



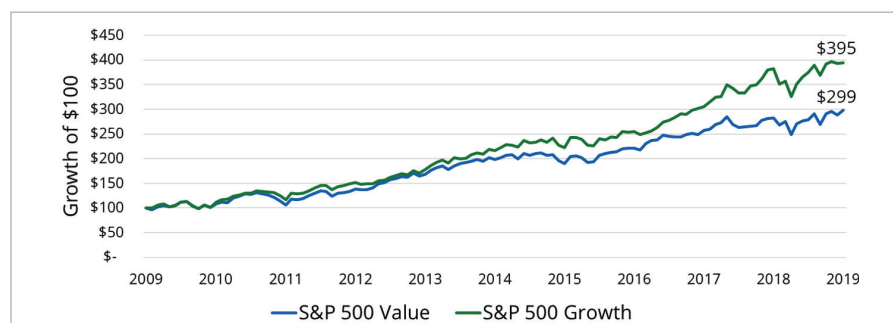
JOE NITTING, CFA, CAIA, ANALYST, RESEARCH

VALUE VS. GROWTH INVESTING: A NUANCED DEBATE

BY JOE NITTING, CFA, CAIA, ANALYST, RESEARCH

The debate over the relative merits of value and growth investing is one we have regularly at Clearstead. While there are cases to be made for both investing styles, we often find their differences are misunderstood. Distinguishing the nuances of each helps us formulate a thesis for each style going forward.

Over the trailing 10-year period, the S&P 500 Value Index has underperformed the S&P 500 Growth Index by 3.2% annually as shown below¹. A logical question is, "is value investing dead?" We believe the short answer is no, but it leads us to the first nuance of value vs. growth investing: value at a company level compared to an index level.



Source: Morningstar Direct. As of 9/30/2019. Past performance is not an indicator of future results.

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Private Client team with Dave Flegal.

Dave has joined Clearstead as a Client Planning Associate. Prior to Clearstead, Dave was Wealth Manager and Tax Preparer for Pinnacle Wealth Planning Services. He has a bachelor's degree and MBA from Baldwin Wallace University, is a Certified Public Accountant, and has his CFP designation.

These changes underscore the firm's commitment to building its integrated wealth advisory practice, promoting the next generation of leadership, and maintaining a rigorous process.

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VALUE: COMPANY VS. INDEX

At a company level, a value stock typically has some or all the following characteristics: a low valuation relative to its fundamental attributes, recent share price underperformance, and the potential to rebound as investors begin to appreciate the fundamental merits of the company.

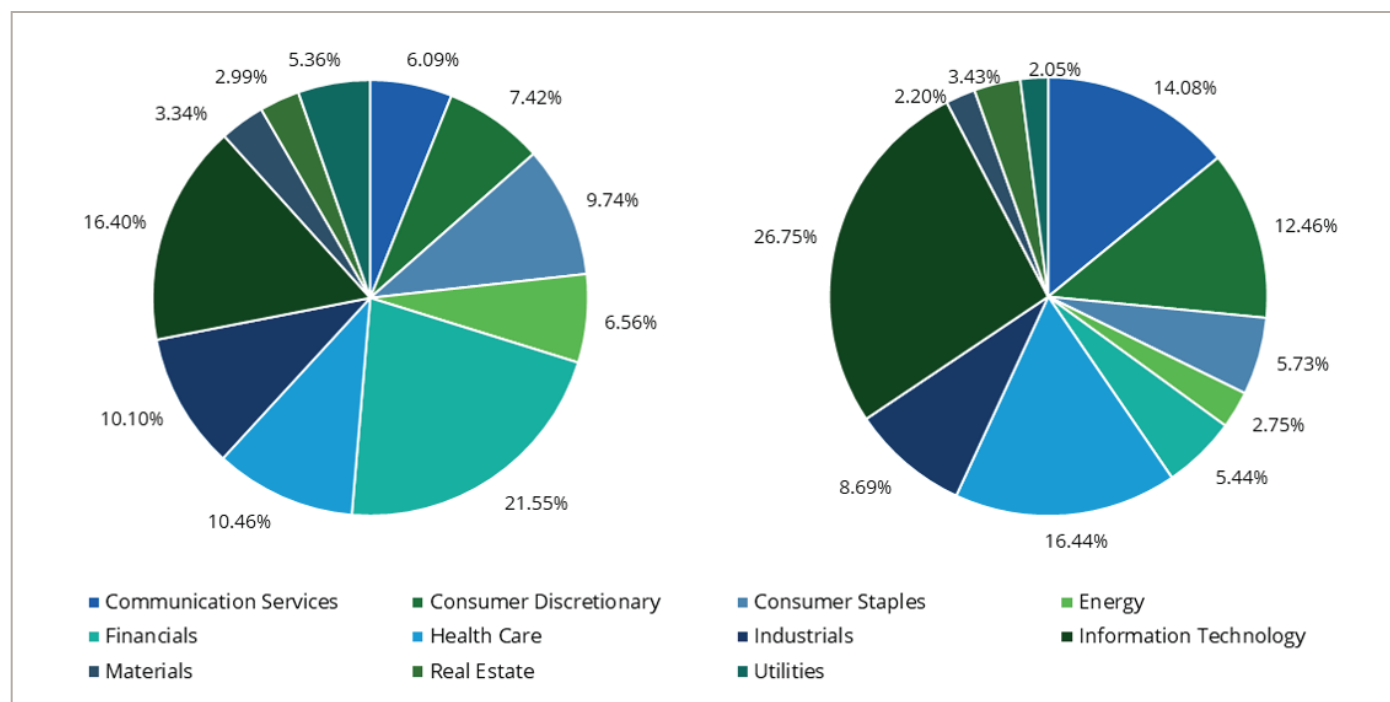
Value at an index level contains another layer of nuance, however. When comparing the S&P 500 Value Index to the S&P 500 Growth Index, the Value Index has significantly lower price multiples: trailing twelve month price-to-earnings, price-to-book, price-to-sales, and price-to-cash flow². These differences are shown in the chart below.

	S&P 500 Value	S&P 500	S&P 500 Growth
P/E Ratio	15.4x	19.3x	24.7x
P/B Ratio	2.3x	3.4x	5.6x
P/S Ratio	1.5x	2.2x	3.5x
P/CF Ratio	11.9x	14.0x	16.4x

Source: Bloomberg. As of 9/30/2019.

Moreover, when digging further, there are differences in sector composition between the two indexes, indicated by the chart below³. Most notably, the S&P 500 Value Index has more exposure to the Financials sector (21.55%) and less exposure to the Information Technology sector (16.40%) than the S&P 500 Growth Index (5.44% and 26.75%, respectively).

S&P 500 Value (Left) vs. S&P 500 Growth (Right)

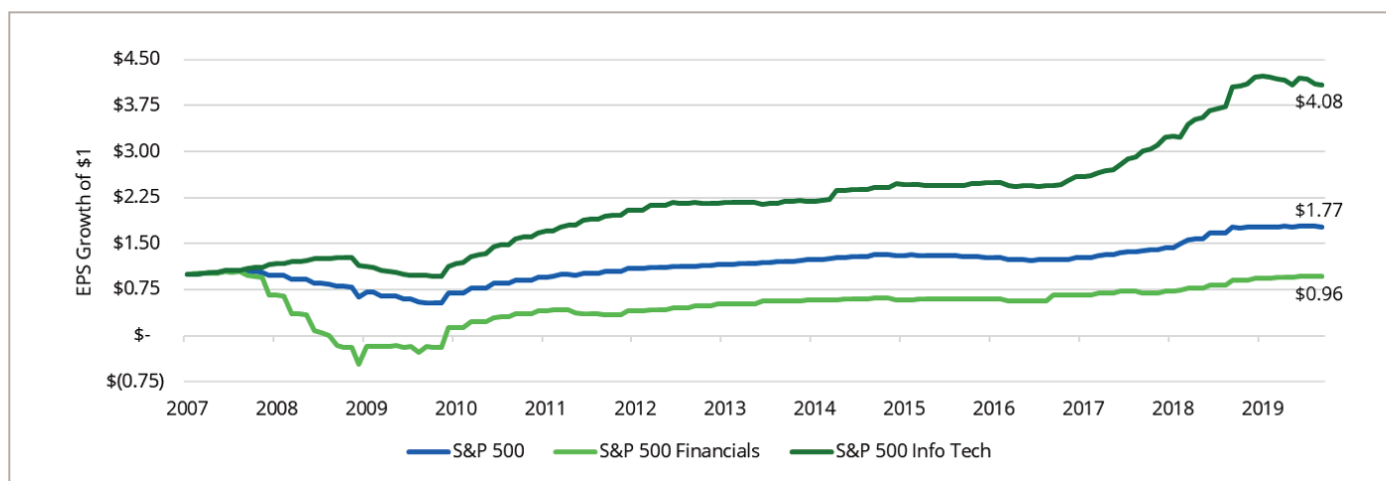


Source: Morningstar Direct. As of 9/30/2019.

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Since 2007 the major sectors of the S&P 500 Value Index have generally experienced lower earnings growth than major sectors of the S&P 500 Growth Index, as seen in the chart below⁴. During that time, investors have flocked to companies such as Microsoft, Amazon, Facebook, Alphabet (Google), and others that have had substantial earnings growth and the potential to disrupt and transform business models such as those in the S&P 500 Value Index (traditional banking, brick-and-mortar retail, etc.) As one might expect, these disruptive companies are in the S&P 500 Growth Index, propelling the S&P 500 Growth Index to outperformance over its value counterpart since 2007.



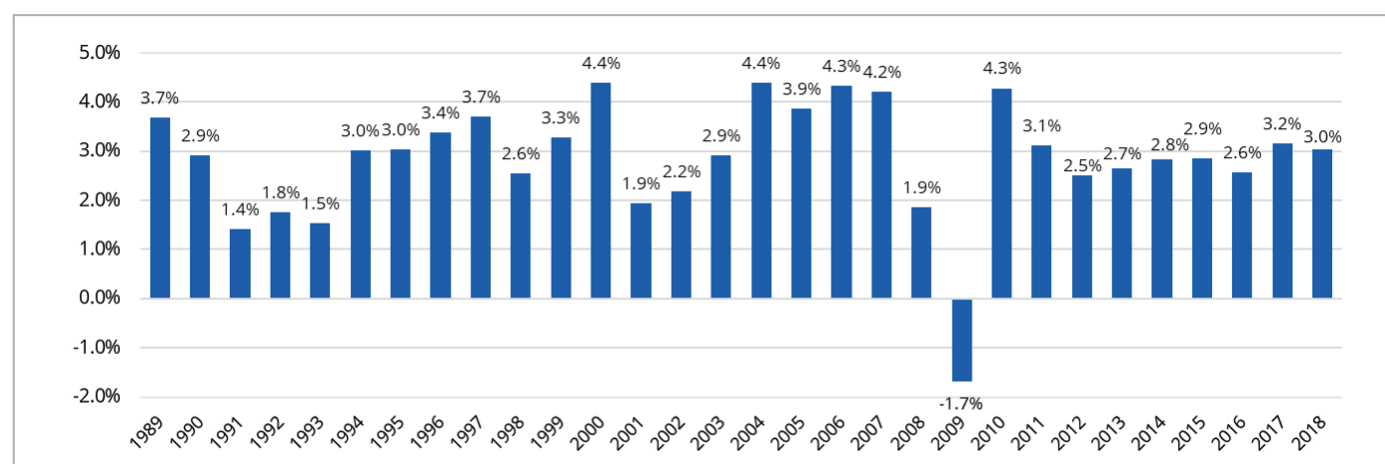
Source: Bloomberg. As of 9/30/2019. Past performance is not an indicator of future results.

WHAT HELPS THE VALUE INDEX GOING FORWARD?

In light of the S&P 500 Value Index's struggles relative to the S&P 500 Growth Index over the last 10 years, two additional questions we are asked are, "when will value (at an index level) come back into favor?" and, "what will the catalyst be for the rebound?" In short, we do not know exactly when the S&P 500 Value Index will return to favor, but our thesis for what will cause it to do so is a reacceleration in global economic growth accompanied by rising inflation and interest rates.

While the global economy has grown consistently since the trough of the 2008 downturn, it has grown at a modest pace of about 3.0% per year, as seen in the chart below⁵. Its modest growth rate has led investors to become more willing to pay higher price multiples for companies with revenue and earnings growth relative to the global economy, causing Growth to outperform Value.

Global GDP Growth



Source: World Bank. As of 12/31/2018.

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However, if the global economy goes into a recession and comes out the other side, we believe investors could rotate out of Growth stocks and into Value stocks. In an environment in which broad-based company-level growth is more robust, we think investors will be more attracted to Value stocks that offer comparable growth prospects to Growth stocks but at lower valuations.

If a reacceleration in global economic growth comes with rising inflation and interest rates, we also think this will benefit Value stocks. Rising interest rates would likely weigh on the speculative cash flows of Growth stocks, making Value stocks appear more attractive. A pickup in inflation also could help Value stocks as companies in the Energy, Materials, and Real Estate sectors benefit directly from rising prices.

CONCLUSION

The S&P 500 Value Index has struggled relative to the S&P 500 Growth Index over the last 10 years. When digging into the underlying reasons, we find sector and accompanying earnings growth differences to be primary reasons for the Value Index's underperformance.

Although the S&P 500 Value Index has struggled, it does not mean value investing is dead. However, at an index level value is likely to lag until the global economy picks up meaningfully, perhaps on the other side of a recession. At Clearstead, while we believe the market cycle is in its later innings, we still believe patience is required before overweighting value stocks in equity portfolios.

Sources:

- (1) Morningstar Direct: 9/30/2019
- (2) Bloomberg: 9/30/2019
- (3) Morningstar Direct: 9/30/2019
- (4) Bloomberg: 9/30/2019
- (5) World Bank: 12/31/2018

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Performance data shown represents past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.

MARKET BENCHMARK RETURNS

November 30, 2019		1M	3M	12M	YTD
US Large Cap	S&P 500	3.6%	7.9%	16.1%	27.6%
US Small Cap	Russell 2000	4.1%	9.1%	7.5%	22.0%
Developed Intl	MSCI EAFE	1.1%	7.8%	12.4%	18.2%
Emerging Intl	MSCI Em Mkt	-0.1%	6.1%	7.3%	10.2%
Real Estate	NAREIT	-1.4%	1.9%	17.3%	27.1%
Core Fixed	BarCap Agg	-0.1%	-0.3%	10.8%	8.8%
Short Fixed	BarCap 1-3Yr	0.0%	0.3%	4.6%	3.8%
Long Fixed	BarCap LT G/C	0.1%	-1.9%	25.4%	21.0%
Corp Debt	BarCap Corp	0.2%	0.1%	15.2%	13.5%

Source: Bloomberg

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