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Value vs. growth – who wins?

Applying active decision-making is key in an uncertain environment

Laurence Taylor
Portfolio Specialist
T. Rowe Price

Key insights

- The market reaction to vaccine data has created some near-term risks. The key is to maintain portfolio breadth for the bumpy journey to a post-coronavirus world.
- In our view, this is not the time to make a call on value versus growth, but instead to apply risk control and active stock decision-making.
- In a low-growth world, real profits generation will continue to matter for investors as will the durability of a business in a world of accelerating disruption.

Global equities have advanced as investors have weighed the worsening coronavirus pandemic against hopes of a potential coronavirus vaccine. As sentiment rises, however, we believe it makes sense to be prudent in terms of portfolio positioning. To be clear, we are optimistic as we look out over one to two years, but we are seeing a second wave of the virus spread, and it is proving to be more extended than the first wave in many places. Vaccine developments are a clear positive, but the market's reaction to the prospect of a post-coronavirus world creates some near-term uncertainty and risk.

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Striking the right balance

One question on investors' minds is that of value versus growth. Thoughts of a post-coronavirus world understandably cause excitement and rotation toward all things "cheap." However, if the economic recovery is disrupted for any prolonged period, markets may favor the Covid-on beneficiaries, which tend to sit on the growth side of the style spectrum.

For us, it is not a matter of timing a style cycle. We do not think this is the time to make a call on value versus growth. Instead, we believe the key is to maintain portfolio breadth, diversification and apply risk control and active stock-decision making as we work through what is going to be an uneven path of recovery and improvement. Valuations are important and we need to manage pockets of excessive optimism, along with any uncertainty that arises with respect to US policymaking.

Applying thought to which stocks look well placed to win on the other side of this crisis, in the second half of 2021 and into 2022, is important for all investors right now, regardless of philosophy. While this is complex, embracing complexity is a challenge we are used to.

Are growth stocks too expensive?

The backdrop to growth stock picking is clearly more balanced today than it was at the peak of the pandemic. Markets have recognized the acceleration of disruption, and many of the beneficiaries have been rewarded. The key at this stage of the cycle is to test the stock thesis to ensure that the "concept" continues to work and is backed by execution and monetization in a post-coronavirus world.

It is also important to maintain a long enough time horizon to own stocks that are likely to compound higher returns over the long term. Even with higher near-term or trailing multiples for certain disruptive growth stocks, we still see strong growth prospects and, hence, more attractive valuations, especially when we look out over a two- to three-year time horizon. However, position size management at this stage is vital, as opposed to trying to justify owning a concentrated, or zero, weighting in a stock.

Stepping back, it is crucial to understand that the digital world we live in has created a different growth leadership cycle to that of the tech bubble back in the late 1990s. Part of the reason why technology platform businesses like Alphabet and Facebook are experiencing political friction now is because they have become so dominant. The profitability aspect was not an issue during the tech bubble because the infrastructure of the internet was so nascent that few, if any companies, could generate real profits from it.

The real issue is what do you pay for the leading growth stocks today? This is a very stock-specific decision at a given point in time, but broadly speaking, we do not see a growth bubble in the market today.

Being a growth manager brings advantages

As growth investors, we continue to benefit from the sheer diversity available within the global opportunity set. Without the use of concentration to do the heavy lifting, the key to execution in 2020 has been embracing the evolution of the opportunity, allied with bottom-up company research.

The financial landscape has changed dramatically in the past decade, and many of the structural changes we have witnessed have not been positive for economic growth or inflation, nor, indeed, for "value" areas of the market. A "normal" growth and inflation cycle tends to assist in the delivery of corporate earnings growth and price returns for key components of the value index (e.g., natural resources). But, instead of a "normal" cycle lifting returns, the "value" factor has suffered as disruption has replaced mean reversion as a dominant market theme.

In our view, having access to an opportunity set that offers strong earnings growth potential, along with being able to find companies that can compound higher returns over time in this new era of low growth and low inflation, is a large advantage.

To be clear, we believe that paying the right price for durable, growth-oriented businesses remains important. We also believe that there are plenty of opportunities for investors to find stocks that have temporarily fallen out of favor but where the intrinsic worth of the business remains intact. However, buying stocks with too much emphasis on optically cheap valuation metrics has been a painful approach over the past decade.

The redistribution of cashflow toward companies that have innovated successfully in a digital world, while disrupting incumbents that have been slow or unable to respond, has been key to success in recent years. Today's technologically enabled world has allowed many companies to generate profits in a way they could not before.

In a world of low growth, we believe real profits generation matters, and finding these profits is the prerequisite for a good growth manager.

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The specific securities identified and described are for informational purposes only and do not represent recommendations.

Important Information

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