Mimosa Investment Management

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Value Versus Growth Investing

Over many years classifying stocks using different measurements has been greatly refined. Large Cap, Small Cap is one way. Industry breakdown, momentum investing are others. In this edition of the Mimosa Memorandum, we'll discuss Value and Growth.

Portfolio Theory has devised a classification system whereby equity investments consist of both Value stocks and Growth stocks. A brief review of these assets classes will set the table on which camp investors will pitch their tents.

The Value Camp

Stocks considered in the Value category share the following characteristics:

- A low P/E ratio. The average P/E of S&P 500 stocks currently sits at 18.4. Certainly investors in value look for cheap stocks, generally selling around a P/E of 15 or lower.
- A share price equal or less than the S&P 500's 2.7 times book value; that is, it's selling cheap.
- Current assets on the balance sheet far greater than current liabilities.
- Higher dividend payouts.

The Growth Camp

As to growth characteristics, note the following:

- Strong earnings growth rate, not simply historic but projected as well; at least 10%.
- A strong earnings per share picture, especially where intrinsic sales growth translate to positive earnings.
- A successful company based on its business model and competitive position.
- Low or no dividend payout.

By way of clarifying theses characteristics, take a look at the top stock holdings the T. Rowe price Value Advantage Fund. These are:

JP Morgan Chase	Proctor & Gamble
Pfizer	Johnson & Johnson
Merck	

On the other hand, the T. Rowe Price Large Cap Growth Fund contains:

Google	Priceline
Amazon	Crown Capital
Gilead Sciences	

Historic Returns

Which stocks work better in investors' portfolio? Note the following returns for Value and Growth funds, using Vanguard's Mutual Funds over differing time periods.

	Q 1 2014	1 Year	5 Year	10 Year
Large Cap Value	4.23%	23.16%	22.01%	6.78%
Large Cap Growth	-0.73%	24.39%	20.30%	6.99%

*Source: Vanguard Mutual Funds Annualized Returns

Over a long period of time Value bests Growth, and as noted in the first quarter of this year, Value clearly won out over Growth. But over more recent periods of time, the return distinction of the two shrinks to pretty much similar results. Investors should not be lured into risky Value or Growth stocks. Some Value stocks may be cheap, but may not ever recover. Conversely some Growth stocks cost too much based on high P/Es.

Modern Portfolio

Styles come and go in modern investing. Since Value and Growth returns demonstrate a somewhat negative correlation, or when one performs well, the other probably won't and vice versa. Therefore it behooves investors to stay in both of the two camps. Certainly tweaking the portfolio makes sense from time to time. This can be handled by adjusting the percentages when either Value or Growth seems superior. At Mimosa, we invest in "Growth at Reasonable Prices", which results in a diversified portfolio of Growth and Value stocks. As Benjamin Graham noted in the 20th century, the intelligent investor sets portfolio policy and sticks with the policy over the long haul.