Growth vs. Value: A Shift in Time

With growth stocks ascendant, value investors may be tempted to join the party. But style leadership changes, suggesting a more balanced approach for long-term investors.

Recent stock performance has favored growth over value by a wide margin, but history suggests the tide will eventually turn.

For growth stock investors, it's been a heady time. Growth stocks recorded a total return of 16.4% for the eight months ended August 31, 2018, significantly eclipsing value's 3.1% showing. This follows 2017 outperformance of growth over value by more than 12 percentage points[1] and is in keeping with a longer-term outperformance of growth stocks. According to a recent study by the CFA Institute, growth stocks have outperformed their value counterparts by 144% since the end of the financial crisis.[2]

Does all this mean that value investors should rethink their strategy? Probably not. As history has shown, leadership between growth and value tends to shift back and forth depending on the stage of the market and economic cycle. Which of the two outperforms the other is ultimately attributable to their fundamental characteristics.

Growth and Value Defined

Growth stocks represent companies that have demonstrated better-than-average gains in earnings in recent years and that are expected to continue delivering high levels of profit growth.

Key characteristics of growth funds include:

- Higher prices than the broader market. Investors are typically willing to pay high price-to-earnings multiples with the expectation of selling shares at even higher prices as the companies continue to grow.
- High earnings growth records. While the earnings of some companies may be depressed during periods of slower economic improvement, growth companies may have the potential to achieve high earnings growth in different economic environments.
- More volatile than the broader market. The risk in buying a given growth stock is that its lofty price could fall sharply on any negative news about the company, particularly if earnings disappoint on Wall Street.

Value fund managers look for companies that have fallen out of favor but still have good fundamentals. The value group may also include stocks of new companies that have yet to be discovered by investors.

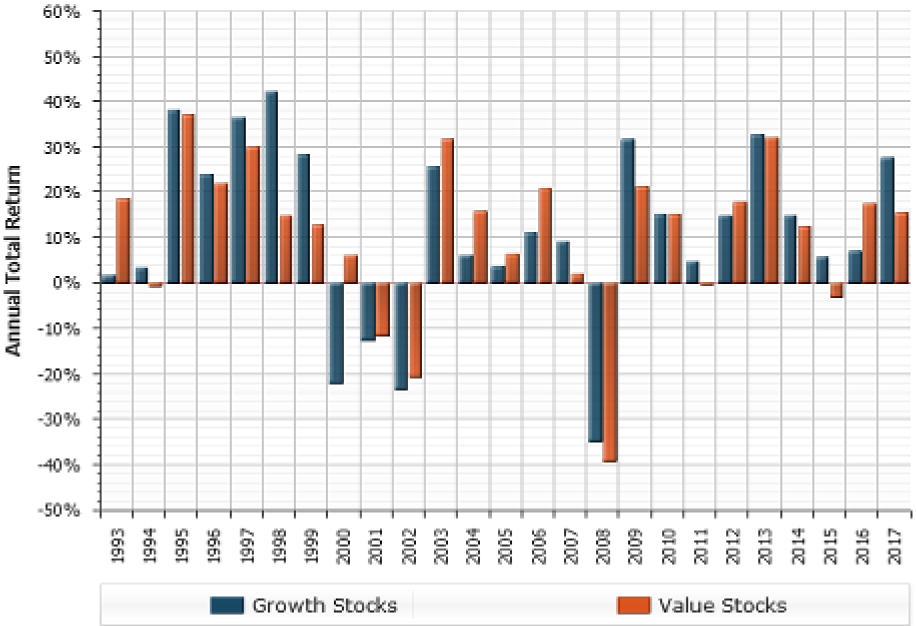
Key characteristics of value funds include:

- Lower prices than the broader market. The idea behind value investing is that stocks of good companies will bounce back in time if and when their true value is recognized by other investors.
- Priced below similar companies in their industry. Many value investors believe that a majority of value stocks are created due to investors' overreacting to recent company problems, such as disappointing earnings, negative publicity, or legal problems, all of which may raise doubts about the company's long-term prospects.
- Carry somewhat less risk than the broader market. However, as they take time to turn around, value stocks may carry more risk of price fluctuation than growth stocks.

Growth or Value... or Both?

Which strategy -- growth or value -- is likely to produce higher returns over the long term? The battle between growth and value investing has been going on for years, with no definitive winner. History shows us that growth stocks, in general, have the potential to perform better when interest rates are falling and company earnings are rising. However, they may also be the first to be punished when the economy is cooling. Value stocks, often stocks of cyclical industries, may do well early in an economic recovery but are typically more likely to lag in a sustained bull market.

Growth vs. Value Take Turns[3]



With the current economic cycle in late-expansion stage, many believe that a shift back to value may soon occur. But for long-term investors, a more balanced approach may be most appropriate. Combining both growth and value stocks, or stock funds, may allow you to take advantage of different economic cycles and smooth out returns over time. Talk to your financial advisor to see how you might best position your portfolio.

[1]Source: DST Systems, Inc. Based on total returns of the S&P 500 Growth and Value indices (spindices.com).

[2]Source: CFA Institute, Growth vs. Value: Waiting for GODOT, August 9, 2018.

[3]Source: ChartSource®, DST Systems, Inc. Based on calendar-year returns from 1993 to 2017. Growth stocks are represented by a composite of the S&P 500/BARRA Growth index and the S&P 500/Citi Growth index. Value stocks are represented by a composite of the S&P 500/BARRA Value index and the S&P 500/Citi Value index. Past performance is not a guarantee of future results. Index performance does not reflect the effects of investing costs and taxes. Actual results would vary from benchmarks and would likely have been lower. It is not possible to invest directly in an index. © 2018, DST Systems, Inc. Reproduction in whole or in part prohibited, except by permission. All rights reserved. Not responsible for any errors or omissions.