Growth Vs. Value – Companies & Investing Styles

The investment community generally refers to companies as "value stocks" or "growth stocks." Value and Growth represent two broad "investment styles" used by money managers as they manage portfolios. Value and growth styles tend to come in and out of favor with investors over time. During the late 1990's, growth stocks dominated, providing superior returns. Since 2000, value stocks have provided superior returns.

Growth stocks generally have higher valuations than value stocks. Value stocks have lower growth rates (earnings, sales, book value, assets) than growth stocks. Because growth stocks grow more quickly, their shares generally trade at higher price earnings (P/E) ratios than value stocks. (A price earnings ratio is calculated by dividing the stock price by the earnings per share.) Don't confuse a higher stock price with a high price earnings ratio. A high priced stock may have a low P/E ratio & vice versa.

The "New Economy" is represented by growth stocks. The "Old Economy" is represented by value stocks. Growth stocks generally are the "concept" stocks, while value stocks are less exciting. The NASDAQ 100, technology, biotech, telecomm, & the internet are dominated by growth stocks. Value stocks include retailers, energy, consumer goods, cyclicals, & older Dow stocks.

The return from value stocks is derived from dividends and appreciation. The dividend rate can be a significant part of the overall return. Growth stocks generally pay no dividends. Instead, they reinvest their earnings in growing the business, so the return is derived solely from price appreciation. Expectations of high future growth rates are factored into the price of growth stocks. Value stocks, since they tend to grow at lower rates, often have disappointment factored into their price.

Growth-oriented investors look for companies where they can ride the momentum of earnings growth. They look at the current & future growth prospects of a company compared to its price. A growth-oriented investor's approach is to try to buy a rapidly growing dollar.

Value-oriented investors look for bargains. A value-oriented investor's approach is to try to buy a dollar for fifty cents. They attempt to calculate the intrinsic value of a business and buy at a lower price, thereby utilizing a margin of safety.