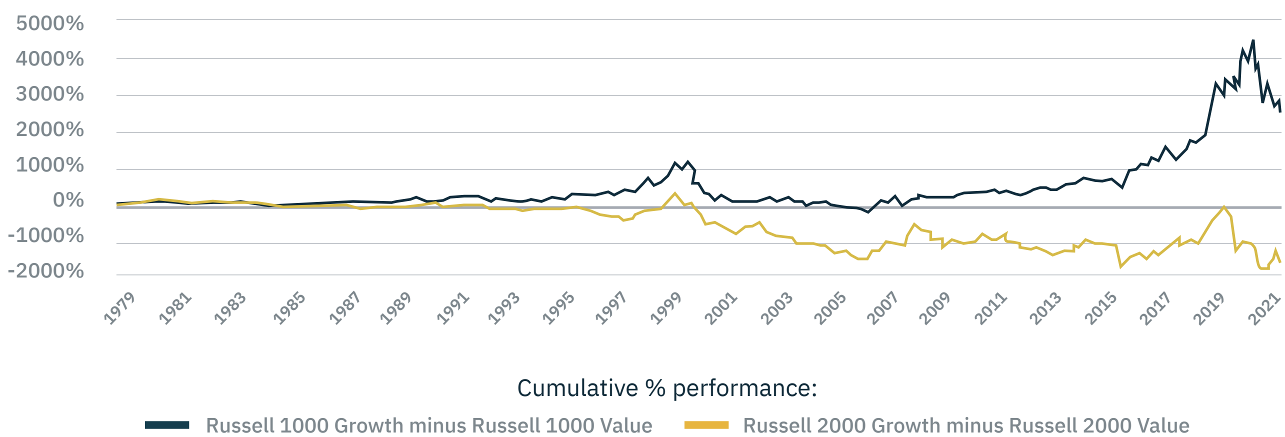
Growth-Oriented

The Growth vs. Value Debate

In the realm of investment decisions, the age-old debate between growth and value factors has been a persistent one. Investors often inquire why our tactical recommendations do not explicitly distinguish between growth and value assets, akin to our differentiation between large and small-capitalization stocks. The answer lies in the nuanced disparities between growth and value indexes, marked by differences in factors such as long-term earnings growth and free cash flow yield.

Exhibit 1: Russell 1000 Growth has outperformed Russell 1000 Value by more than 2,500% since inception



Source: Charles Schwab, Bloomberg, as of 12/30/2022

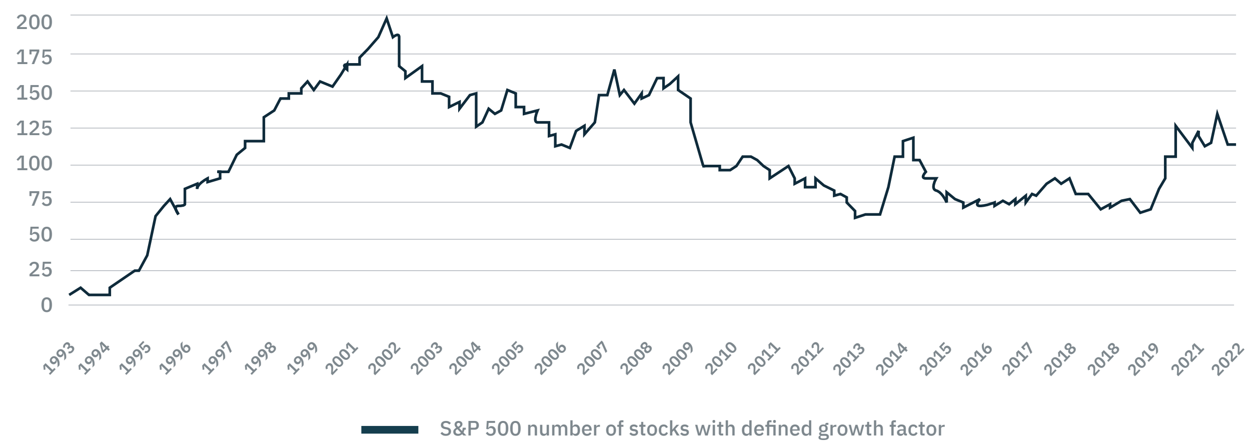
Growth indexes typically emphasize companies exhibiting robust long-term earnings growth prospects, often characterized by a propensity to reinvest earnings into expansion and innovation. In contrast, value indexes gravitate towards companies with high free cash flow yield, highlighting their capacity to generate substantial cash flow relative to their market capitalization.

Therefore, it is the intricate interplay of these distinguishing attributes that forms the bedrock of our strategic decision-making process, leading us to adopt a holistic investment perspective that transcends the conventional growth versus value dichotomy.

Beyond Indexes - Real Characteristics Matter

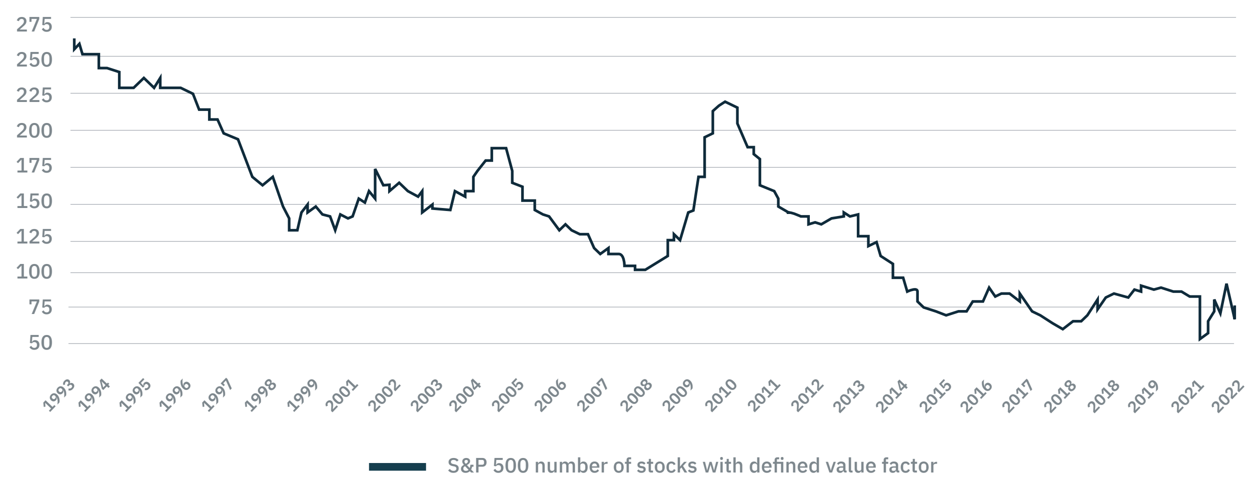
Looking beyond the indexes, it becomes apparent that the number of stocks that genuinely exhibit growth or value characteristics may differ substantially from the total index count. The availability of growth stocks within S&P 500 Growth has gradually decreased over the years, while the number of value stocks in S&P 500 Value has been on the rise. However, the true distinction lies in how many stocks actually exhibit these characteristics. A notable example is that of stocks demonstrating a standard growth attribute, with five-year average sales growth above 15%, which remains relatively unchanged over time.

Exhibit 2: Unchanged number of growth stocks over last quarter century



Source: Charles Schwab, Bloomberg, as of 12/30/2022

Exhibit 3: Shrinking number of value stocks over last quarter century



Source: Charles Schwab, Bloomberg, as of 12/30/2022

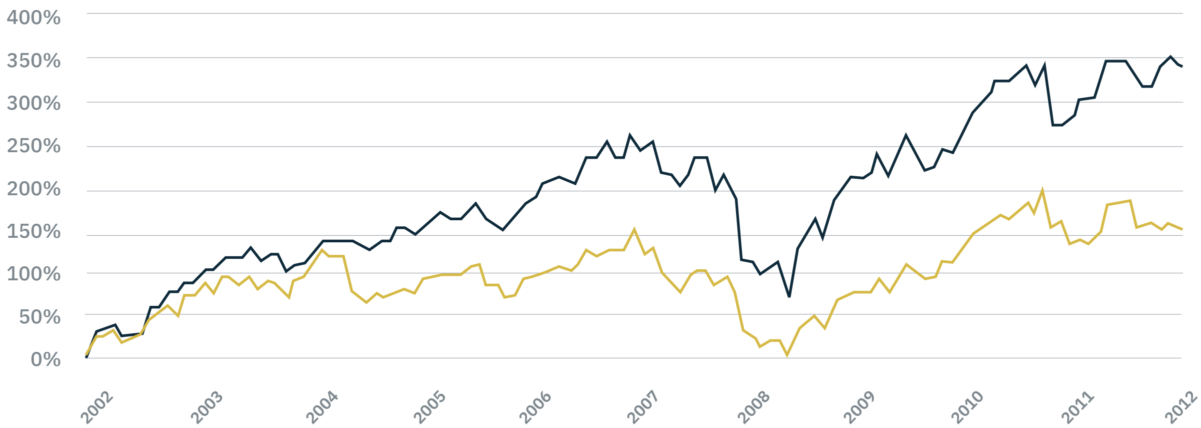
Conversely, within the S&P 500 Value index, stocks adhering to a standard value characteristic (price-to-sales below 1.0) are significantly outnumbered by the total number of index members. This challenges the simplistic view of overweighting growth vs. value or vice versa based solely on index classification, as performance at the index level may not fully reflect the underlying characteristics of growth and value stocks. The interplay of these factors underscores the importance of delving deeper into stock-specific attributes when making investment decisions, transcending the confines of index-level analysis.

Unmasking Myths

The early 2000s witnessed the dramatic implosion of the tech bubble, causing significant turmoil in the equity market. This event resulted in a 57% drop in the S&P 500, a 78% plunge in the Nasdaq, and anastonishing 83% decline in the tech-heavy Nasdaq 100, ultimately reaching its lowest point in October 2002.

For savvy investors seeking hidden opportunities, exploring undervalued tech stocks through factor analysis was a natural choice. Surprisingly, many of these deeply discounted tech stocks were housed in growth indexes. In October 2002, the forward price-to-earnings (P/E) ratio of tech stocks within the S&P Growth index was 20.5, significantly lower than the 25.6 forward P/E of tech stocks in the S&P Value index. This underscored the presence of numerous attractively priced tech stocks in the Growth index, impacting value identification and future performance.

Exhibit 4: There's value to be had in growth



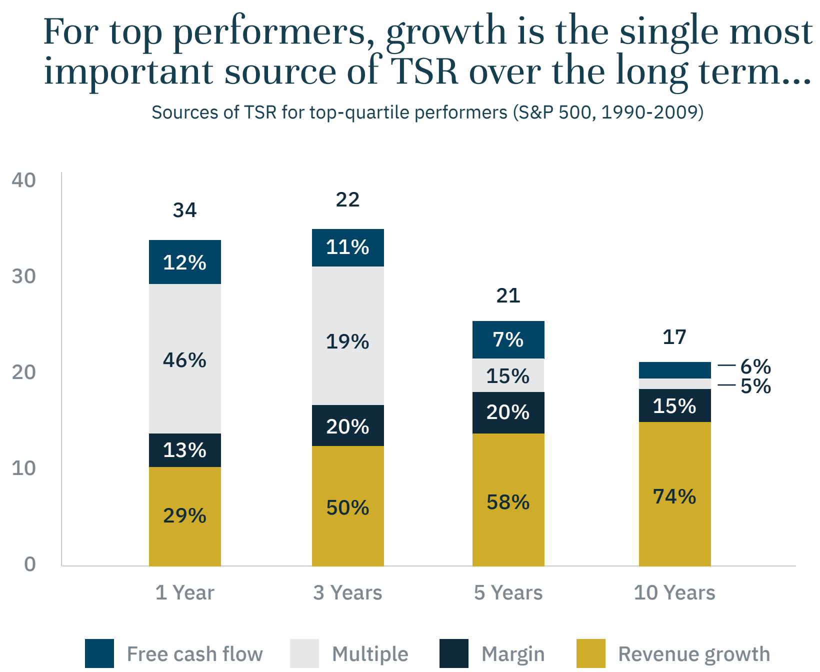
Cumulative % performance for NASDAQ 100 stocks from 10/9/2002 with:

Foward P/E < 22.6   Forward P/E > 22.6

Whether you are looking over the past 5, 10, 20, or 30 years, growth has outperformed value. Technological advancements, innovations, and new product introductions are the driving force behind revenue growth and ultimately, value creation. Studies have shown that revenue growth is the key driver in stock performance when looking over a multi-year time horizon (Exhibit 5).

We believe that sales growth is what starts the flywheel to drive margin expansion, profitability, and the reallocation of that capital by management to create shareholder value. As such, our strategies are growth-oriented.

Exhibit 5: Revenue growth is the key driver in stock performance



Source: Boston Consulting Group. Threading the Needle: Value in a Low-Growth Economy. The 2010 Value Creators Report

Definitions

Forward price-to-earnings is a measure of the price-to-earnings ratio (P/E) using forecasted earnings.

All indexes are unmanaged and an individual cannot invest directly in an index. Index returns do not include fees or expenses.

The Russell 1000 Index® measures the performance of the 1,000 largest companies in the Russell 3000.
The Russell 1000 Growth Index® measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
The Russell 1000 Value Index® measures the performance of those Russell 1000 companies with lower price to-book ratios and lower forecasted growth values.
The Russell 2000 Index® measures the performance of the 2,000 smallest companies in the Russell 3000 Index.
The Russell 2000 Growth Index® measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.
The Russell 2000 Value Index® measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.
The S&P 500 is widely regarded as the best single gauge of the U.S. equities market. This market capitalization-weighted index includes a representative sample of 500 leading companies in the foremost industries of the U.S. economy and provides over 80% coverage of U.S. equities.
The S&P 500 Growth and Value Indices form an exhaustive, multi-factor style series covering the entire market capitalization of the S&P 500. Constituents, weighted according to market capitalization, are classified as growth, value, or a mix of growth and value.