A SIMPLE GUIDE TO GROWTH VERSUS VALUE INVESTING

Investors use many different approaches when putting their money to work. Two of the classic approaches are 'growth investing' and 'value investing', which we explain in this guide. These approaches are often said to be part of the 'investment style' of particular funds, and fund managers may use them when evaluating equities (company shares).

Growth investing

Growth investors focus on potential. They search for companies they believe will increase their earnings at an above-average rate compared to the rest of the market, resulting in a higher share price. Growth companies often aim to continually expand, so they may reinvest a significant part of their profits to generate growth.

The ideal 'growth' company has a resilient business model and is run by a management team that reinvests carefully to capitalise on future growth opportunities. Growth companies can give investors a substantial return, but some are smaller, newly formed businesses where the risk of failure may be higher. Some common features of successful growth firms include:

- management team with a good record of innovation
- successfully creating growth through careful spending
- competitive advantages – preferably operating in an expanding industry
- attractive projected earnings growth.

Value investing

Value investors look for bargains. They search for companies they believe are undervalued by the market. These could be companies affected by poor results, going through transition, or affected by short-term uncertainty. Many value investors look for a catalyst that can lead to improvement in a company, such as a new product being developed, a positive change in management, better working methods, or a pick-up in the broader economy.

Value investors also believe that stock market uncertainty is not something to fear, because it offers an opportunity to invest in quality companies unfairly hit by short-term sentiment. So price is the driving factor in making a value-based investment decision. Other potential indicators of an attractive value company can include:

- a high dividend yield (the income a company pays out to its shareholders)
- low valuation compared to industry peers
- a record of increasing dividend payments over time
- reasonably sustainable revenues.

The market has historically moved in cycles, with periods when growth has outperformed, and those when value has been more in favour:

Growth has typically outperformed*:

- when economic growth is weak and earnings growth is scarcer
- when interest rates are persistently low
- during periods of significant innovation – such as the growth of the internet in the 1990s and and increasing digitalisation in the 2010s.

Value has typically outperformed*:

- during strong periods for the economy, when company earnings are increasing and consumers are spending more money
- when inflation is picking up, helping to boost revenues.

* Past performance is not a guide to future returns. Historical trends are not an indicator of what styles or companies might do well in future.

Which style is best?

Growth and value companies perform very differently depending on their industry, regional exposure, or market capitalisation (size). Growth and value companies are present in all parts of the market. The prospects for both types will vary, depending on their individual characteristics, as well as broader market factors.

On a long-term view, the return from value companies has typically been higher than from growth companies*. Yet not all companies that appear good value are a good investment and there are many periods when a growth approach has worked better. Growth and value have a cyclical relationship, which is why many investors use fund managers with experience of investing across a range of market environments, or in both types of stocks. Investing in growth and value can help to increase diversification within a portfolio.

At a glance

- ✓ Growth investors focus on the potential of companies
- ✓ Value investors see market uncertainty as an opportunity to find undervalued companies
- ✓ Growth and value companies are present in all parts of the market
- ✓ Investing in a range of growth and value companies can help to improve diversification within a portfolio

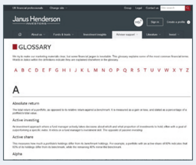
*Source: Refinitiv Datastream, MSCI World (Growth) Total Return Index vs MSCI World (Value) Total Return Index, 31 December 1976 to 31 December 2021.

Glossary

Diversification: A way of spreading risk by mixing different types of assets/asset classes in a portfolio. It is based on the assumption that the prices of the different assets (such as property, equities or bonds) will behave differently in any given scenario. Holding a range of assets that do not act in a similar fashion in different market conditions should help to improve diversification.

Dividend yield: The income received on an equity investment relative to its current share price, expressed as a percentage. It enables comparisons of the level of income provided by different investments such as equities, bonds, cash or property, or between funds at a point in time.

Inflation: The rate at which the prices of goods and services are rising in an economy. Consumer Price Index (CPI) and Retail Price Index (RPI) are two common measures.



Glossary

Please see HGi.co/glossary for a glossary of financial terms used in this document.

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