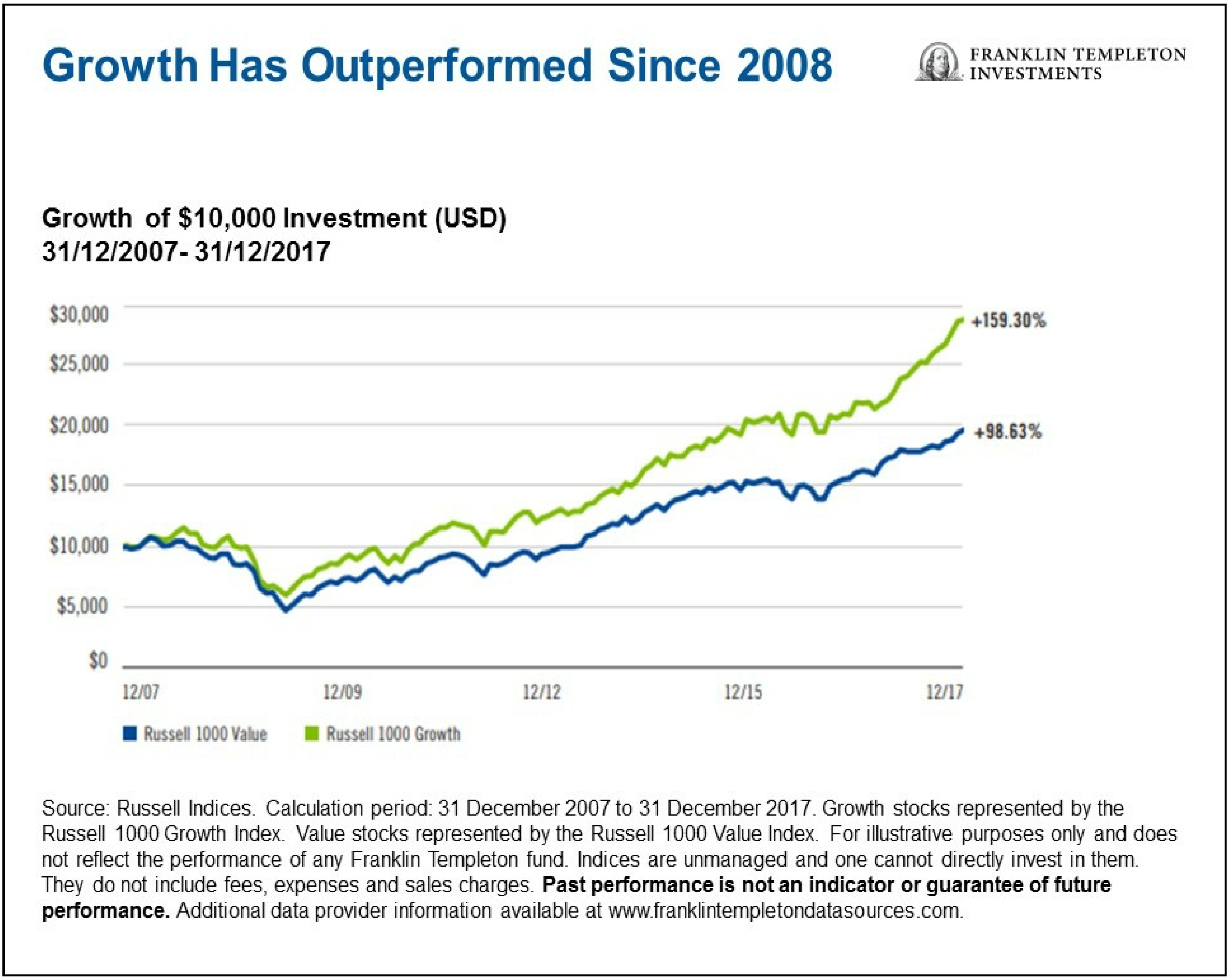
EQUITY

Is it Time for Value Stocks to Shine?

August 20, 2018

Since 2008, US growth stocks (particularly in faster-growing sectors such as technology) have tended to perform better than US value stocks, as the chart below shows.

As the performance gap between growth and value widens, more investors may be wondering when this dynamic between growth and value might change.

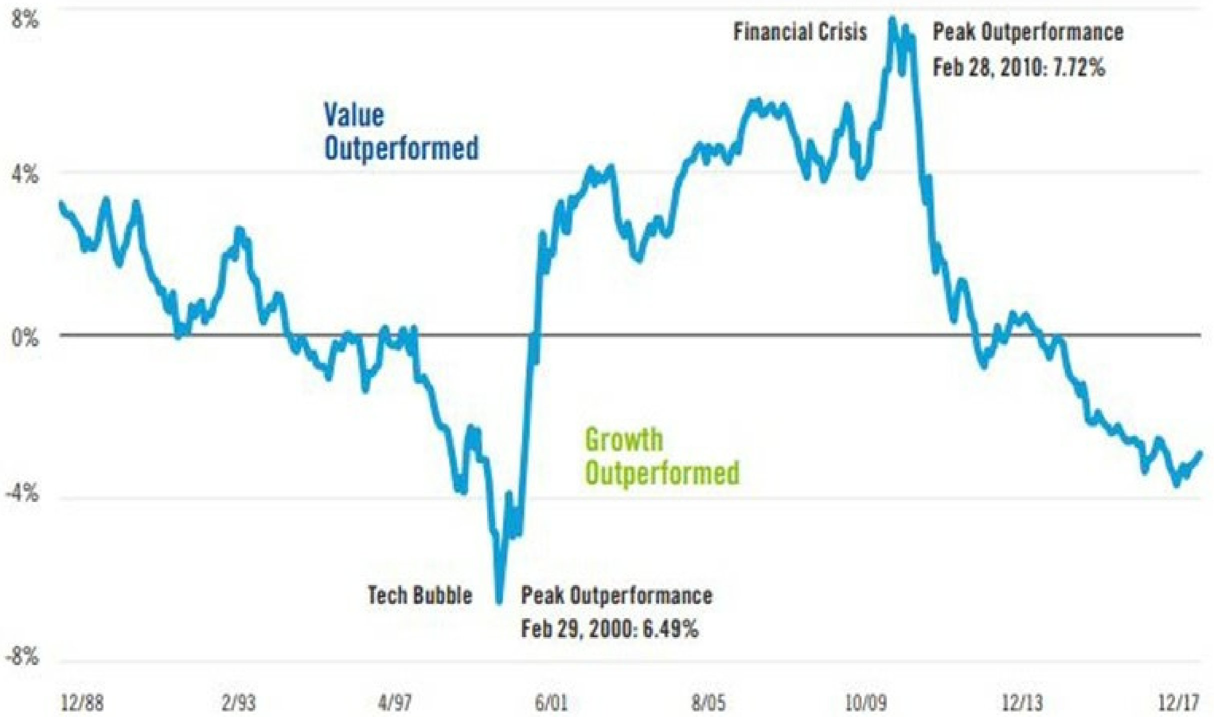


However, a different pattern emerges over longer periods of time. As the chart below shows, value outperformed growth for a 10-year that peaked about a year after the market bottom during the financial crisis. Since then, growth investing has had generally better performance.

Growth Versus Value Over 30 Years

FRANKLIN TEMPLETON INVESTMENTS

Rolling 10-Year Annualised Excess Return
31 December 1988 - 31 December 2017



Source: Russell Indices. Calculation period: 31 December 1988 to 31 December 2017. Growth stocks represented by the Russell 1000 Growth Index. Value stocks represented by the Russell 1000 Value Index. For illustrative purposes only and does not reflect the performance of any Franklin Templeton fund. Indices are unmanaged and one cannot directly invest in them. They do not include fees, expenses and sales charges. **Past performance is not an indicator or guarantee of future performance.** Additional data provider information available at www.franklintempletondatasources.com.

A Bit of Background

In the United States, at the peak of the tech bubble, growth had significantly outperformed value for a number of years. By February 2000, the 10-year average annual return differential had reached 6.49% in favour of growth.[1]

Only 10 months later, in December 2000, that 10-year differential had been wiped out.

In this podcast and article, Stephen Dover, head of equities at Franklin Templeton Investments, recalls some of the prominent tech names that were leaders during the boom and bust.

CHARACTERISTICS OF GROWTH AND VALUE INVESTING

Growth investing focuses on companies that are growing at a faster-than-average rate. These companies often have accelerating revenues, earnings and cash flows, but also typically have relatively high price-to-earnings (P/E) metrics. Often, dividend payouts are low or non-existent, since profits are used to expand the business.

Value investing focuses on companies whose stock prices don’t reflect their intrinsic or fundamental value. The companies are often mature, and their stocks may have suffered due to a temporary earnings setback or an economic or political event hampering their industry. They are often characterized by low P/E or price-to-book ratios and sometimes by higher-than-average dividend yields.

> “If you look back to the technology names before the technology crisis, who did it look like was going to win? It looked like it was going to be—let’s see if you can remember these names—Yahoo, CompuServe, Alta Vista, Compaq computer, Netscape. Great companies, multi-billion dollar companies, great big impact on the indices. They’re all gone or bought out or something else has happened. That’s the difficulty of growth.”

Stephen Dover, 13 March 2018

Dover says one of the reasons why growth has outperformed value over the past 10 years is due to monetary policy that has kept global interest rates low. The lower an interest rate is, the greater the value of future earnings.

> “All things being equal, when you have artificially low interest rates, growth companies [are] worth more than value companies because earnings in 10 years become more valuable than earnings in one year.”

Stephen Dover, 13 March 2018

That said, Dover cites rising inflation and higher interest rates as potential headwinds for growth stocks.

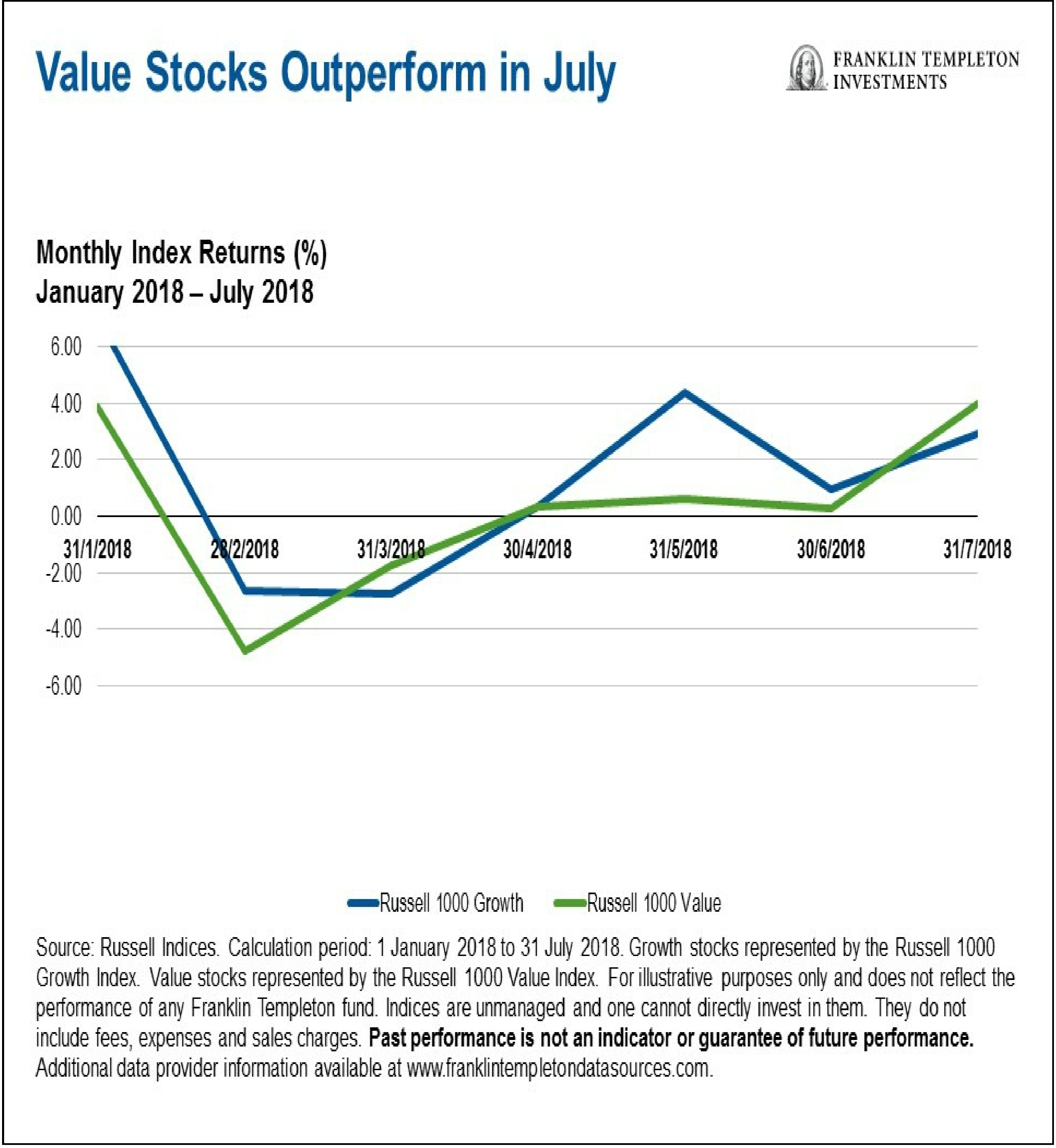
Why Value May Catch Up with Growth

As growth stocks have outperformed value in recent years, some of our investment professionals think value stocks have become cheap, based on historical levels.

According to Templeton Global Equity Group’s analysis of companies in the MSCI All Country World Index universe, at the end of the second quarter of 2018, global valuations spreads (the gap between the market’s cheapest and most expensive stocks) were the widest they have been in at least 30 years.[2]

“Put another way, value globally has only been this cheap 1% of the time in the past three decades. This could be a meridian hour for value investors.” – Templeton Global Equity Group, July 2018

Valuations may also explain why US value stocks outperformed US growth stocks during July 2018, as the chart below shows.



In this article and video, Franklin Mutual Series CEO Peter Langerman explains why he thinks a shift to higher interest rates could benefit value investing going forward.

> “We are not predicting that there’s going to be a period of dramatic value outperformance versus growth. Rather, fundamentals suggest to us there should be more of an equilibrium reached. And so, we think it’s an environment that’s more attractive for us as value investors than it has been for the past several years.”

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1. Source: Russell Indices. Growth stocks represented by the Russell 1000 Growth Index. Value stocks represented by the Russell 1000 Value Index. Indices are unmanaged and one cannot directly invest in them. They do not include fees, expenses and sales charges. Past performance is not an indicator or guarantee of future performance. Additional data provider information available at www.franklintempletondatasources.com.

2. Source: MSCI Indices, as at June 2018. Indices are unmanaged and one cannot directly invest in them. They do not include fees, expenses and sales charges. Past performance is not an indicator or guarantee of future performance. Additional data provider information available at www.franklintempletondatasources.com.

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