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GROWTH VERSUS VALUE—A BALANCING ACT, NOT AN ALL OR NOTHING APPROACH

THOUGHT LEADERSHIP PERSPECTIVES

BY ALEC BAUM, CFA

OVER THE LAST DECADE, THERE HASN'T BEEN MUCH TO COMPLAIN ABOUT WHEN IT COMES TO EQUITY PERFORMANCE.

Even after the sharp decline seen in financial markets earlier this year, equity indices have rebounded with strength and now sit at or near all-time highs. The resilience, performance, and consistency of the market in the last ten years has been nothing short of impressive—that is, unless you're a value investor.

Value and growth investment styles are two philosophies that are often compared and studied. The basic premise behind value investing is that companies who are undervalued, based on a variety of metrics, are sought out with the hopes that the market will eventually realize its full worth—it can be thought of as "seeking to buy a dollar for 50 cents". Growth investing, on the other hand, is less concerned about the valuation of a company and more concerned about current and expected growth rates—even if there is a premium to pay. Growth investing can be thought of as "buying 50 cents for a dollar, expecting to sell it for 5 dollars".

At Fairman Group Family Office, we advocate for a balanced portfolio with equal exposure to both value and growth investment styles as the optimal long-term approach. Through a detailed look at both current and historical market environments, we aim to present a strong argument as to why balance in the portfolio is best.

HISTORICAL COMPARISON

Historically, value stocks have outperformed growth stocks in a meaningful way. Data going back to 1927 shows that, when viewed over multiple market cycles, value stocks have held an advantage over growth stocks when it comes to returns. The researchers Eugene Fama and Kenneth French are two leaders in value and growth investing research, and have published many papers that focus on differences in the two styles. One data point they have published shows that if an investor placed $1 in value stocks and $1 in growth stocks in 1927, the value stocks would have grown to $51,514, whereas the growth stocks would have only increased to $2,922—a difference of almost 3.5% annually.[1]

Value stocks don't always outperform growth stocks—there have been several extended periods in history where growth has led the way—but when value comes back into favor, it tends to do so quickly and sharply. The 1990's are a great example of this relationship. By 1999, growth stocks had performed better than value stocks on a 1, 5, 10 and 20 year basis. The dot-com bubble burst in 2000, hitting growth and tech stocks especially hard, and by 2002 value stocks had actually managed to flip the table on growth—outperforming them on a 1, 5, 10 and 20 year basis.[2]

CURRENT ENVIRONMENT

We are currently experiencing the widest margin of growth stock outperformance we have seen since 1927, leading many to believe that this could be a permanent shift in the market rather than another temporary period of leadership change. Since 2007, we have seen consistent outperformance from growth stocks. On a 10 year basis, the Russell 1000 Growth Index has outperformed the Russell 1000 Value Index by a whopping 7.25% annually. Expressed in dollar terms, a $10,000 portfolio invested fully in the growth index would have returned almost $49,000, whereas a $10,000 portfolio invested fully in the value index would return almost $26,000—a difference of over $23,000. The bulk of the returns difference comes from sustained outsized returns in tech stocks (think Apple, Amazon, and Facebook)—all classified as growth stocks—coupled with poor returns in sectors such as energy and financials, which are classically value stocks.

Even after taking into account the last thirteen years of growth stock market leadership, value stocks have still meaningfully outperformed on a long-term basis. History has shown that over any one period, it is not uncommon for value stocks to experience worse relative performance to growth stocks—however, it has been the ability to hold value stocks through these periods that has earned value investors their premium.

MOVING FORWARD

Experts are debating what to expect moving forward regarding the two styles of investing. The researchers Kenneth Fama and Eugene French published a 2020 paper that looked more in depth at the value premium, and were unable to conclude that the value premium had gone away.[3] Vanguard, one of the world's leading asset managers, also doesn't see the value premium as having gone away, stating "Value companies will benefit from the eventual return to more normal conditions and a potential shift from monetary to fiscal stimulus that could change the inflation and interest rate environment".[4] However, there are some that believe our economy has shifted in such a way that will permanently allow growth stocks to outperform value stocks.

So what do we make of the growth vs. value debate as it pertains to client portfolios? For one, it's important to evaluate managers in the appropriate context. Just as small cap fund performance should be evaluated against a small cap benchmark (rather than large or mid cap), growth and value managers should be compared to their respective peer group. This is especially important during the current environment, where even the best performing value funds are unable to keep up with growth funds—for instance, according to Morningstar data, the top-performing Large Cap Value fund would still find itself in the bottom quartile of Large Growth funds.

Trying to time market leadership in terms of growth vs. value investing has proven to be a daunting task—one we believe should be addressed through a long-term target rather than short-term 'guesses'.

LET OUR EXPERTS HELP YOU EVALUATE YOUR PORTFOLIO FOR A MORE BALANCED APPROACH. CONTACT FAIRMAN GROUP FAMILY OFFICE TO LEARN MORE.

1) http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/index.html, 2) https://raffawealth.com/value-vs-growth/, 3) Fama, Eugene F. and French, Kenneth R., The Value Premium (January 1, 2020). Fama-Miller Working Paper No. 20-01, Available: SSRN: https://ssrn.com/abstract=3525096 or http://dx.doi.org/10.2139/ssrn.3525096, 4) https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article/InvComGrowthVsValue

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