Treason is merely a matter of dates

Value vs. growth, the perennial debate of our time is finally spilling out onto the streets. It is without a doubt the topic on which I have talked more to clients about than any other in my career and likely drunk hundreds upon hundreds of litres of coffee in the process. Starbucks, you are welcome.

As was always the case, what drives up value stocks drives down growth stocks and it's rare that the two can co-rally in harmony. Right now, the forces which value investors have lamented for a decade are finally surfacing and value indexes around the world in 2021 are notching up gains over twice that of growth indexes. Namely, we have post COVID inflation and bond yields to thank for this, along with a good dollop of sentiment-driven profit taking.

What is the connection? Well, growth stocks thrive in economic periods where bond yields are low i.e. where bonds are expensive. This is because the yield on bonds is used in the primary calculation of the value of a company's future earnings. So when yields on bonds rise, the discount factor increases making future company earnings less valuable in today's market… bad for growth stocks, good for value and that's what's happening right now.

Interestingly enough, this is chiefly why the last 10 years has been so good for equity growth investing because we have been in a ripping bull market for bonds which has collapsed yields, thus boosting the discount factor for future earnings of growth stocks.

Inflation is the second factor. With inflation on the rise, cash is worth more today than it will in the future and thus those long-term earnings projections which growth stocks rely on to justify their price become less attractive (coincidentally this is one of the reasons why gold is back on the charge). The supercharger of the growth bear market is when central banks raise interest rates to control runaway inflation. Well, higher rates lead to higher yields, which feeds into my first argument.

This is why some value managers see today's market as a perfect storm in which value investing is going to charge ahead, whilst growth remains trapped under high inflation and rising bond yields. The reopening speed of global economies will likely unlock many of the questions about the longevity of the value rally and thus the prospects for growth stocks, so expect some volatility in the short term.

So now we have covered off the basics, let's talk about something we all know. The last 10 years has been a massive boon for anyone meaningfully invested into growth equities and clients have well and truly gorged on the growth market. But consider a new client who comes bounding into a traditional growth tilted portfolio in January 2021. Looking back at the last 5 years, they would likely be drooling at the prospect of supernormal gains in line with the track record, only to be rudely awoken to the fact that value investors, who have been largely locked in the dungeons for a decade, have stolen their lunch! My point is, growth WAS a great investment and likely long term still is, but the variable factor in winning and losing with a growth portfolio is the dates.

For those who say, "ah well I have a diversified fund, so I am protected", we say, do you? Studies looking at the asset allocations of fund managers who claim to be neither a growth nor value investor are actually chockablock with growth stocks. So, in 2021, even investors who thought they owned 'middle of the road' fund managers with growth and value, have found themselves suffering underperformance, whereas true blue value funds are off to the races.

Despite the fact that value and growth remain mutually exclusive when it comes to dominance, their inclusion in a properly diversified portfolio should never be. 2021 has been a perfect time to showcase the benefits of both active management and diversification across the asset classes and styles.

Controversial comment - TAM still owns growth, 100% yes, we do. One has to remember that yes, growth style is out of favour, but that doesn't mean the companies being invested into have deteriorated in their prospects. Likewise, TAM owns what we believe to be some of the most experienced value investors on the planet in our portfolios, who have had to stomach decades of lacklustre returns but stuck to their guns the whole way through and are now reaping the rewards wholesale. Or I should say, we are reaping the rewards wholesale.

Yes, a diversified portfolio won't have the five-year numbers of clients who chose pure growth, but in this 2021 market, those relative five-year gains are starting to quickly deteriorate in favour of managers holding both high quality growth and high quality value.

So, as the quote goes, "Treason is merely a matter of dates". Perhaps it is a fitting final conclusion on the debate in value vs growth. Neither is better, it's merely a matter of dates.

Isn't the trick to simply own the best of both worlds over all periods? We certainly think so.

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