



FRANKLIN TEMPLETON  
INVESTMENTS

# IT'S EASY TO FORGET

Five Forgotten Truths about  
Value Investing



# GROWTH VS. VALUE

Perceptions about growth and value vary, but after a period of relative outperformance by one investment style over the other, it may be time to revisit the fundamentals of each.

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

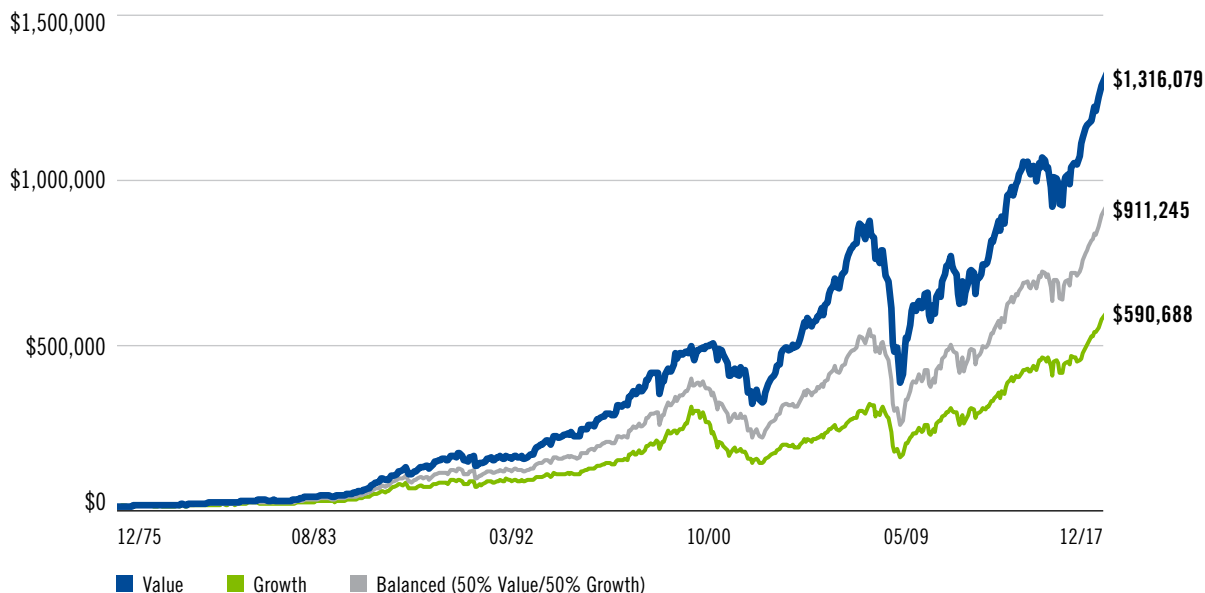
**Value investing** seeks companies whose stock prices don't reflect their intrinsic or fundamental value. The companies are often mature and their stocks may have suffered due to a temporary earnings setback or an economic or political event hampering their industry. They are often characterised by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

## Growth and Value Can Complement Each Other

Before exploring the long-term benefits of value investing and why it may be poised for a return to favour after underperforming in recent years, it's important to note that both value and growth investments can be appropriate components of a diversified portfolio. Each has characteristics that may help it perform better in different market environments, potentially smoothing out a combined portfolio's returns over time.

### A Blend of Styles Can Smooth the Journey<sup>1</sup>

Growth of \$10,000 31/12/1975–31/12/2017



**Past performance is not an indicator or a guarantee of future performance.**

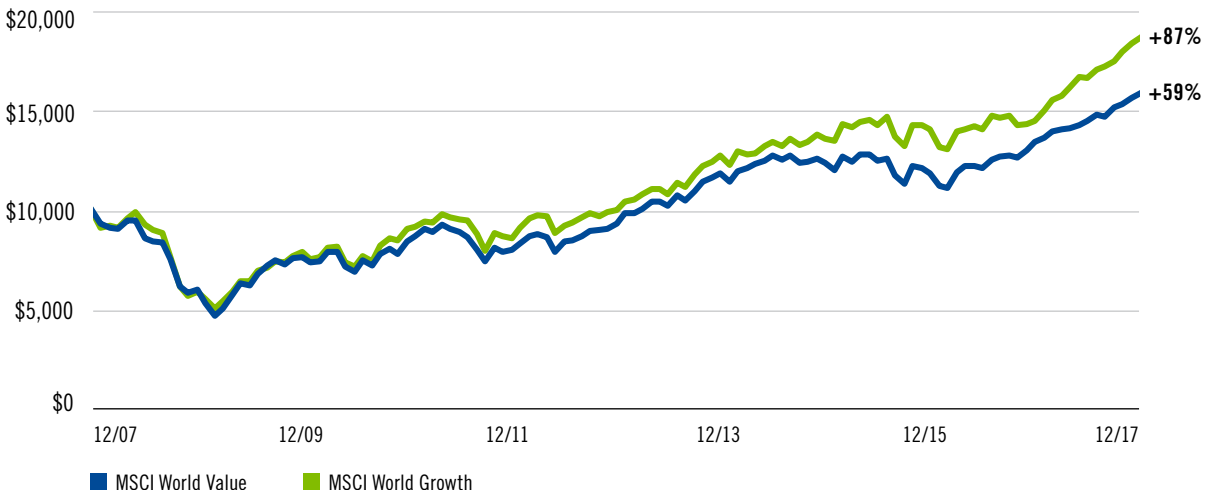
1. Source: Morningstar, Inc. 31/12/2017. Growth is represented by MSCI World Growth GR USD Index and Value is represented by MSCI World Value GR USD Index. Both are market capitalisation-weighted indexes derived from MSCI World Index. The Growth index focuses on companies with higher price-to-book ratios and higher forecasted growth values, the Value index on lower values. The Balanced portfolio began at 50% in each index and was rebalanced annually. See [franklintempletondatasources.com](http://franklintempletondatasources.com) for more information. Indexes are unmanaged and one cannot invest directly in an index. Index returns do not reflect any fees, expenses or sales charges.

# 1 | GROWTH STOCKS HAVE OUTPERFORMED RECENTLY, YET GROWTH AND VALUE HAVE CYCLED OVER TIME.

Scanning the performance of growth stocks and value stocks over recent years, investors may believe the way to achieve better performance is by investing exclusively in growth. Growth stocks outperformed value stocks in seven of the 10 years through 2017, handily outpacing the return of value stocks over that period.<sup>2</sup>

## Growth Stocks Have Outperformed in Recent Years<sup>2</sup>

Growth of \$10,000 31/12/2007–31/12/2017



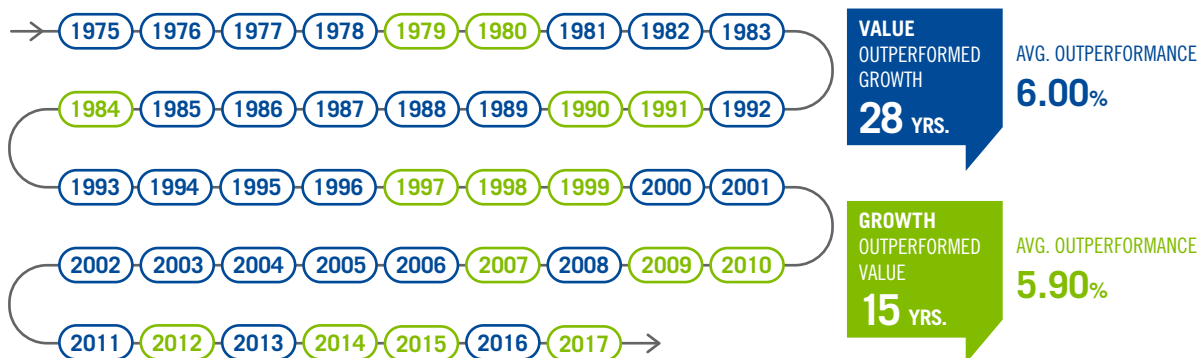
For illustrative purposes only and does not reflect the performance of any Franklin Templeton fund.

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But when examining a longer time frame a more complete pattern emerges. **Since 1975, value has prevailed in 28 years—versus growth in 15 years.** Regardless of which style won the given year, the average performance differential has been similar, yet substantial.

## A Different Picture Emerges Looking Further Back<sup>2</sup>

Annual Returns 1975–2017



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2. Source: Morningstar, Inc. 31/12/2017. Growth is represented by MSCI World Growth Index and Value is represented by MSCI World Value Index. Indexes are unmanaged and one cannot invest in an index. Index returns do not reflect any fees, expenses or sales charges.

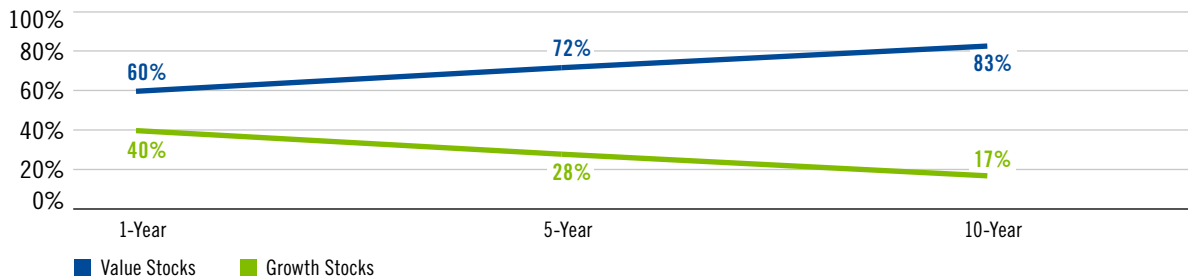
## 2 | VALUE INVESTING HAS REWARDED LONG-TERM INVESTORS.

Investors are typically counseled to not think in the short term with equity investments. In a one-year period, almost anything can happen.

When looking at longer time frames, however, another interesting pattern emerges. Value begins to show that it has had a performance edge over longer time frames.

### Frequency of Value Stocks Outperforming Growth Stocks over Various Investment Time Frames<sup>3</sup>

Monthly Rolling Periods 31/12/1975–31/12/2017



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### Persistence and Magnitude

The average annual returns for value and growth stocks based on rolling 1-, 3-, 5-, 10-year periods between 1975 and 2017 are shown below. Value, on average, has outperformed growth over all of these periods. For 10-year periods, the average difference in end value of the initial \$100,000 investment is over \$61,000.

### DIFFERENTIAL IN GROWTH OF \$100,000

#### Average Difference in End Value

All Rolling Periods 31/12/1975–31/12/2017

All Periods over Full Period <sup>4</sup>	Average Annual Returns <sup>4</sup>		Average Difference in End Value of \$100,000
	MSCI World Value Index	MSCI World Growth Index	
1-Year	12.89%	10.89%	+\$1,995
3-Year	11.78%	9.89%	+\$6,837
5-Year	11.65%	9.70%	+\$15,241
10-Year	11.45%	9.42%	+\$61,733

*Charts and tables are for illustrative purposes only and do not reflect the performance of any Franklin Templeton fund.*

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3. Source: Morningstar, Inc. 31/12/2017. Growth is represented by MSCI World Growth Index and Value is represented by MSCI World Value Index.

4. Source: Morningstar, Inc. 31/12/2017. Average returns and values calculated by Franklin Templeton. Based on the average of all returns (rolling monthly) for each designated time period for each index as shown, applied on a \$100,000 investment over that time period.

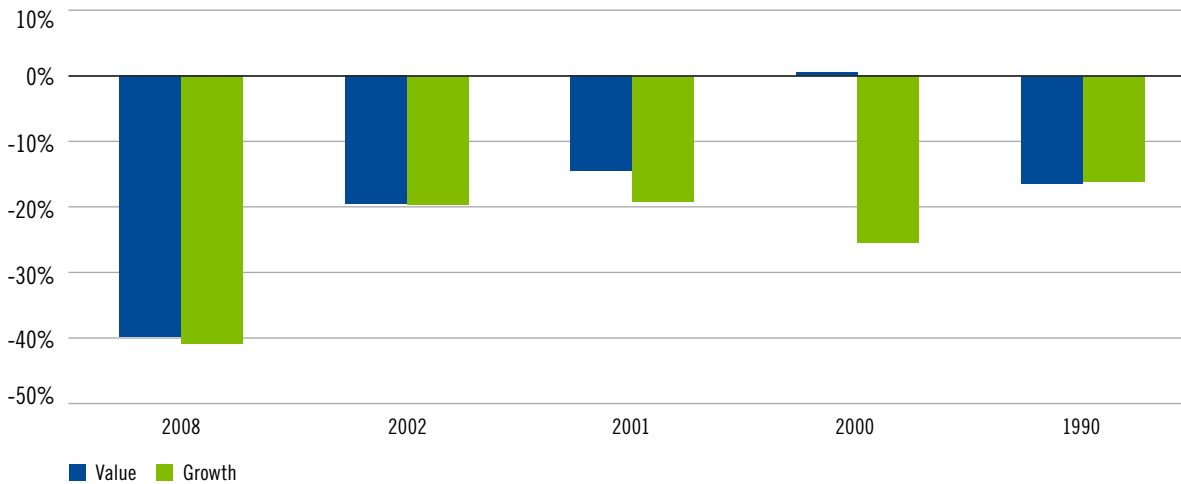
Indexes are unmanaged and one cannot invest directly in an index. Index returns do not reflect any fees, expenses or sales charges.

# 3 | VALUE HAS DELIVERED BETTER RETURNS IN MOST DOWN MARKETS.

## The Pain Index

Standard deviation is often used to illustrate risk, but another way to look at risk that may better measure the pain of loss investors feel focuses on annual returns in down markets. By this measure, value has a leg up on growth. In 2008, the financial crisis wreaked havoc on all types of investments and marked the worst year in the last 42 for both value and growth stocks. Value has performed better in 4 out of 5 years the MSCI World Index declined the most.

### Growth vs. Value in the Five Worst Years for the Stock Market Since 1975 As Determined by MSCI World Index Performance<sup>5</sup>

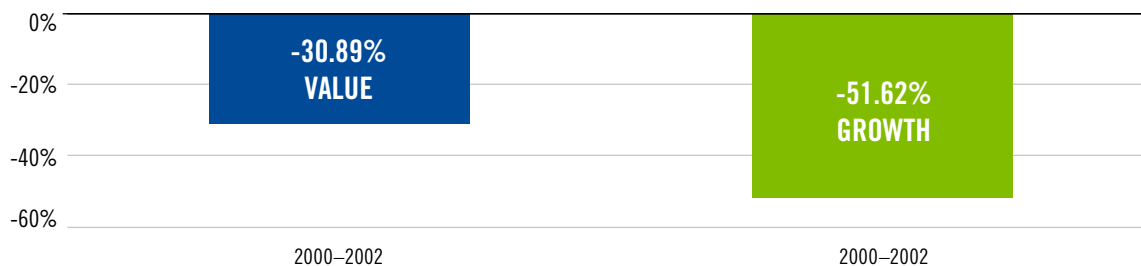


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## The Capitulation Effect

What actually drives investors out of their investments depends on the investor, but often a persistent, substantial decline can push individuals out of their best laid plans. As measured by worst three-year cumulative total return, value again trumped growth.

### Worst Cumulative Total Return over Three Calendar Years 1975–2017<sup>6</sup>



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5. Source: Morningstar, Inc. 31/12/2017. Growth is represented by MSCI World Growth Index and Value is represented by MSCI World Value Index.

6. Source: Morningstar, Inc. 31/12/2017. The MSCI World Growth Index reflects the three-year period ending 31/12/2002. The MSCI World Value Index reflects the three-year period ending 31/12/2002.

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# 4 | HISTORY MAY NOT REPEAT, BUT IT OFTEN RHYMES.

## Echoes of 1999

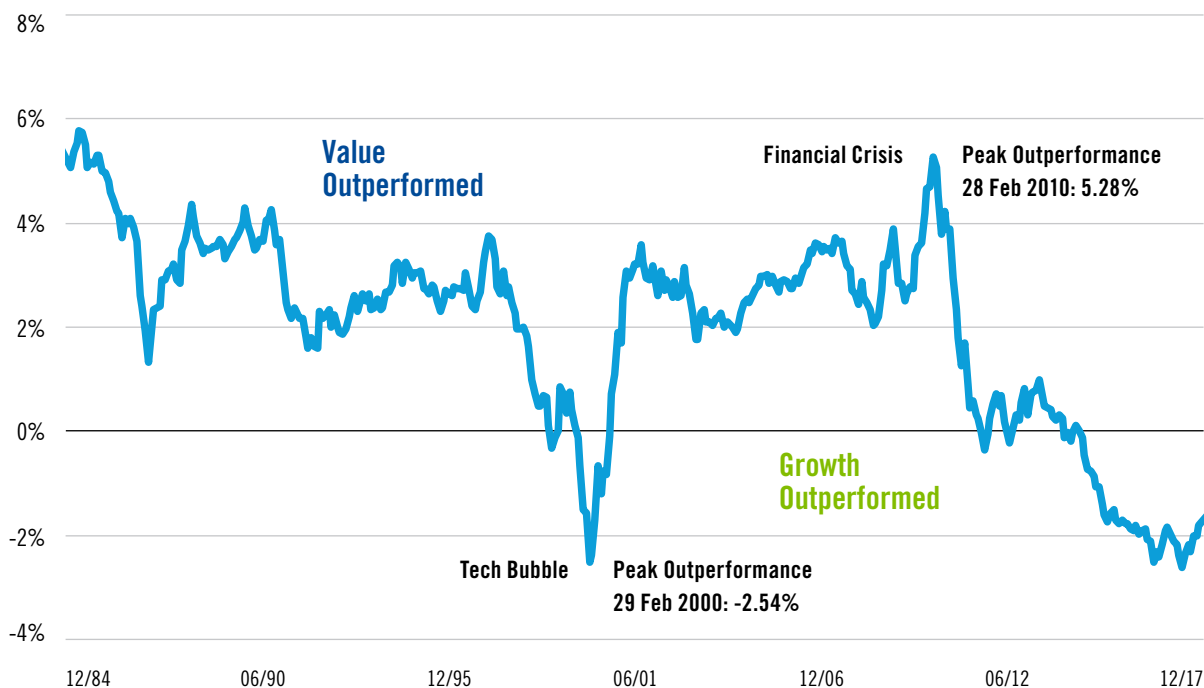
The chart below illustrates a comparison of the 10-year average annual returns of the MSCI World Growth Index and the MSCI World Value Index on a rolling basis. At the peak of the tech bubble, growth had significantly outperformed value and by February 2000, the 10-year average annual return differential had reached 2.54% in favour of growth. Only 8 months later, in October 2000, that differential had been wiped out.

Similarly, value investing subsequently accumulated a 10-year record of outperformance that peaked about a year after the market bottom during the financial crisis. Since then, growth investing has had generally better performance, leading to a significant 10-year advantage.

### MSCI WORLD VALUE INDEX VS. MSCI WORLD GROWTH INDEX

#### Rolling 10-Year Annualised Excess Return<sup>7</sup>

31/12/1984–31/12/2017



*This chart is for illustrative purposes only and does not reflect the performance of any Franklin Templeton fund.*

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7. Source: © 2017 Morningstar. Excess return calculated by Franklin Templeton. MSCI World Growth Index rolling 10-year average annual return is subtracted from the MSCI World Value Index counterpart. Values above 0 represent value outperformance; under 0 represents growth outperformance. Indexes are unmanaged and one cannot invest directly in an index. Index returns do not reflect any fees, expenses or sales charges.

# 5 | SOONER OR LATER, FUNDAMENTALS MATTER.

## The Price of Success

Amazon is one of the current stock market success stories prized by investors who like its innovation, sales growth and earnings potential. That outlook has pushed its share price up, so that its market capitalisation exceeds \$560 billion.<sup>8</sup> Consider, however, an alternate basket of 23 iconic companies that as a group have a comparable market cap. Then compare their price/earnings (P/E) ratios to Amazon's.

### What Can \$358 Billion Buy?

As of 31 December 2017

AMAZON.COM Inc. <sup>10</sup>		23 ICONIC COMPANIES <sup>10</sup>		Market Cap (\$M) <sup>8</sup>	P/E Ratio <sup>8</sup>	
\$563.7	MARKET CAP <sup>8</sup> (\$Billions)	\$563.3		American Express Company	\$86,499	19.1
\$177.9	2017 NET SALES <sup>9</sup> (\$Billions)	\$672.6		General Motors Company	\$57,386	9.2
\$3.0	2017 EARNINGS <sup>9</sup> (\$Billions)	\$39.3		Ford Motor Company	\$50,672	11.3
185.9	P/E RATIO <sup>8</sup>	14.3	WTD. AVG	eBay Inc.	\$39,589	5.6
				Allstate Corporation	\$37,696	14.5
				Target Corporation	\$35,490	13.7
				Corning Inc	\$27,799	13.6
				Yum! Brands, Inc.	\$27,666	25.2
				CBS Corporation Class B	\$23,600	81.9
				Ingersoll-Rand Plc	\$22,342	21.9
				United Continental Holdings, Inc.	\$19,967	10.6
				D.R. Horton, Inc.	\$19,151	18.6
				Skyworks Solutions, Inc.	\$17,385	17.6
				Campbell Soup Company	\$14,481	16.8
				Viacom Inc. Class B	\$12,398	6.6
				Wyndham Worldwide Corporation	\$11,730	20.8
				Garmin Ltd.	\$11,169	16.2
				Kansas City Southern	\$10,911	20.7
				Harley-Davidson, Inc.	\$8,563	15.9
				Goodyear Tire & Rubber Company	\$7,959	8.3
				Macy's Inc	\$7,672	11.1
				Xerox Corporation	\$7,421	13.4
				Foot Locker, Inc.	\$5,748	11.8
				<b>Total Market Cap</b>	<b>\$563,294</b>	<b>14.3</b> Wtd. Avg

## The Bottom Line

There are many ways to value companies, and P/E ratio is one simple measure. Faster growing companies usually have higher P/E ratios due to future expectations. But here's the bottom line question an investor might ask:

**"Is a growth company growing *fast enough* and will it grow *long enough* for me to accept one third the sales, and just 7% of the earnings, now, in anticipation of better sales and earnings down the road?"**

8. Source: FactSet. Data as of 31/12/2017. Market capitalisation reflects the number of a company's outstanding shares multiplied by the share price. Price/earnings ratio is a comparison of a company's share price to its per share earnings. A higher P/E is considered to be more expensive.

9. Source: FactSet. Data as of 31/12/2017. Earnings reflect net income after extraordinary items. Net sales reflect reported revenues.

10. Companies are for illustrative purposes only. They do not necessarily reflect holdings in any Franklin Templeton fund.

## WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Value securities may not increase in price as anticipated or may decline further in value. Growth stock prices reflect projections of future earnings or revenues, and can, therefore, fall dramatically if the company fails to meet those projections.

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