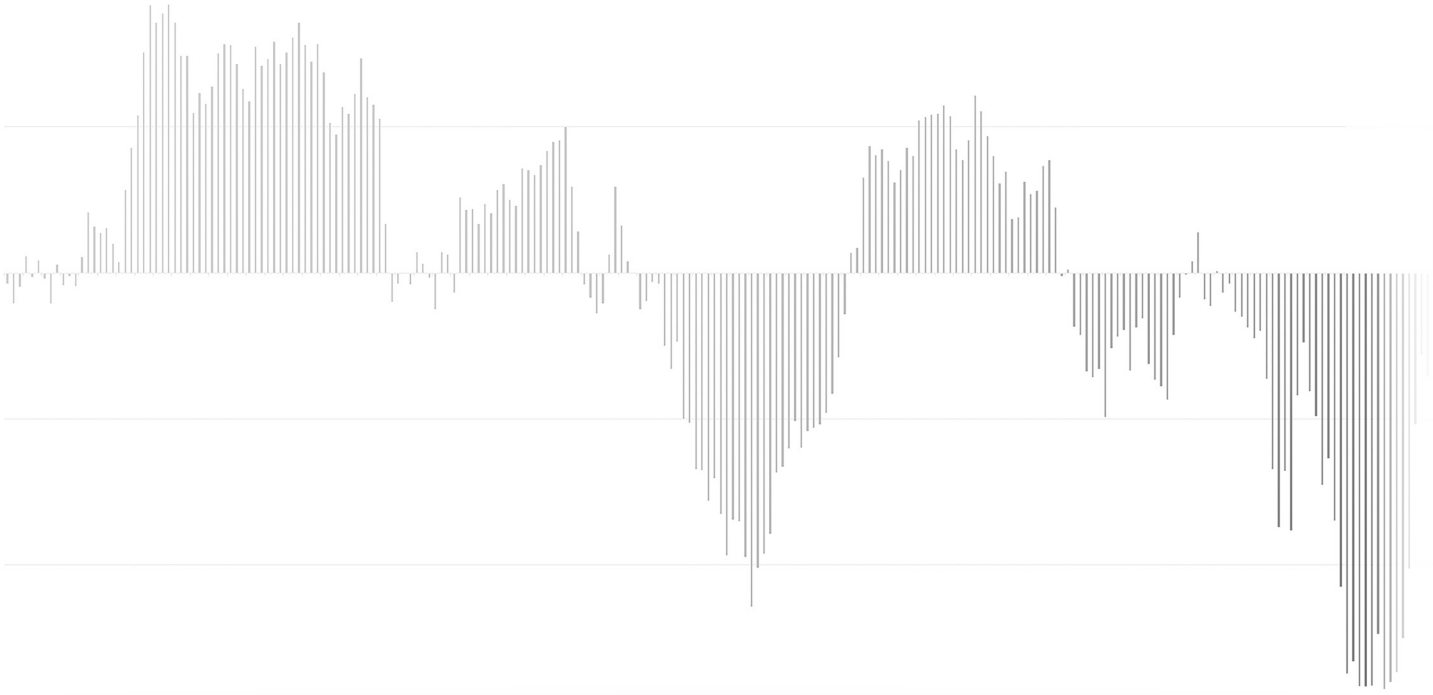
First Ascent Asset Management

GROWTH AND VALUE

Understanding Investment Styles



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Growth and Value: Two Styles of Stock Investing

Stocks are often grouped into two distinct categories or styles, growth and value. Knowing the differences between the two and how to incorporate them into a portfolio can help investors smooth out the ride toward their long-term financial goals.

Growth and Value Defined

Growth stocks are stocks of companies that are priced higher than the broad market based on some measure like price-to-earnings, price-to-book, or price-to-sales. They are often priced higher because they've had strong earnings growth in the past and are expected to have better-than-average future growth potential, although that growth potential may not materialize.

Because their stock price is so dependent on strong future growth, any small change in future expectations for one of these stocks can lead to very large price changes. As such, growth stocks tend to be more volatile than the broad market.

Value stocks are stocks of companies that are priced lower than the broad market based on some measure like price-to-earnings, price-to-book, or price-to-sales. They may be priced low based on the poor performance of the company or because the market fails to currently appreciate the underlying value of the firm.

Value stocks are generally less volatile than growth stocks, although not over all time periods.

The Rationale and the Risk

Growth stock investors expect the strong earnings growth of the companies in which they invest to continue in the future and, perhaps, even exceed the market's expectations for them.

The risk is that the earnings growth of those firms will falter, or that the market will go through a period where it places less value on—that is, will pay less for—earnings growth.

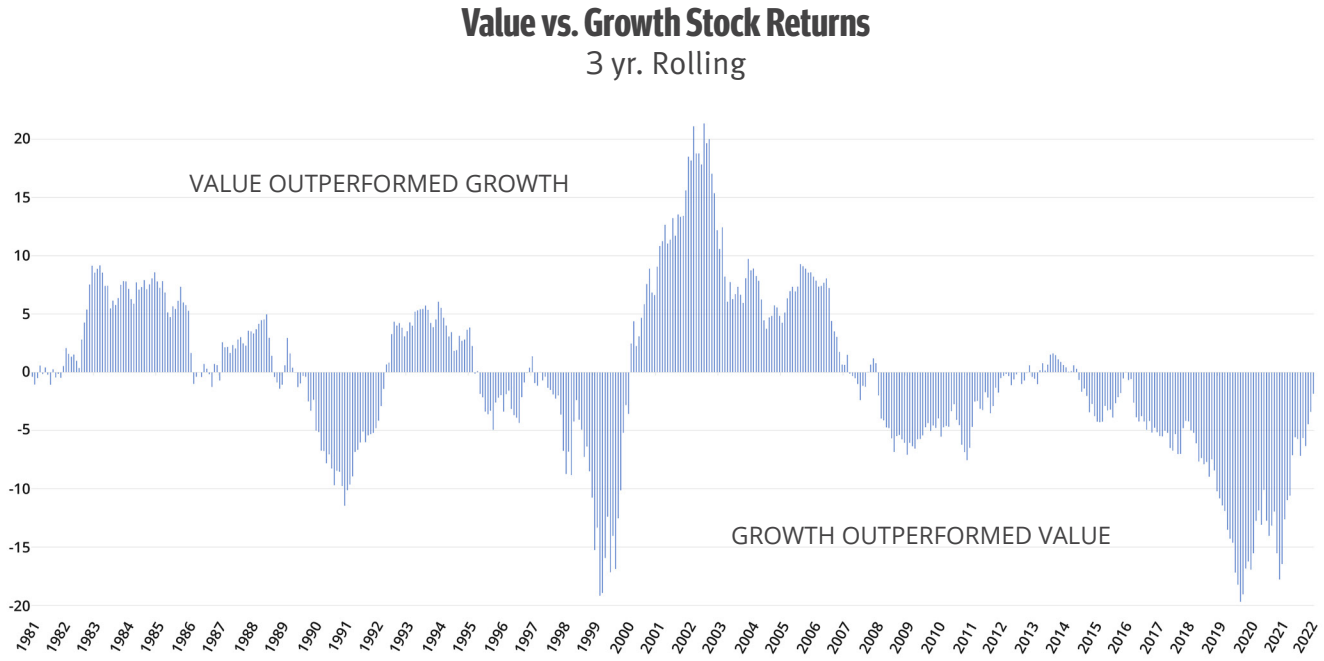
Value investors buy stocks that are cheap with the expectation that their share prices will increase when the market recognizes the full potential—that is, the value—of the stock's issuer.

The risk is that the stock is priced cheaply for a good reason, or that the market fails to recognize the full potential of the firm within a reasonable period, if ever.

Performance of Growth and Value

Historically, growth stocks and value stocks have outperformed each other in hard to predict cycles. Recently, growth stocks have had the advantage. Between 2009 and 2022 growth stocks produced an annualized return of 15.0% compared to 11.1% for value stocks[1].

Growth's dominance over value has not always been the case. As can be see in the chart below, there have been many times over the 40+ years when value stocks performed better than growth.



Russell 1000 Value vs Russell 1000 Growth. Data Source: Morningstar

Whether growth will continue to edge out value in the near future is the subject of much debate. Time will tell. Regardless, history firmly teaches us that growth and value are likely to go in and out of favor over the coming years.

Given this cyclicality of performance, it may be tempting to try to time investments in growth and value to correspond to their respective periods of outperformance. While there is some research to suggest that growth and value perform better in certain market or economic conditions, there is no evidence to suggest that this information can be used successfully to time investments in growth and value over the long term on a consistent basis.

1. As represented by the Russell 1000 Growth Index and the Russell 1000 Value Index for the period 1/1/2009 to 12/31/2022.

Rather than attempting to time investments in growth and value, here are two more reasonable approaches:

1. Maintain a portfolio weighting to growth and value that approximates their respective weights in the broad market.
2. Maintain a slight to modest tilt toward either growth or value, depending upon your expectations of which will perform best over the long term. There is academic research that suggests that value has had an historic long-term edge over growth. But given growth's recent strong performance relative to value, one could reasonably come to a different conclusion.

What is clear, though, is that including exposure to both growth and value stocks can help in properly diversifying a long-term portfolio.