Investing with style

How do you define your approach to investing? There may be many answers to that question. One answer goes to the style of investing that you choose: *value* or *growth*.

Are you looking for value?

The goal of a value investor is to seek out “bargains,” finding those companies whose stock may be out of favor for one reason or another and whose stock is inexpensive relative to the company’s earnings or assets. Value investors are looking for companies that have shown low or no sales growth, have little corporate debt and experience below-average earnings increases.

Identifying a company that meets the above criteria is only the first step. The next step is to determine whether or not the company’s low share price is unjustified. For instance, can the undervaluation be traced to the fact that the company’s industry or products are currently out of favor? Has the company experienced short-term earnings disappointments? Or is it because of some problem within the company for which there is no immediate or near-term solution? The answers to those questions will determine whether true value exists.

The value approach goes back to the work of Benjamin Graham, widely regarded as the “father of value investing” and whose wisdom may still be worth following today. His 1934 book, *Security Analysis*, coauthored with David Dodd, advocated a fundamental analysis of a company’s balance sheet before deciding to invest. Graham also emphasized the importance of building a “margin of safety” into one’s analysis. The investor’s aim, he said, should be to “purchase a dollar for 50 cents.”

It’s often said that patience is a key attribute of the value investor. By its very nature, value investing means being able to sit back and wait. The belief is that other investors soon will draw the same conclusions about a company’s potential and bid up the stock price. While the value investor waits, he or she still may receive some reward: Value stocks typically have an above-average dividend yield.

Are you seeking growth?

For growth investors, it’s a matter of expectations. Growth investors are on the lookout for companies whose sales and earnings are expected to grow steadily. Because a profitable company rarely goes unnoticed, growth stocks generally are not inexpensive. However, given the appreciation potential that they see, growth investors are willing to pay the premium involved.

The companies whose shares fall within the growth style are those: whose sales growth is greater than that of their competitors; that usually have incurred major debt for expansion; and that usually will deliver little in the way of dividends. They have high earnings per share and high price/earnings and price/book ratios.

Because their appreciation usually is based upon earnings announcements, share prices of growth stocks tend to fluctuate rapidly. But, despite volatility, a good growth stock will report steadily growing earnings. The growth investor’s challenge, of course, is to buy early enough, not sell off the winners too early, and not hang on to the losers too long.

Style drift

A stock identified as either “growth” or “value” need not retain that characteristic forever. Over time stocks may drift from one category to the other as their fortunes change. As that happens, a portfolio inadvertently may drift from one style to the other. The significant variability of the investment returns between these two styles suggests that “style diversification” may be appropriate or, at least, that style should be one of the metrics by which an investment portfolio is measured periodically.

A combination of styles?

History shows that the market does not tend to favor one style of investing over another for very long. Both growth and value have had their day in the sun.

It isn’t necessary to choose one style over the other. There are ways to build your portfolio in a manner that combines value and growth stocks in a proportion with which you can be comfortable. In other words, you can think of not one style versus the other but, rather, of the styles falling across a spectrum. In that manner you stand the best chance of taking maximum advantage of the market’s changing preferences.

We can help you find where you want to be along that spectrum. Just give us a call to set up an appointment.