WHICH IS BETTER – VALUE OR GROWTH INVESTING?

The debate between value and growth investing has been raging for decades with exponents of each philosophy espousing the merits of their side of the divide. Firstly, how wide is the divide and, secondly, is there a clear winner?

The MSCI World Value Index defines value according to 3 variables – price to book-value, forward earnings yield and dividend yield.

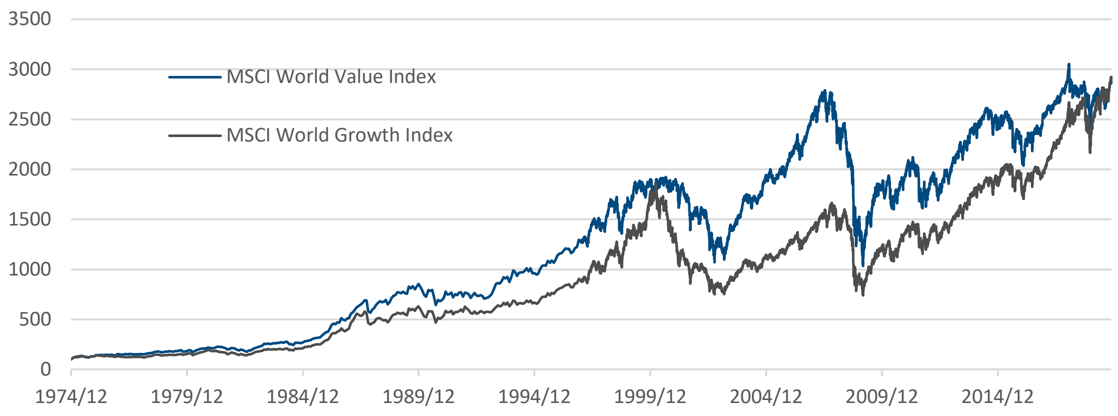
The MSCI World Growth Index defines growth according to 5 variables – consensus forward earnings per share growth – both short-term and long-term, internal growth rate, historical earnings growth trend and long-term historical sales per share growth.

Clearly, the definitions are very different and should produce components in the portfolios that are completely different. A company with a high forecast earnings growth is unlikely to be trading at a low price to book-value, for example.

Conventional wisdom and logic, though, does lend one to believe that buying good companies with sound dividends, trading at a low price (value) should do better than investing in companies where assumptions about future growth, while based on sound analysis (growth), can disappoint. Even growth managers will admit the principle but continue to espouse their philosophy due to their supposed ability to beat the odds.

A comparison of performances over time shows how the two factors have produced markedly different results.

Long-term Value versus Growth



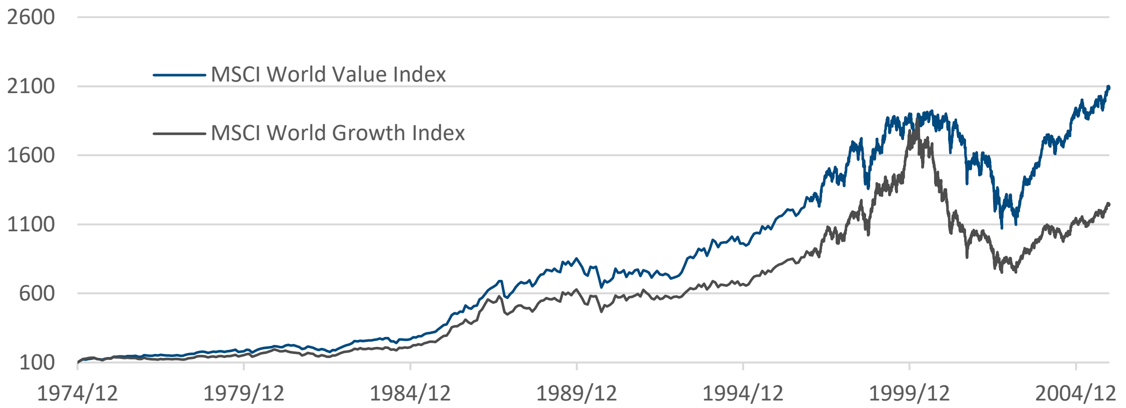
Source: Bloomberg

Over the last 45 years, value-investing has led growth until quite recently when growth caught up to finish, coincidentally, at the same point today. But one can clearly see with the naked eye that there was a huge gap between value and growth at the peak and it has taken but a few years to close that gap. For 35 of the 45 years, the conventional wisdom held true and value outperformed growth.

Notably, that was through many market crises such as oil wars, gold bubbles, Asian market sell-offs and the dot.com fallout, not to mention the Y2K non-event.

It is instructive to split the chart above into the two periods.

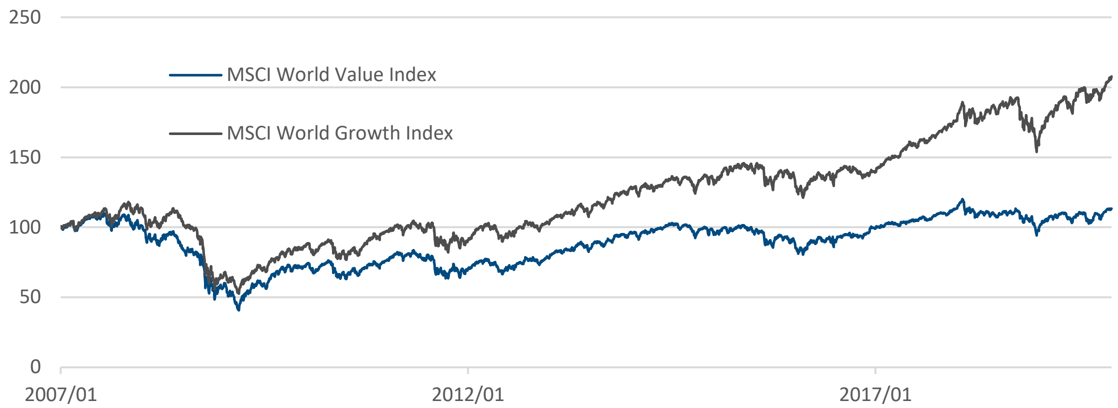
Value vs Growth until the global financial crisis of 2008



Source: Bloomberg

All it took to disrupt a 35-year trend was massive interference of global central banks in markets that needed no help, depending on one's point of view. After the Global Financial Crisis of 2008, which was fuelled by too much easy money, central banks across the developed world dropped interest rates to close to 0% to try and stimulate economies to grow out of the crisis by issuing too much easy money. One consequence of this was companies borrowing at low interest rates to buy back their own stock, thus increasing earnings per share and internal growth rates and boosting growth-type shares to all-time high prices which have prevailed for the last 10 years. The chart below shows how the superiority of value stocks has been severely disrupted with growth dramatically outperforming value since 2009.

Value vs Growth since 2009



Source: Bloomberg

In a global environment of low interest rates that shows no signs of abating, the big question remains – what will it take for value to re-assert itself? Can the trend in the chart above reverse if "normality" does not return to markets or is growth destined to continue to outperform?

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