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TEMPLETON

# 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.

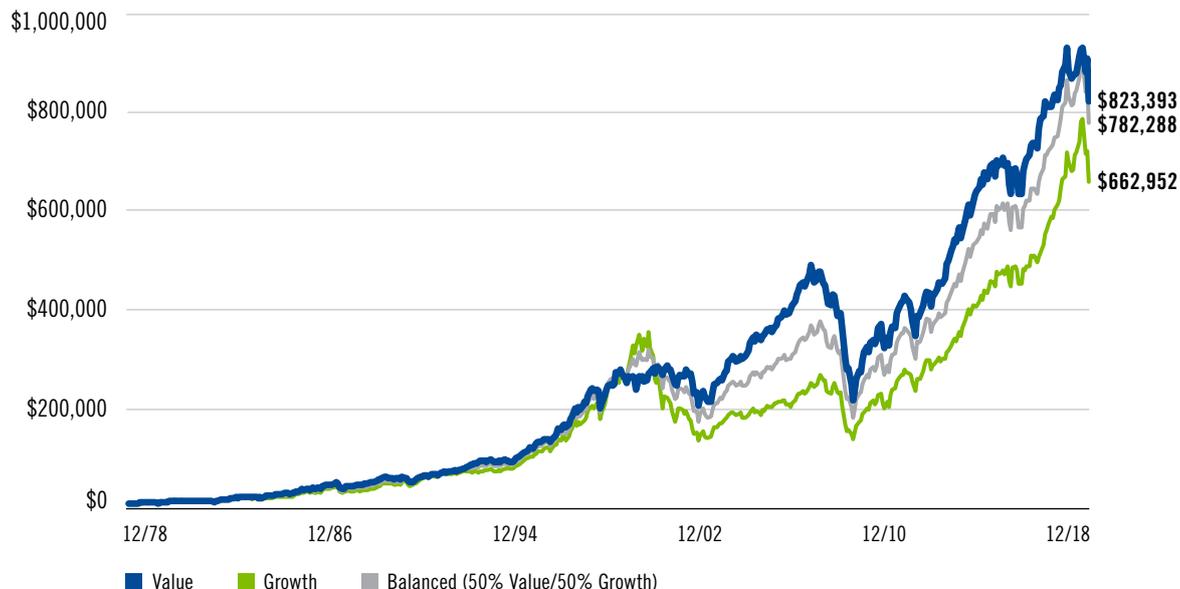
**Value investing** seeks companies whose stock prices don't reflect their intrinsic or fundamental value. The companies are often mature and their stocks may have suffered due to a temporary earnings setback or an economic or political event hampering their industry. They are often characterised by 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 31/12/1978–31/12/2018



1. Source: Morningstar, Inc. 31/12/2018. Growth is represented by Russell 1000 Growth Index and Value is represented by Russell 1000 Value Index. Both are market capitalisation-weighted indexes derived from the Russell 1000 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. **Past performance does not guarantee future results.**

# 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 2018, 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 31/12/2008–31/12/2018

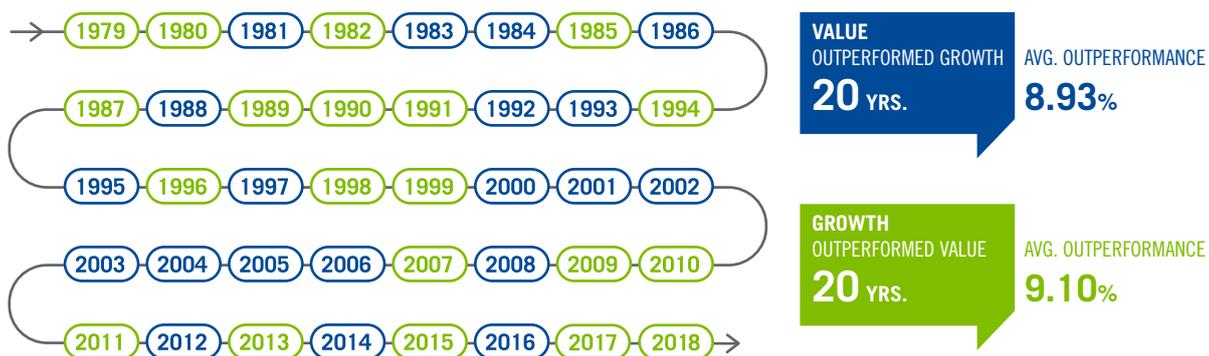


*For illustrative purposes only and does not reflect the performance of any Franklin Templeton fund.*

But when examining a longer time frame a more complete pattern emerges. **Since 1979, value has prevailed in 20 years—and so has growth.** 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 1979–2018



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2. Source: Morningstar, Inc. 31/12/2018. Past performance does not guarantee future results. Growth is represented by Russell 1000 Growth Index and Value is represented by Russell 1000 Value Index. Indexes are unmanaged and one cannot invest in an index. Index returns do not reflect any fees, expenses or sales charges.

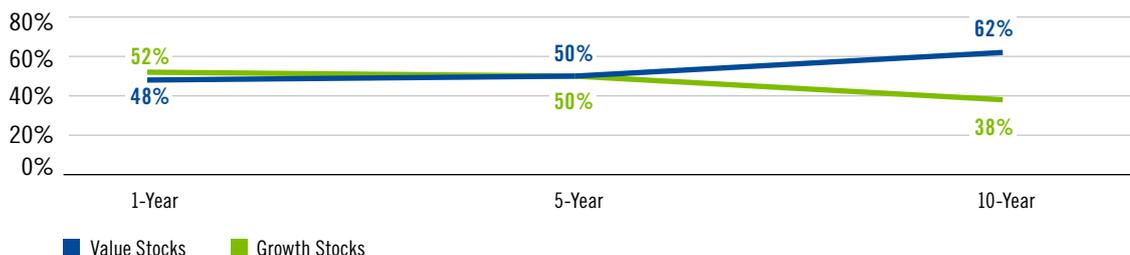
## 2 | VALUE INVESTING HAS REWARDED LONG-TERM INVESTORS.

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 the long run.

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

Monthly Rolling Periods 1979–2018



### Persistence and Magnitude

The average annual returns for value and growth stocks based on rolling periods between 1979 and 2018 are shown below. Value, on average, has outperformed growth over periods of a year or longer. For 10-year periods, it has outperformed almost two thirds of the time. Of course, an average is simply that, and over any particular period one style may outperform the other.

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

#### Average Difference in End Value

All Rolling Periods 1979–2018

All Periods over Full Period <sup>4</sup>	Average Annual Returns <sup>4</sup>		Average Difference in End Value of \$100,000
	Russell 1000 Value Index	Russell 1000 Growth Index	
1-Year	13.10%	13.17%	-\$17
3-Year	12.17%	11.40%	+\$1,531
5-Year	12.08%	11.10%	+\$4,012
10-Year	11.21%	10.20%	+\$13,907

Charts and tables are for illustrative purposes only and do not reflect the performance of any Franklin Templeton fund. Past performance does not guarantee future results.

3. Source: Morningstar, Inc. 31/12/2018. Growth is represented by Russell 1000 Growth Index and Value is represented by Russell 1000 Value Index.

4. Source: Morningstar, Inc. 31/12/2018. 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.

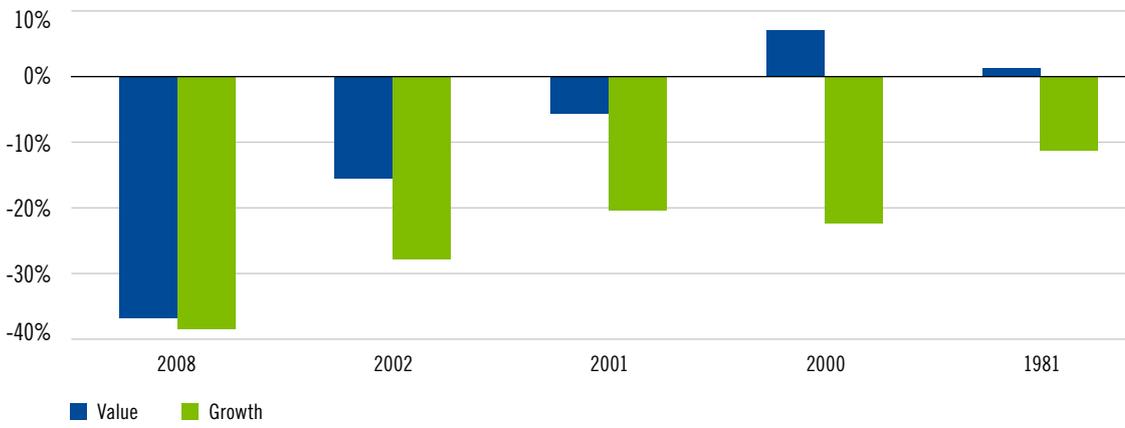
Indexes are unmanaged and one cannot invest directly in an index. Index returns do not reflect any fees, expenses or sales charges.

# 3 | VALUE HAS DELIVERED BETTER RETURNS IN 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 37 for both value and growth stocks. But with the exception of that year, value has performed substantially better in years the S&P 500 Index declined the most.

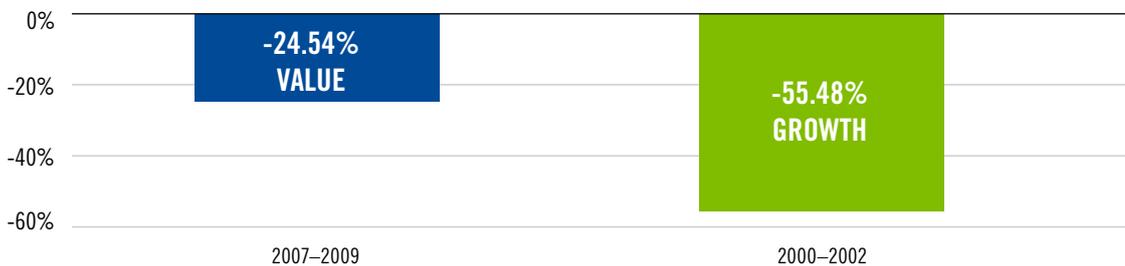
**Growth vs. Value in the Five Worst Years for the Stock Market Since 1979 As Determined by S&P 500 Index Performance<sup>5</sup>**



## 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, which showed a loss of well more than half its value over its worst three-year period.

**Worst Cumulative Total Return over Three Calendar Years 1979–2018<sup>6</sup>**



5. Source: Morningstar, Inc. 31/12/2018. Growth is represented by Russell 1000 Growth Index and Value is represented by Russell 1000 Value Index.

6. Source: Morningstar, Inc. 31/12/2018. The Russell 1000 Growth Index reflects the three-year period ending 31/12/2002. The Russell 1000 Value Index reflects the three-year period ending 31/12/2009.

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

### Echoes of 1999

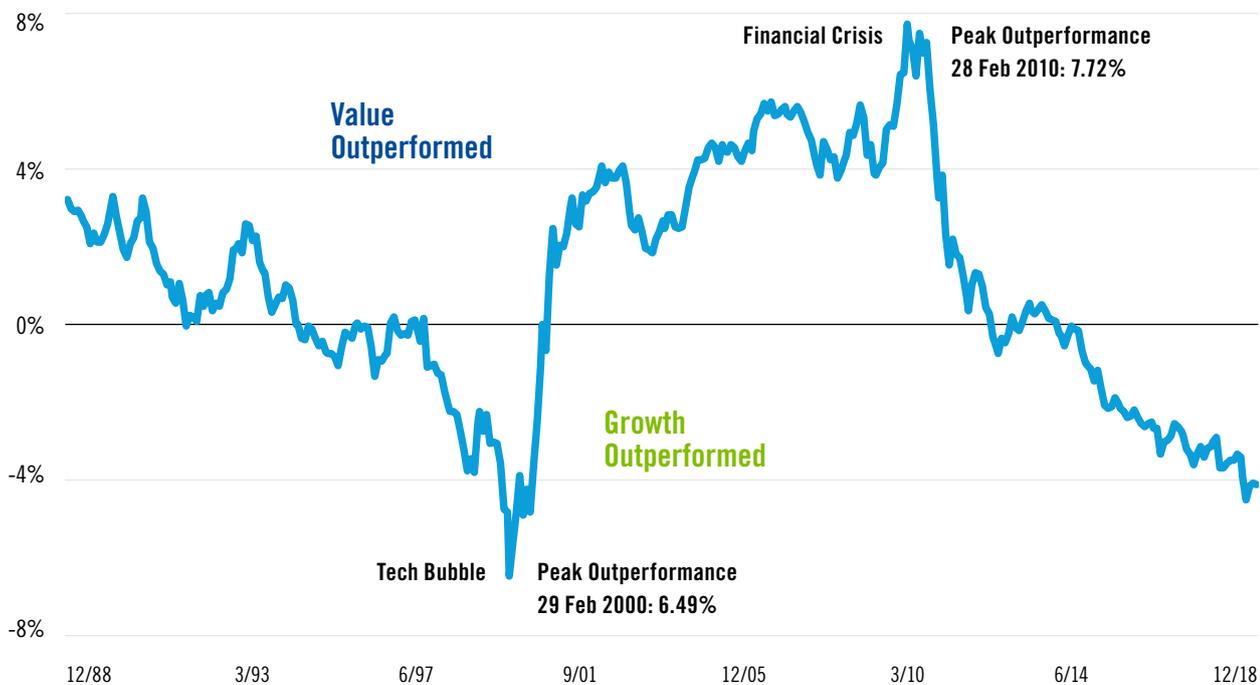
The chart below illustrates a comparison of the 10-year average annual returns of the Russell 1000 Growth Index and the Russell 1000 Value Index on a rolling basis. At the peak of the tech bubble, growth had significantly outperformed value for a number of years and by February 2000, the 10-year average annual return differential had reached 6.49% in favour of growth. Only 10 months later, in December 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.

### RUSSELL 1000 VALUE INDEX VS. RUSSELL 1000 GROWTH INDEX

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

31 December 1988–31 December 2018



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

7. Source: © 2019 Morningstar. Excess return calculated by Franklin Templeton. Russell 1000 Growth Index rolling 10-year average annual return is subtracted from the Russell 1000 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 \$737 billion.<sup>8</sup> Consider, however, an alternate basket of 19 iconic companies that as a group have a comparable market cap. Then compare their price/earnings (P/E) ratios to Amazon's.

### What Can \$737 Billion Buy?

As of 31 December 2018

#### AMAZON.COM Inc.<sup>10</sup>



#### 19 ICONIC COMPANIES<sup>10</sup>

	Market Cap (\$B) <sup>8</sup>	P/E Ratio <sup>8</sup>
Allstate	\$27.4	13.9
American Airlines	\$14.8	10.6
Capital One	\$35.4	6.4
Celgene	\$44.9	11.6
Cigna	\$72.3	18.0
FedEx	\$42.1	8.8
Ford Motor	\$31.1	8.3
General Motors	\$46.8	6.0
Goldman Sachs	\$61.4	6.6
International Paper	\$16.2	8.3
Kansas City Southern	\$9.6	15.6
Macy's	\$9.2	5.4
Micron Technology	\$35.5	2.6
Nucor	\$15.8	7.0
Target	\$34.5	11.0
Tyson Foods Class A	\$19.1	10.4
United Continental	\$22.8	10.9
Valero Energy	\$31.8	10.3
Walt Disney	\$164.5	15.0
<b>Total Market Cap</b>	<b>\$735.4</b>	<b>11.0</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 less than 23% of the sales, and just 14% of the earnings, now, in anticipation of better sales and earnings down the road?”**

8. Source: FactSet, 1/3/2019. Data as of 31/12/2018. 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, 1/3/2019. Data as of 31/12/2018. 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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