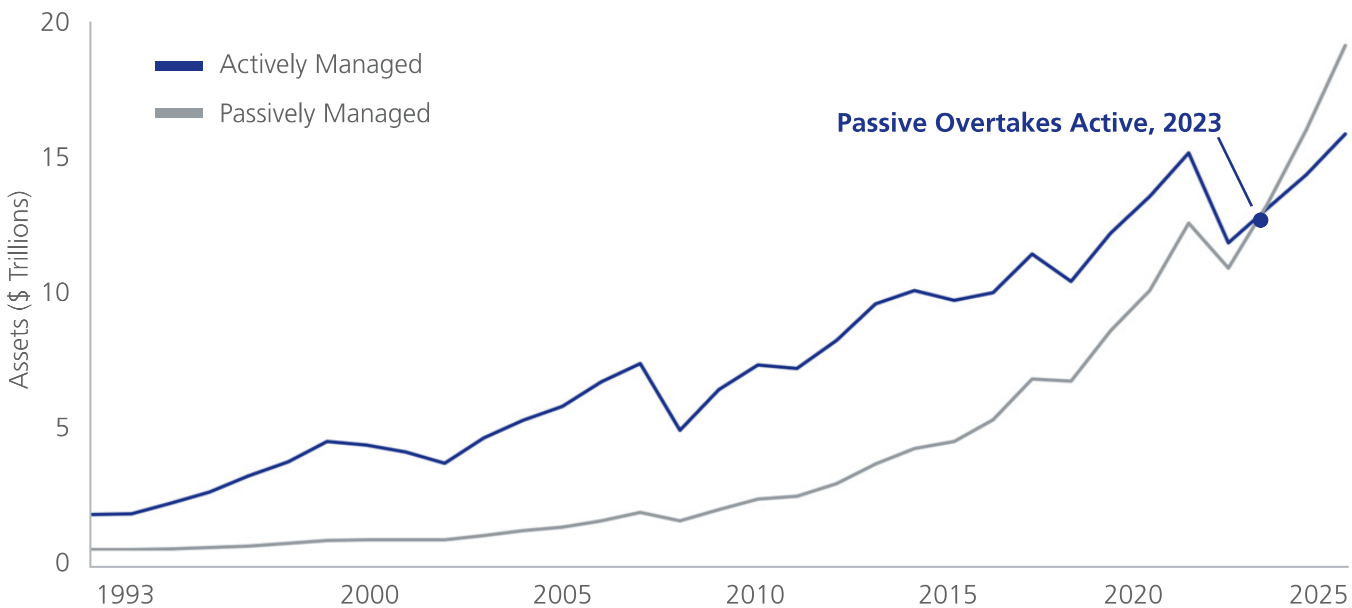
Summary

Capital has crowded into a concentrated set of exposures including mega-cap growth stocks, artificial intelligence (AI) capex beneficiaries, passive S&P 500 indexes, and leveraged private-market vehicles. These approaches are not inherently flawed, but their risks may be underappreciated, and the scale of capital flows has starved other areas of the market. Value investing, a long-established discipline, has been a particular casualty of this neglect, but history suggests this doesn't persist indefinitely. Prior periods of extreme style dispersion have given way to a renewed relevance for strategies grounded in valuation and risk discipline. If prior cycles are a guide, the coming decade should favor disciplined value investors.

Passive Flows, Private Markets, and the AI Trade

One of the defining themes of this cycle has been the growth and dominance of passive investing, a strategy that tracks the market index. This approach began as a contrarian philosophy and was popularized by Jack Bogle, the iconoclastic founder of The Vanguard Group and creator of the retail index fund[1]. However, passive investing is now far from contrarian, with passive strategies representing nearly 60% of all US equity fund assets (figure 1). These low-cost, market-cap-weighted vehicles have absorbed enormous price-insensitive capital flows while benefiting from the price discovery delivered by active managers. While the merits of a passive approach are well understood, the risks may be less appreciated. Passive inflows appear to disproportionately benefit large-cap stocks, amplifying price distortions and deepening market concentration[2]. Consistent with the inelastic-markets view that flows have outsized price impact[3], these dynamics are amplified by the rise of passive investing[4], leaving an ever-larger share of the market indifferent to valuation. While cap-weighted passive strategies have been relative beneficiaries of these flows[2], with concentration now elevated and more capital crowding into the same valuation-agnostic vehicles, it appears as though passive investors may be taking more risk than ever before.

Figure 1: US Equity Fund Assets, Active Versus Passive

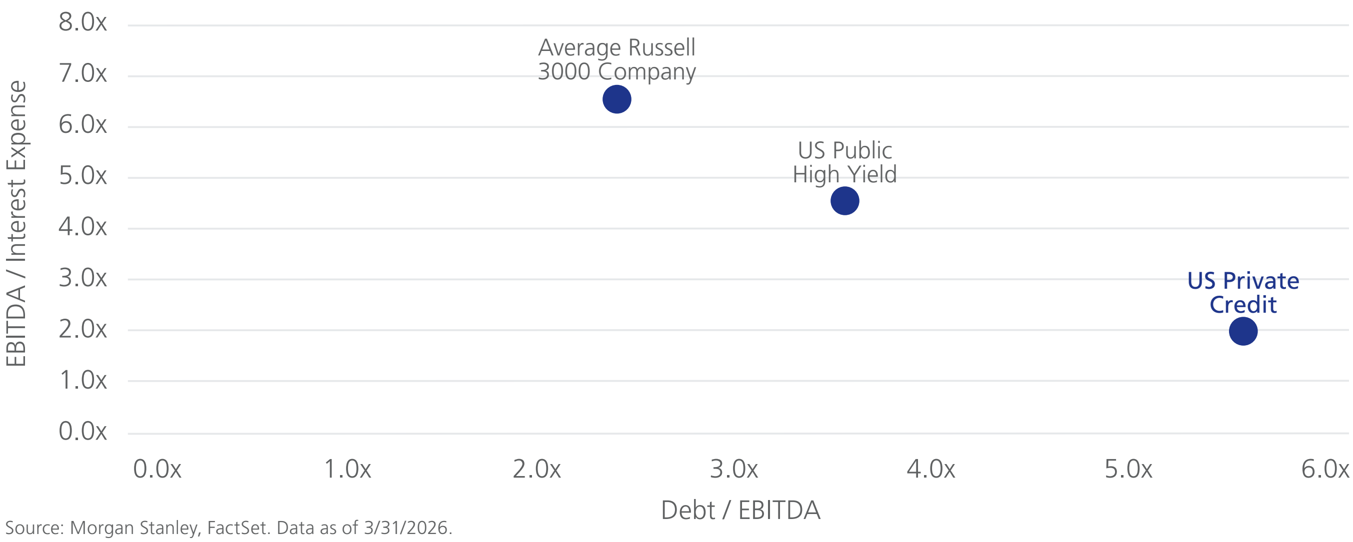


Source: Morningstar. Value investing is a long-term discipline, and there is no assurance that a value-oriented approach will outperform other investment strategies over any given period. Past Performance does not guarantee future results.

Private markets have been another major beneficiary of capital rotation. Vehicles spanning private equity, credit, real estate, and infrastructure have attracted significant flows in part due to their purported diversification benefits and superior risk-adjusted returns, claims that remain actively debated. Despite this, private markets have grown to represent roughly 10% of global assets under management[5,6], driven by institutional adoption and an expanding retail investor base. However, the conventional framing of these investments may understate their real economic risks. For instance, in its own examinations, the Securities and Exchange Commission (SEC) found that certain advisors have been presenting misleading track records, cherry-picking favorable results, relying on stale performance figures, omitting leverage effects, providing incomplete information about predecessor firms, and crediting personnel for returns they didn't primarily earn[7]. A separate SEC examination alert flagged failures in private-fund valuation processes that led to inflated management fees and carried interest[8].

Additionally, at Nuance, we believe the diversification and lower-volatility qualities often cited are largely an accounting or timing illusion. A private fund's net asset value (NAV) is a periodic estimate, not a price that can be transacted upon at any moment. Therefore, when a reported mark holds steady, that tells you little about whether the underlying economic value, liquidity, or downside risk has actually remained unchanged. Pricing something infrequently cannot reduce underlying economic risk; it can only delay recognition of potential losses for downside potential. In fact, the risk can be materially higher than that of public-market equivalents, particularly where illiquidity is combined with financial leverage, a combination that global regulators have flagged as a potential source of systemic stress[9]. Companies backed by private-equity sponsors and private-credit borrowers typically carry riskier credit profiles than public companies, including the public high-yield issuers that private credit is often compared to (figure 2). For instance, debt-to-EBITDA ratios for these companies typically range from 4x to 7x (often flattered by aggressive EBITDA add-backs) and tend to carry more floating-rate debt than their public peers. Additionally, private credit lenders frequently apply fund-level leverage on top of the already highly leveraged borrowers. In value-add and opportunistic private real estate vehicles, fund level leverage averages roughly 55% of gross asset value[10], significantly higher than the 33% debt to market assets ratio of publicly traded REITs[11]. While leverage amplifies returns in favorable environments, it also amplifies losses in periods of stress, and investors lulled by smooth reported returns may be unprepared for these downside risks.

Figure 2: Borrower Credit Fundamentals



Source: Morgan Stanley, FactSet. Data as of 3/31/2026.

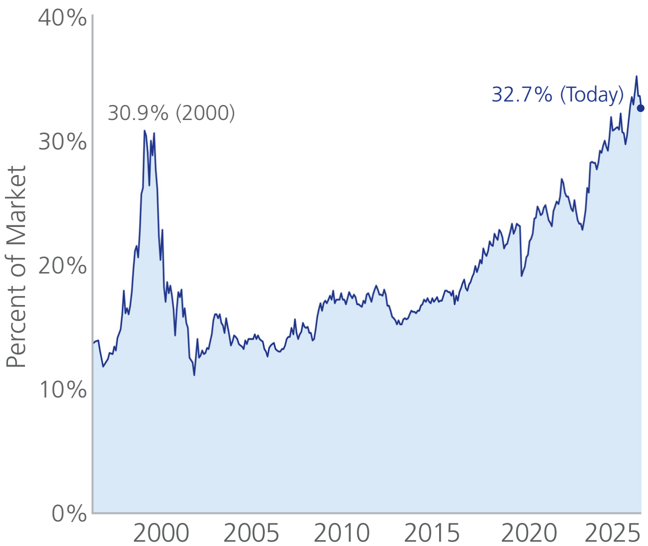
Finally, the promise of AI has drawn significant capital into many businesses with a credible AI narrative, including cloud service providers, model developers, and those benefiting from the infrastructure buildout cycle spanning datacenters, power, and compute. While AI technology will almost certainly prove to be transformative and valuable, the dot-com era as well as the technological booms that came before it are a reminder that investors have repeatedly overestimated their ability to pick the winners of a major technological transition as it unfolds.

Nonetheless, today's investors in both public and private markets appear largely undeterred. Although the ultimate winners of AI value creation remain far from certain, the price of many stocks leaves little room for error or competitive disruption with the cyclically adjusted price to earnings ratio approaching the peak registered in 2000 (figure 3). Additionally, both market concentration in the tech sector (figure 4) and outperformance of mega-cap stocks (figure 5) are now comparable to prior cycle peaks. Historically, these conditions have preceded below-average index-level returns and a favorable backdrop for value-oriented investors.

Figure 3: S&P 500 Cyclically Adjusted Price to Earnings Ratio

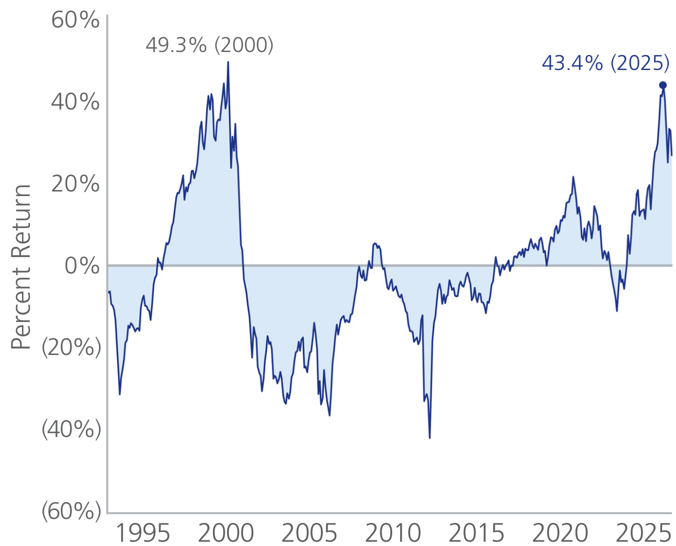
Source: Robert Shiller

Figure 4: Technology Sector Share of the US Market



Source: Morningstar

Figure 5: Three-Year Return, S&P 500 Less Equal Weight



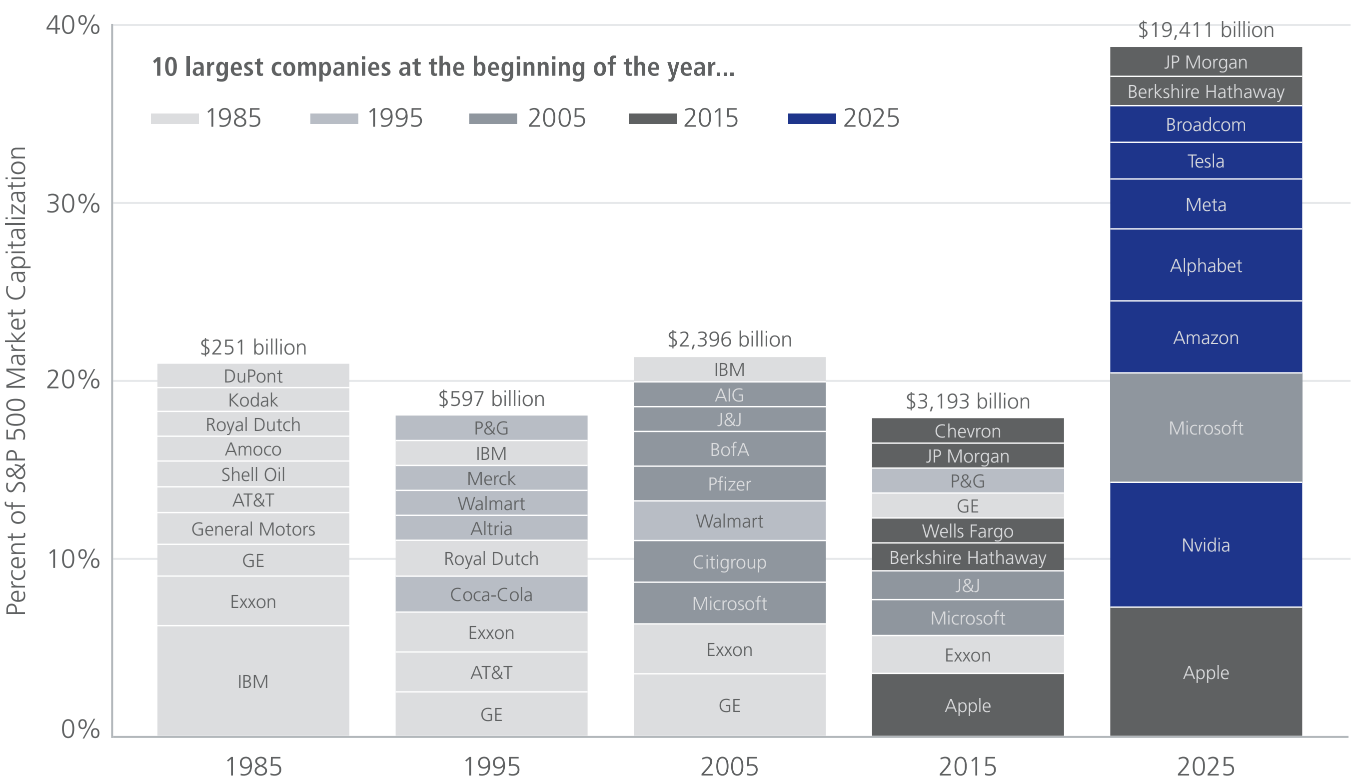
Source: FactSet

The Enduring Logic of Buying Good Businesses Cheaply

As capital has crowded into the popular investment approaches of this cycle, it has seemingly abandoned value-investing strategies that may prove most valuable just as they have become deeply out of favor. Valuations are stretched, leverage is elevated, and concentration sits at historic highs, yet many investors are seeking safety by crowding further into the same corners of the market.

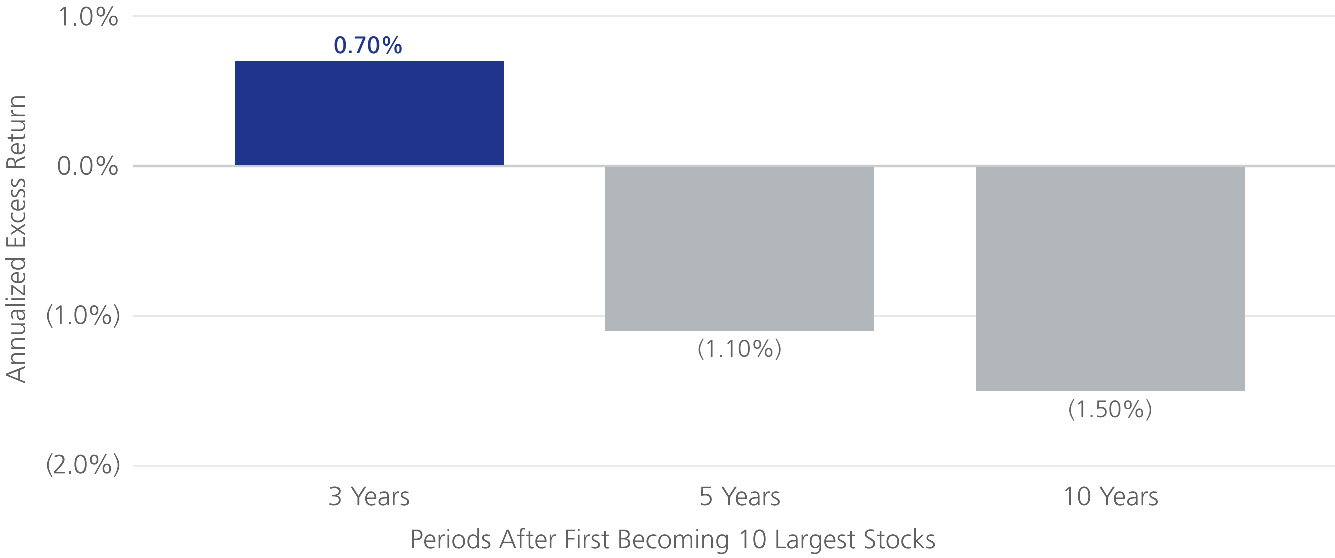
Value investing, by contrast, anchors decisions on the price paid relative to fundamentals, rather than crowding into what has already worked. The point isn't to avoid technology or to bet on a collapse in richly valued stocks, it's to avoid paying prices that require exceptional outcomes just to earn an acceptable return. Value investing offers resilience through the ownership of durable, conservatively financed businesses purchased at sensible valuations. Additionally, the liquidity and flexibility of public-market strategies are more important than ever as investors navigate the underlying shifts in technology and markets. AI will reshape competitive landscapes, strengthening some businesses and undermining others, and the sheer uncertainty of this evolving technology raises the cost of locking capital in illiquid private vehicles. Passive strategies are equally ill-equipped to navigate this environment. A passive approach is a wager that the winners of the last decade will be the winners of the next, an outcome the historical record rarely supports (figures 6 and 7). In an ever-changing market, disciplined value investors can adapt. They can seek out businesses that are resilient to technological disruption without depending on speculative expectations being met and apply the valuation and balance-sheet discipline needed to protect capital through a full market cycle.

Figure 6: The 10 Largest S&P 500 Companies, by Decade



Source: JP Morgan

Figure 7: Excess Return After Entering the 10 Largest Stocks

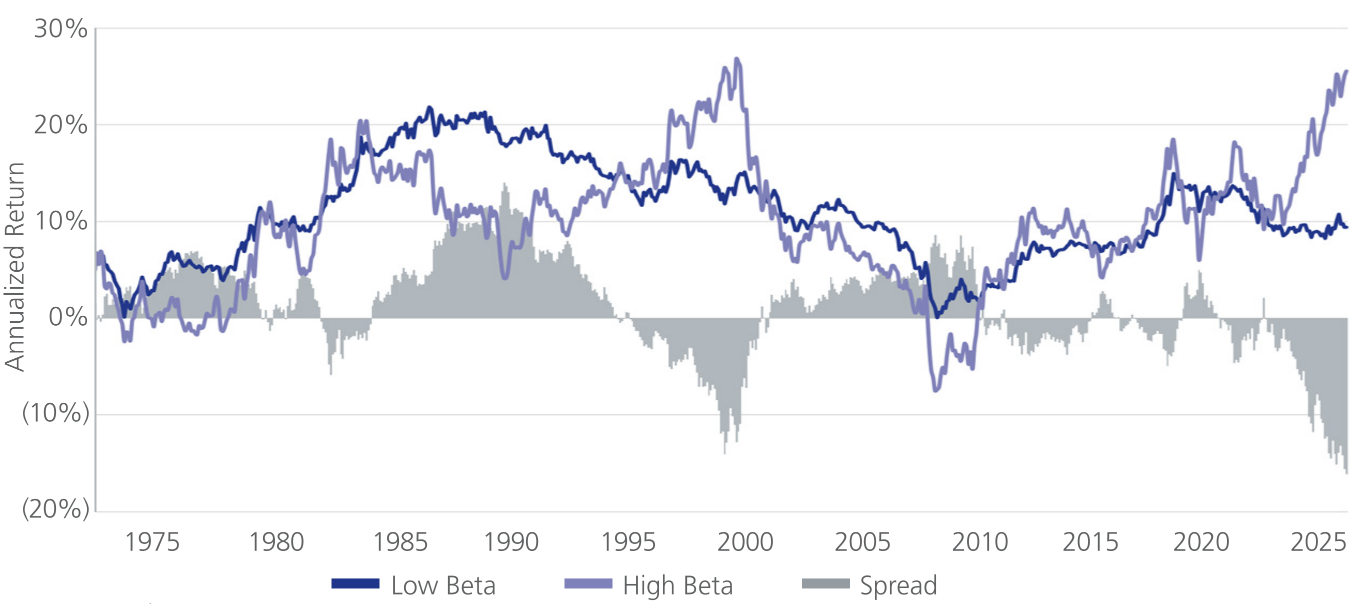


Source: Dimensional Fund Advisors

History Doesn't Repeat, But It Rhymes

The period culminating at the peak of the dot-com bubble was the last time markets exhibited a comparable combination of narrow leadership, growth-driven enthusiasm, and extreme appetite for high-risk stocks. Several measures suggest today's conditions are even more extreme: broad market indices are more concentrated now than they were then, and over the trailing decade ended June 2026, the highest-beta stocks in the US market have outperformed their lower-risk counterparts by a margin that now surpasses the froth seen at the dot-com peak (figure 8).

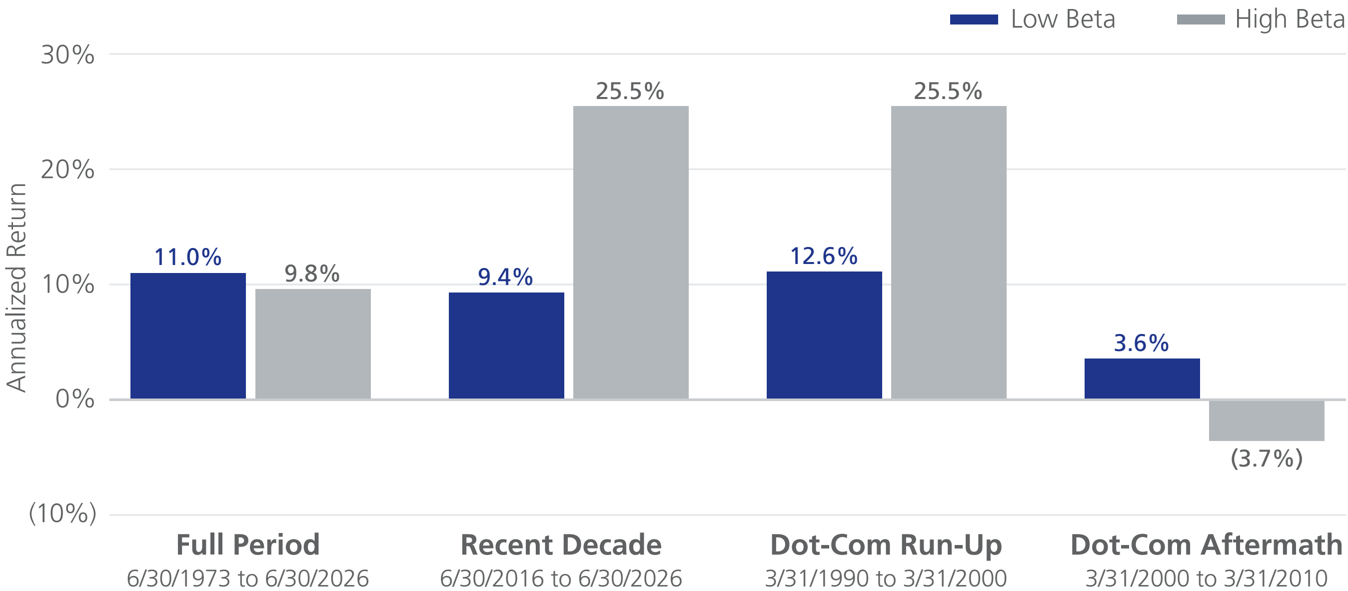
Figure 8: Rolling 10 Year Return, Low & High Beta Quintiles



Source: Ken French

The last time high-risk stocks outperformed by a similar margin, the following decade delivered negative total returns for the S&P 500, outperformance of value versus growth, and one of the strongest stretches on record for lower-risk value strategies specifically (figure 9).

Figure 9: Annualized Returns by Beta Quintile, Selected Periods



Source: Ken French. The historical periods presented were selected to illustrate specific historical patterns discussed in this paper and do not represent a comprehensive, random, or exhaustive sampling of all available historical time periods. The selection of alternative start and end dates could produce materially different results. Readers should not assume that these are the only periods relevant to an evaluation of beta-based or value/growth performance patterns. Past performance during any of the periods shown, or any other historical period, is not indicative of future results, and there is no assurance that returns during comparable future periods will resemble those shown in Figure 9.

History does not repeat exactly, but it does suggest that when a market is this narrow, this expensive, and this comfortable with leverage, a shift in leadership can meaningfully benefit value strategies. While the precise timing of any leadership shift is impossible to predict with confidence, we believe the current backdrop makes the opportunity for value investors today look more compelling than it has in decades.

Looking Ahead

The 2000–2010 period illustrates how an expensive, narrowly led market can produce deeply disappointing index-level results even as lower-risk value strategies continue to compound. It's a reminder that one of the greatest risks to long-term compounding is paying up to join the consensus when expectations reach their most optimistic levels. We see that pattern forming again in today's narrow, momentum-driven market, where AI-related businesses are treated as sure things. This paper is the first of three. The second, 'Why Mid Cap Value, Why Now,' turns from the broad case for value to a specific one proposing mid cap value as the best way to capture it. The third will follow on active value investing.

About Nuance

Nuance Investments, LLC (Nuance) is a boutique classic value investment firm headquartered in Kansas City, Missouri. Founded in 2008 and one hundred percent employee-owned, the firm manages two composites: Nuance Concentrated Value and Nuance Mid Cap Value.

The Nuance Investments investment philosophy is a classic value approach founded on the belief that identifying leading business franchises selling at a discount to fair value has the potential to generate excess returns over time. Our performance focus is on superior risk-adjusted returns.

For more information about Nuance or the strategies discussed in this paper, please contact Nuance Client Services at client.services@nuanceinvestments.com.

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Compliance Statement