

Value vs. Growth Debate Misses the Point

January 8, 2021



For the past five years, growth stocks, especially technology-sector equities, have significantly outperformed value stocks, which has some investors debating the merits of the two styles.

According to research firm Factset, between Dec. 21, 2016 and Nov. 30, 2020, iShares Russell 1000 Growth ETF (IWF) saw a total return of 134.67%, while the iShares Russell 1000 Value Index ETF (IWD) gained 33.02%. That's a significant return spread between the two ETFs, translating to a full 16.43% annualized relative outperformance.

Lately, however, value stocks are showing signs of life. From Aug. 31, 2020 to Nov. 30, 2020, value beat growth, according to a [story](#) in ETF Database. Comparing Vanguard Value ETF (VTV) to Vanguard Growth ETF (VUG), VTV outperformed VUG, 6.4% to 2.1%. This value rebound has some investors questioning if a rotation out of pricey growth stocks and into cheap value equities may be happening.

The discussion between value and growth stocks misses the point. This matters because investors need to rethink their views about the two styles as technological innovation changes the economy and the market. We believe growth stocks can be worth the premium prices paid for them; here are some metrics to consider.

HOW GROWTH CAN BE WORTH THE PRICE

Traditional value metrics include measurements such as price-to-earnings, but in our view traditional value metrics aren't suitable when researching growth stocks. Let's use Amazon.com (AMZN) as an example. During the most recent five-year period, the online retailer's PE ratio averaged 219. That's 11.37 times the S&P 500 valuation. During those five years, Amazon minimized reported profits and instead reinvested nearly all cash flow into adding capacity and modernization. The firm's action didn't harm share prices as the stock rose from a low of \$502 to over \$3,400.

Instead of PE ratios, investors could use other traditional metrics in their research, such as earnings growth and cash flow, or new-customer growth and sales. Using these metrics, look at the difference between chipmaker Intel (INTC) and graphics processor NVIDIA (NVDA).

For the most-recent five years, Intel's sales grew an average 5.2% annually, while profits grew 12.5%. Meanwhile, NVIDIA saw 18.5% annual sales increase, spurred by its fast-growing gaming, video, and advanced-sensors business. Based on the market served by NVIDIA's products, the firm's profits are forecasted to grow 18.3%, which is reflected in its current lofty share price.

FINDING VALUE IN GROWTH COMPANIES

Technology is not limited to "tech" companies; rather it's changing every company, every facet of business. Here are just a few examples:

- **Entertainment:** Netflix (NFLX) first disrupted the movie-rental company space through video compression and taking advantage of faster home-internet connections. Now it uses artificial intelligence to analyze subscriber viewing preferences, competing with Hollywood's movie studios by producing its own content.
- **Medical:** Align Technologies (ALGN) makes 3D digital scanners to create clear teeth aligners for people who want straighter teeth at a low price. Their technology has a global reach and is taking business from traditional orthodontic practices and providers.



- **Industrial/Consumer:** TREX (TREX) combines technology and sustainability for the outdoor residential market by creating a wood alternative to traditional lumber. Made of recycled plastic bags, its engineered lumber-alternative is colorfast and termite-proof. Sales are forecast to be \$867 million this year, nearly double the \$440 million it sold in 2015.

While some traditional valuation metrics may not properly measure today's growth companies, that doesn't mean investors should buy growth stocks blindly. Scrutinize their paths to profitability. If a fast-growing company is generating cash and choosing to reinvest into research and expansion, it is investing in its future. Beware the company that's growing quickly by spending investor cash while losing dollars for each sale. That's a red flag for investors.

The debate over growth and value will continue, but investors may want to reconsider how these styles may evolve as innovation's influence on the economy is rapidly changing businesses.

ASHFIELD CAPITAL PARTNERS

This communication has been prepared solely for informational purposes, based upon information generally available to the public from sources believed to be reliable, but no representation or warranty representation, express or implied, has been made as to the accuracy or completeness of the information contained herein and is not an offer to buy or sell or a solicitation of an offer to buy or sell any security or to participate in any trading strategy. If any offer of securities is made, it will be pursuant to a confidential offering memorandum, an investment management agreement or other offering materials, which contains material information not contained herein and which supersedes this information in its entirety. This communication is not designed to be a comprehensive analysis of any topic discussed herein, and should not be relied upon as the only source of information. Additionally, this communication is not intended to represent advice or a recommendation of any kind, as it does not consider the specific investment objectives, financial situation, applicable risk factors, and/or particular needs of any individual client or investor and should not be relied upon as the basis for investment decisions. Additional information is available upon request.

The investments discussed herein are for illustrative purposes only and it should not be assumed that such investments were or will be profitable or that the investments or recommendations Ashfield Capital Partners makes in the future will be profitable or will equal the anticipated results discussed herein. Past performance is not necessarily indicative of future results. The indices, markets and countries referenced in this communication are provided for informational purposes only and should not be used as the basis for making an investment decision. The indices, markets and countries referenced in this communication are included merely to show the general trend in the markets in the periods indicated and are not intended to imply that the underlying returns were comparable to the indices, markets or countries either in composition or element of risk. There are significant differences between client accounts and the indices, markets and countries herein including, but not limited to, risk profile, liquidity, volatility, and asset composition.