

Comparing the results of value and growth stock market indexes

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Intermediate Trading



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Whenever the topic of portfolio design is discussed, you can be sure that the issue of value investing versus growth investing will come up. It is an issue when considering how to invest in U.S. stock mutual funds and non-U.S. stock mutual funds.

The term *value* suggests that the investor is buying stock that is relatively less expensive, as opposed to stock that is relatively more expensive. The stock of a company that is classified as a “value stock” typically has a lower price-to-earnings ratio, which simply means that the stock currently has a lower price per share relative to the company’s earnings per share. Think of it as investing in the home that needs repair versus putting more money down for the glitzy house on the hill. Very simply, value stocks are priced more attractively. The real question is whether or not value stocks tend to outperform growth stocks.

Growth stocks are just the opposite. They have higher price-to-earnings ratios; thus, an investor who purchases a growth stock is paying a higher price per share because he or she believes the stock price might go even higher.

Clearly, value and growth are relative measures. In fact, evaluating a stock’s price (in value versus growth terms) is much like trying to determine if the price of a home you are interested in buying is priced right. Rather than wax philosophical, let’s focus on the results of actual value and growth US stock market indexes.

Does It Make a Difference?

As reported in Table 1, the 26-year annualized return of growth-oriented large-cap U.S. stock was 8.60 percent (which represents the average of the Russell 1000 Growth Index and the Lipper US Index of Large Growth funds). The term *cap* is an abbreviation of capitalization. Capitalization is the way in which stocks are size classified (large-cap, midcap, small-cap). Capitalization is calculated by multiplying the current price of a stock by the number of shares that have been sold to investors.

The two value-oriented large-cap U.S. stock measures in this study (Russell 1000 Value Index and the Lipper US Index of Large Value funds) had an average return of 9.03 percent over the period 1990–2015. Large-cap U.S. stock with a value orientation had a higher 26-year average return than large-cap U.S. stock with a growth orientation. This difference in favor of value is referred to as a *value premium*. There was a value premium among large-cap U.S. stocks, which translated into a total dollar premium of over \$9,200 during this particular 26-year period (assuming a starting investment of \$10,000).

The 26-year average annualized return of two midcap value measures (Russell Midcap Value Index and the Lipper US Index of Midcap Value funds) was 10.49 percent, considerably better than the 9.72 percent average return of the combined midcap growth indexes. The difference in performance amounted to a value premium of over \$22,000.

Table 1: Annual Returns of Value and Growth U.S. Equity Indexes

Annual Returns	S&P 500 Index	3-Month T-Bill	Barclays Aggregate Bond Index	U.S. Large Growth¹	U.S. Large Value²	U.S. Mid Growth³	U.S. Mid Value⁴	U.S. Small Growth⁵
1990	(3.10)	7.53	8.96	(1.04)	(6.07)	(7.22)	(11.08)	(1.04)
1991	30.47	5.37	16.00	39.31	27.59	55.42	32.83	39.31
1992	7.62	3.44	7.40	5.94	11.12	6.93	17.32	5.94
1993	10.08	3.00	9.75	6.77	15.67	12.64	14.74	6.77
1994	1.32	4.22	(2.92)	0.90	(0.90)	(1.08)	(1.72)	(0.90)
1995	37.58	5.47	18.47	36.05	35.80	36.60	29.31	36.05
1996	22.96	5.05	3.63	21.84	21.36	15.47	20.09	21.84
1997	33.36	5.06	9.65	29.04	31.83	16.94	28.52	29.04
1998	28.58	4.77	8.69	37.59	16.94	15.33	1.68	37.59
1999	21.04	4.63	(0.82)	33.99	9.07	62.51	5.92	33.99
2000	(9.10)	5.79	11.63	(21.05)	4.48	(13.94)	14.89	(21.05)
2001	(11.89)	3.43	8.44	(22.15)	(7.09)	(20.61)	4.53	(22.15)
2002	(22.10)	1.60	10.25	(28.00)	(17.60)	(27.94)	(12.15)	(28.00)
2003	28.68	1.01	4.10	28.36	29.02	39.07	38.58	28.36
2004	10.88	1.37	4.34	6.88	14.25	14.76	21.63	6.88
2005	4.91	3.13	2.43	6.42	6.66	10.84	10.70	6.42
2006	15.79	4.71	4.33	6.90	20.27	10.84	17.94	6.90
2007	5.49	4.38	6.97	13.39	1.15	16.42	1.10	13.39
2008	(37.00)	1.37	5.24	(39.92)	(36.93)	(44.18)	(39.08)	(39.92)
2009	26.46	0.15	5.93	37.86	22.33	44.47	36.98	37.86
2010	15.06	0.14	6.54	15.92	14.27	26.02	23.20	15.92
2011	2.11	0.05	7.84	(0.13)	(0.89)	(3.48)	(2.95)	(0.13)

2012	16.00	0.09	4.22	15.59	16.69	14.59	18.42
2013	32.39	0.06	(2.02)	34.45	32.88	36.13	34.92
2014	13.69	0.03	5.97	11.69	12.23	9.91	11.85
2015	1.38	0.05	0.55	5.64	(3.74)	(0.58)	(4.90)

26-Year Average Annualized Return	9.29	2.89	6.26	8.60	9.03	9.72	10.49	
26-Year Standard Deviation of Return	17.99	2.30	4.94	21.42	16.67	24.61	17.90	:
Growth of \$10,000	\$100,721	\$20,999	\$48,474	\$85,435	\$94,694	\$111,584	\$133,660	\$79,000

¹ Average of Russell 1000 Growth Index and Lipper US Index of Large Growth funds

² Average of Russell 1000 Value Index and Lipper US Index of Large Value funds

³ Average of Russell Midcap Growth Index and Lipper US Index of Midcap Growth funds

⁴ Average of Russell Midcap Value Index and Lipper US Index of Midcap Value funds

⁵ Average of Russell 2000 Growth Index and Lipper US Index of Small Growth funds

⁶ Average of Russell 2000 Value Index and Lipper US Index of Small Value funds

Among small-cap U.S. equity, the value premium over the 26-year period was an astonishing 187 basis points (bps); that is, a 26-year value return of 10.19 percent minus a 26-year growth return of 8.32 percent equals a value premium of 187 bps. With a 26-year annualized return of 10.19 percent, small-cap value turned \$10,000 into \$124,669, or \$44,791 more than the ending balance in small-cap growth.

The annual returns in Table 1 reflect performance from one point-in-time (January 1, 1990) to another point-in-time (December 31, 2015). Clearly, many investors won't invest for that length of time or that specific period of years, so it's useful to examine performance in smaller time frames, such as five-year periods. The performance premium for value and growth are calculated in rolling five-year periods of time and are reported in Table 2.

The premium (whether growth or value) for each five-year period is shown in basis points. For instance, over the five-year period from 1992 to 1996, large-cap value U.S. equity demonstrated a 240 bps premium over large-cap growth U.S. equity. Among midcap U.S. equities during the same period, there was a value premium of 203 bps. Among small caps, the five-year value premium from 1992 to 1996 was 363 bps.

As shown at the bottom of Table 2, large-cap value demonstrated a performance premium 50 percent of the time. The average five-year value premium was 462 bps. Conversely, large-cap growth outperformed large-cap value 50 percent of the time by an average of 274 bps.

Among midcap US equity, value outperformed growth 55 percent of the time by an average of 462 bps (over five-year periods). When growth outperformed value (45 percent of the time), the margin of victory averaged 271 bps. Among midcap U.S. stocks, a value tilt has historically provided better performance than a growth tilt.

Among small-cap U.S. equity, value beat growth 73 percent of the time by an average of 487 basis points (again, over five-year periods). However, when small-cap growth outperforms (27 percent of the time), the difference can be large. For example, during the five-year period of 1995–1999, small-cap growth beat small-cap value by 860 bps. Overall, however, when small growth outperformed small-cap value, the average margin of victory was 324 bps.

A Few Words About Basis Points

There are 100 basis points in one percentage point. For example, Fund A has a return of 10 percent and Fund B has a return of 11 percent. The 11 percent return of Fund B is 100 bps higher than the 10 percent return of Fund A. Or if Fund A has a return of 10 percent and Fund B has a return of 10.01 percent, Fund B has a higher return by 1 bps. The basis point measurement system is the clearest way to compare returns.

Table 2: Value and Growth Premiums over 5-Year Rolling Periods

5-Year Period	U.S. Large-Cap Equity		U.S. Midcap Equity		U.S. Small-Cap Equity	
	Growth ¹ (bps)	Value ² (bps)	Growth ³ (bps)	Value ⁴ (bps)	Growth ⁵ (bps)	Value ⁶ (bps)
1990–1994	66		212			
1991–1995		47	254			
1992–1996		240		203		
1993–1997		186		212		
1994–1998	405		123			
1995–1999	898		1,160		860	
1996–2000	167		302			
1997–2001		239		229		
1998–2002		438		417		
1999–2003		770		698		
2000–2004		1,285		1,689		
2001–2005		771		1,112		
2002–2006		692		693		

2003–2007		176	59		
2004–2008		237		130	
2005–2009	131		94		
2006–2010	167		141		52
2007–2011	412		251		234
2008–2012	169			102	
2009–2013	340		114		357
2010–2014	44			56	177
2011–2015	219			5	262
Average Premium (bps)	274	462	271	462	324
Percentage of Time with Premium (%)	50%	50%	45%	55%	27%

¹ Average of Russell 1000 Growth Index and Lipper US Index of Large Growth funds

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Summary

These results do not argue for eliminating growth-oriented assets from a portfolio. However, this analysis does suggest that a value “tilt” may be justified in the long run.

The long-run advantage of a value tilt is illustrated in Table 3. As the length of the investing period increases (from one-year periods to three-year rolling periods to five-year rolling periods to 10-year rolling periods), the frequency of a value premium increases.

For example, between 1990 and 2015, large-cap value outperformed large-cap growth 54 percent of the time over the 24 three-year rolling periods. Over 17 rolling 10-year periods, large value beat large growth 65 percent of the time. Among small-cap indexes, small-cap value outperformed small-cap growth in 73 percent of the five-year rolling periods, but 82 percent of the time over rolling 10-year periods.

Table 3: Frequency of a Value Premium Rolling Time Periods (1990–2015)

Frequency of Value Premium among US Equity

	U.S. Large-cap Stock (%)	U.S. Midcap Stock (%)	U.S. Small-cap Stock (%)
26 One-Year Periods	50%	50%	54%
24 Three-Year Periods	54%	58%	50%
22 Five-Year Periods	50%	55%	73%
17 Ten-Year Periods	65%	76%	82%

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Value stocks can perform differently from other types of stocks, and can continue to be undervalued by the market for long periods of time.

Growth stocks can perform differently from the market as a whole and other types of stocks, and can be more volatile than other types of stocks.

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