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Growth versus value – not necessarily a case of one or the other

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Key points

- While some growth and value investors are rigid in their views, history shows that different market and economic environments will periodically favour one style or the other.
- History also shows, that trying to predict changes in style leadership is very difficult and, ultimately, a 'hit-or-miss' investment strategy.
- The dispersion of style-based returns is unpredictable, from one year to the next. Rather than limit themselves to one style or the other, investors should consider a combination of both.

Investment style is a subject that tends to polarize investor opinion – there are growth investors and there are value investors, and, for some, the divide shall not be breached. Proponents on each side of the fence argue passionately about the respective merits of their approach. Yet, it is very difficult to say with any certainty whether one is more successful than the other. Different market and economic environments will periodically favor one style or the other. Which begs the question – is a more flexible approach, combining both growth and value investments, the best way forward?

What does history tell us?

Certainly, over longer timeframes, history shows that value investors have achieved superior returns to growth investors, and with lower level of overall risk[1]. However, this knowledge would not have been helpful for investors over the past decade, for example, as growth-oriented investing has outperformed value substantially[2].

Analysis of historical data also highlights the fact that there is no discernible relationship between the returns from growth investing and those from value investing, from one year to the next. Each style has characteristics that may help it perform better or worse in different market environments. This suggests that both value and growth investments can be important components of a diversified portfolio, with the potential to provide a smoother combined portfolio return over time.

[1]**Source:** Frank Russell Company "LSE" via FactSet as at 31 December 2019. Past performance is not a reliable indicator of future returns.

[2]**Source:** Frank Russell Company "LSE" via FactSet as at 31 December 2019. Past performance is not a reliable indicator of future returns.

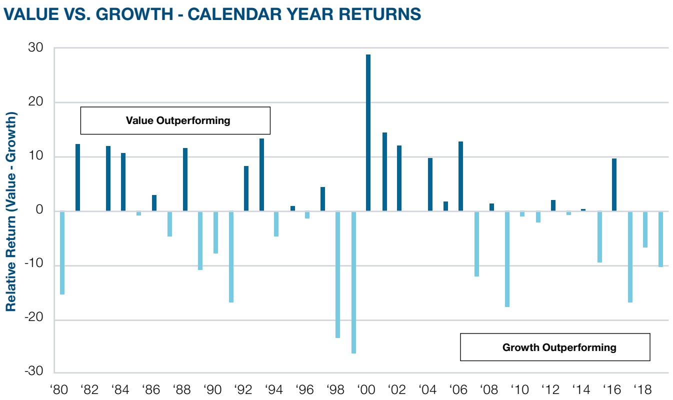
Style-related returns are unpredictable

Looking back over the last 40 years, what is immediately evident is the inconsistent and unpredictable nature of relative US equity style-related returns. Figure 1 depicts the year-on-year relative performance of value versus growth investments, showing large swings throughout the period, with no discernible pattern to the returns. Given the random dispersion of style-based returns from one year to the next, it doesn't make sense to rigidly adhere to one style over another. At the same time, trying to predict the changes in style leadership is also very difficult and, ultimately, a 'hit-or-miss' investment strategy.

In fact, it is sector-specific factors that have been most influential in determining one style's outperformance of another, frequently resulting in wide divergence of relative performance. In the late 1980s/early 1990s, for example, weak performance in the value-oriented financial sector caused value to underperform growth considerably. Conversely, in the late 1990s, the rapid ascent of technology-related companies saw growth massively outperform value, before reversing completely in early 2000 as the so-called dotcom bubble collapsed. The global financial crisis severely impacted value strategies once more in the late 2000s, sharply underperforming growth as confidence in the global financial sector was severely undermined.

More recently, growth has again meaningfully outperformed value, driven by the emergence of a number of innovative, industry-disruptive, businesses, most notably within technology and consumer-related sectors. Meanwhile, value investors have been particularly hindered by a combination of lower trending commodity prices and ongoing financial sector weakness.

(Fig. 1) The advantage of growth or value is neither consistent nor predictable



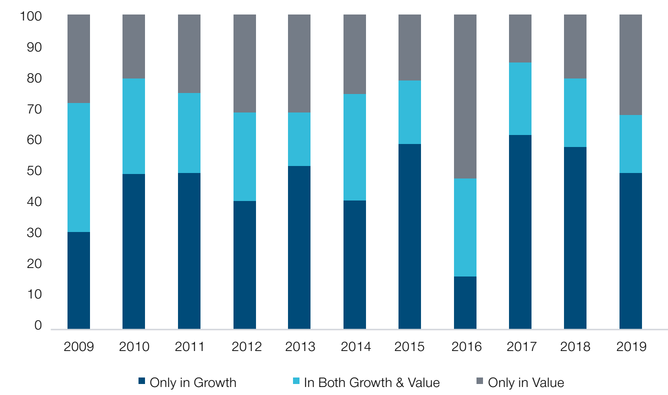
Past performance is not a reliable indicator of future returns.
Source: Frank Russell Company "LSE" via FactSet, as at 31 December 2019. (see Additional Disclosures)

Where to from here?

If we can agree that each investment style has its own respective merits, and that it is almost impossible to consistently predict changes in style leadership, then it is reasonable to suggest that a strategy that incorporates a mix of growth and value investments makes good sense for many investors.

Historically, the stocks that have generated the best annual returns have included both value and growth companies. Take 2015, for example, this was a very strong year for growth investors on the back of stellar performance from the so-called 'FAANG' (Facebook, Amazon, Apple Netflix, Google) stocks. This is well documented, however, what is lesser known is that over 20% of the best performing stocks in the market in 2015 were, in fact, value stocks (See Figure 2). A similar pattern has been observed throughout the past decade. Regardless of the dispersion in relative returns between the two investment styles, the best performing individual stocks each year have come from across the market. The point here is that investors who rigidly limit themselves to only one investment style are almost certainly leaving money on the table.

(Fig. 2) Best returns consistently come from across the broad US equity market



Past performance is not a reliable indicator of future returns.
Source: Frank Russell Company "LSE" via FactSet, as at 31 December 2019. (see Additional Disclosures).

Top decile of annual Russell 1000 Index company returns. Includes companies listed only on Russell 1000 Growth Index and only on Russell 1000 Value Index, as well as companies included on both indexes.

With strong individual stock performances historically coming from across the market, including both ends of the style spectrum, it makes sense to maintain a diversified US equity exposure – incorporating both value names with credible paths towards improvement, as well as higher multiple growth companies where we believe the long-term potential remains underestimated by the market. Such a broad-based approach should ensure reasonable participation in any market environment or conditions, regardless of which side of the style spectrum outperforms the other.

Notes
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