About Investing

Where now for the growth vs value debate?

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After a decade in which growth investments were dominant the pendulum has, over the past two years, swung back towards value again. As we consider the shifting tides of the investment world, how will the changing fortunes of growth and value investing play out in the years to come?

The debate around growth and value investing is age-old and you'll find plenty of people to argue equally strong cases on either side. The argument surfaced again as markets sought to grapple with lockdowns in 2020, and more recently as governments and central banks seek to manage rising inflation.

What's happened so far?

When thinking of growth stocks, it's the big technology names that come to mind. The likes of Alphabet (owners of Google), Amazon, Apple, Meta (formerly Facebook) and Microsoft were well-placed to benefit from the move to home working and the surge in demand for online shopping.

At the start of 2020, these five companies were worth around $5tr (US dollar) and made up 17.5% of the value of the S&P 500 Index.[1] By the end of the year, they were worth more than $7tr, and their share of the index rose to 22%.[2]

Fast-forward to late 2022, and it was value investing's time to perform more strongly, while technology stocks faltered. For the year to 31 October 2022, the MSCI World Value Index was down 7.69%, compared with a 28.21% drop in the MSCI World Growth Index over the same period [3].

The inflation risk

Global inflation has risen sharply in recent months, reaching 40-year highs in both the UK - where it hit 9.6% in October 2022[4] - and the US, which recorded a rate of 9.1% the same month.[5]

Central Banks were clear in their determination to cool things down through interest rate rises and other measures to reduce money supply in their economies. However, the acceleration in interest rate rises is expected to slow down over the coming year.[6]

Ongoing inflation increases may result in a prolonged shift away from growth stocks such as big technology, in favour of a more value-led approach. This is because as money becomes worth less in the future, there is arguably a case for seeking out lower-valued companies against a backdrop of rising prices.

The prospects for technology stocks

Technology shares have fallen out of favour in 2022 as growth investments in general have been hit hard by macroeconomic headwinds.[7] These include the war in Ukraine, rising inflation and the ongoing disruption that the COVID-19 pandemic has caused to global supply chains.

Rising interest rates also played a part, as some technology firms borrowed heavily to fuel their growth, leading to concerns that high interest rates could hit returns.

The Nasdaq Composite Index, which houses most of the big global technology names, was down 3.91% in the six months to 31 October 2022.[8]

Technology companies are popular with growth investors because they are expected to grow significantly in future, hence the typically high valuations (whereas value investors look for companies that seem undervalued).

Growth investors might still point to long-term factors that will help technology stocks to keep growing, such as changing demographics and advances in technology. But like many growth stocks, technology companies can look particularly expensive at times of higher inflation, when investors tend to be more focused on what a company is earning now rather than what it might earn in future.

What about electric vehicles?

Electric vehicles are seen by some as growth stocks as the industry and consumers begin to move away from traditional petrol and diesel cars.

Electric vehicles now account for one in five new car sales in the UK, with 14.4% of registrations in the first half of 2022 being for pure battery electric vehicles and another 6.4% for plug-in hybrids.[9] This shift is thought to have been accelerated by the pandemic and rising fuel prices, with many taking advantage of incentives and increased savings to buy an electric or hybrid car.

Growth opportunities

Beyond the big names, there are growth opportunities for clients encouraged by the prospect of high returns, and who are prepared to take on the associated higher risk.

This is where active fund managers can come into their own, looking outside of the indices for companies seeking to innovate and disrupt in their sectors.

These might include lesser-known companies which use technology to gain a market advantage. Or they might include particular products and services that look well-placed to drive returns, for example, contactless payment systems, online security and domestic holiday rental accommodation.

A more balanced approach

The success of growth or value will be driven by hard to predict factors, such as the path for interest rates and inflation, and what will happen on economic growth.

Given this uncertainty, one option is exposure to both styles. Increasingly, the thought process is less about growth or value and more about taking a selective approach. Focusing on high quality companies, with good business models, remains key.

The fundamentals behind companies and sectors will continue to be closely scrutinised. Growth and value investing may each be built in as part of a diversified portfolio, or perhaps as part of a 'core and satellite' approach for the right investors.

Find out more

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Asset Management

[1] CNBC, 28 January 2020
[2] The Economist, 16 December 2020
[3] MSCI, 31 October 2022
[4] Office for National Statistics, 16 November 2022
[5] The Guardian, 13 July 2022
[6] Reuters, 30 November 2022
[7] Money Week, 10 November 2022
[8] NASDAQ, 31 October 2022
[9] Car Magazine, 5 July 2022