AM I A "GROWTH" OR "VALUE" INVESTOR?

By Matt Schmitt, CFA®, Director of Equity Strategy

Each new year affords us a chance to revisit investing concepts that we can often lose sight of or take for granted.

You or your financial advisor likely have some of the stock investments in your portfolio divided between "growth" and "value" categories for prudent diversification, but why are these allocations to these two buckets considered fundamental to sound management?

Let's review the definitions of growth and value and why they represent the yin and yang of a healthy mix of investments.

Growth investing focuses on companies whose business models are geared for rapid expansion and are expected to grow sales and earnings at a rate faster than the market average. They likely have a competitive advantage with a new product or service in a new or rapidly growing industry. To capture this advantage, they plow profits back into their business (e.g., new equipment, acquisitions, personnel) and are not as concerned about dividends while they maximize their customer reach. These companies are often able to grow at a pace faster than that of the broader economy and thus this is another reason for the 'growth' label. By nature, growth stocks can be riskier and can experience stock price swings triggered if that product or service misses the mark and the anticipated growth does not materialize.

Value investing, on the other hand, focuses on companies whose stock prices don't necessarily reflect their true current worth when measured by fundamentals such as revenue, earnings or profit margins. These are sometimes more mature businesses that are more reliant upon overall economic growth to grow their revenue and earnings, which are trading at share prices considered a bargain. Sometimes this is because they have fallen temporarily out of favor or their particular products and services are in a down cycle. As time goes on, investors believe the market will properly recognize the company's value and the stock price will rise. Many of these stocks also have a proven track record of steady dividends from which investors benefit. Many feel that value stocks have more limited downside risk and, therefore, can be safer investments than growth stocks. Do not mistake this though as value stocks can and do decline during periods of market disruptions just like their growth counterparts as we witnessed in the spring of 2020.

Modern portfolio theory says you want to have both camps represented in your overall investment mix. While one strategy may be in vogue presently and may have even enjoyed a prosperous run over many years, history shows the market eventually rotates to the other strategy.

No doubt that as of late, growth investors have enjoyed the edge. During the pandemic, high-tech companies in the S&P 500, like Facebook, Apple, Netflix, Google, Amazon and Microsoft, have gotten the most bang for the investment buck because their products and services thrive in an economy experiencing shutdowns during the pandemic. During 2020, growth stocks outperformed value stocks with the Russell 1000 Growth Index returning 38.5% as compared to the Russell 1000 Value Index return of 2.8%. Over the past 3, 5 and 10 years this has also held true with the same growth benchmark beating value by 16.9%, 11.3% and 6.7% per year over the respective time periods.

When will value make its way back? Conventional wisdom says value investing will make its way back eventually, and there may be some signs of it recently. Value stocks have been on a solid run recently, but we have seen brief periods of value outperformance over the past several years only for growth to resume its leadership. History shows that value stocks have outperformed growth stocks over many decades, but we are also presently in the longest period of outperformance for growth stocks on record.

As you dig deeper into the growth and value strategies, you will note that each approach can be further sliced and diced by factors like market capitalization (small-cap, mid-cap and large-cap). In a typical Morningstar style box grid, you will see growth, value and "blended" boxes divided by the three market cap categories, and this can help you better target your strategies. Currently, "small" is categorized as less than $12 billion in market cap, "medium" is $12 billion–$34 billion, and "large" are those companies greater than $34 billion in market capitalization (total shares outstanding x current price per share).

With this many choices, it is generally best to consult with your investment advisor on your personal financial goals in determining the best allocation between growth and value for you and your family. The question of whether a growth or value stock investing strategy must be evaluated in the context of an individual investor's time horizon and the amount of volatility, and thus risk, that can be tolerated. A Commerce Trust advisor can help you select the right mix of growth and value stocks to support your long-term financial goals.

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