

# Perspectives



## Identity Matters: Growth Versus Value Stocks?

Investors slice and dice the stock market in a myriad of ways. With the advent of ETFs and the rising popularity of factor investing, it's easier than ever to access (or avoid) very specific portions of the stock market. Despite the prevalence of niche factor products, the most common way to segment investments (equities or mutual funds) is by market capitalization (size of the company) and style (growth, blend, value). For mutual funds, this is in large part thanks to the ubiquity of the Morningstar Style Box, a nine-box grid with market capitalization on the x-axis (from small to large) and style on the y-axis (from value to growth). A mutual fund that invests in large capitalization stocks with high growth characteristics would reside in the upper right box while another that invests in small capitalization stocks with a value tilt resides in the bottom left box. For mutual funds, its location within the Morningstar Style Box is no small matter as this corresponds to the peer group that Morningstar, and other data providers, use to compare returns, fees, and other investment characteristics.

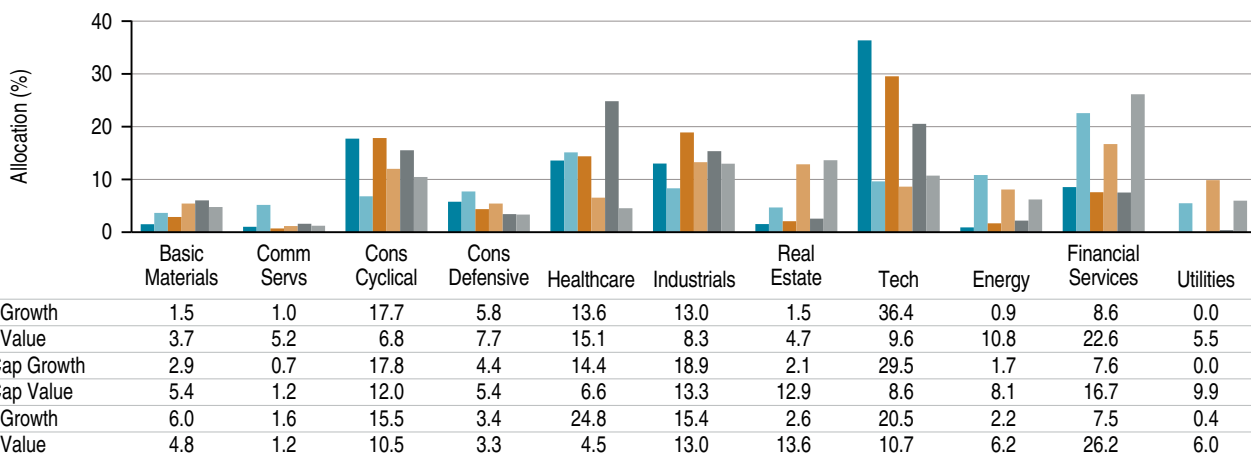
While the definitions of small, mid, and large capitalization stocks are largely agreed upon, the definitions of growth and value can differ, sometimes dramatically, among investment firms, index providers, and gatekeepers such as Morningstar and Lipper.

### Identity Matters

Broadly speaking, growth stocks are those that have demonstrated stronger-than-average earnings growth in the past, a trend which is expected to continue. Value stocks tend to be those that have fallen out of favor, meaning their share prices are likely to have dropped off, and investors believe the situation to be temporary. Those divergent classifications lead to distinct characteristics of both growth and value stocks.

### Valuation

Growth stocks tend to have valuations that are higher than the broader market (for large caps, a good comparison is the Russell 1000 Index) because investors are willing to pay up for above-average future growth prospects. Because value stocks have typically fallen out of favor (or have been left behind in a market upswing), the valuations tend to be lower than the broader market. Investors need more enticement to purchase shares of companies whose future growth prospects are less clear. There are several valuation techniques that can be utilized but the most common are price-to-earnings, price-to-book, and price-to-sales. Some value-focused managers also use price-to-intrinsic value, which compares the current price to the manager's perceived value of the company.



Source: Morningstar

## Historical and Future Growth Estimates

Like the name suggests, growth stocks should have higher historical and future growth rates (earnings, sales, cash flow, etc.) than the broader market. Within growth stocks, there are degrees of “growthiness” with higher octane names growing at much faster rates than the broader market. On the flip side, value stocks tend to have lower growth rates, both historical and expected.

## Yield

Another differentiator between growth and value is yield (dividend/share price). Value stocks often have higher yields than growth stocks. This is primarily because value stocks tend to be more mature (and therefore slower growing) companies and are more likely to pay a dividend. When faced with a choice between re-investing capital or paying a dividend to shareholders, more mature firms may decide that paying dividends is a better value-add for shareholders. Less mature growth companies, on the other hand, might have less cash on hand to begin with and may find re-investing back into the business a better long-term value proposition for shareholders. It’s important to note that not all value stocks pay dividends and many growth stocks do.

Other factors also vary among growth and value stocks, but the three discussed above are the most prominent. Because certain types for firms tend to exhibit similar characteristics, a clustering by sector results. The Russell indexes are popular domestic stock indexes that capture both the size and style variants in the stock market. The Russell 1000 includes the largest domestic stocks while the Russell 2000 includes the smallest domestic stocks. The below chart shows the sector allocations as of September 2018 for each of the Russell growth and value indexes.

This can have big implications for returns. Take technology, a sector that has performed very well in the last few years. The Russell 1000 Growth index had an allocation of 36% to technology stocks versus less than 10% for the Russell 1000 Value index, which is one of the reasons for vast underperformance of the latter versus the former for the year to date through September 30. The table below shows calendar year returns for the six indexes going back to 2007.

The performance differentials for any given calendar year can be substantial but are not consistent. Taking a diversified approach that includes both growth and value stocks across market capitalization allows investors to benefit from the unique characteristics of each group without attempting to time the market.

## Calendar Year Returns 2007-2018

Index	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Year to Date
Russell 1000 Growth	11.81	(38.44)	37.21	16.71	2.64	15.26	33.48	13.05	5.67	7.08	30.21	17.09
Russell 1000 Value	(0.17)	(36.85)	19.69	15.51	0.39	17.51	32.53	13.45	(3.83)	17.34	13.66	3.92
Growth/Value Rtn Differential	11.99	(1.59)	17.52	1.20	2.25	(2.25)	0.96	(0.40)	9.49	(10.26)	16.55	13.17
Russell Mid Cap Growth	11.43	(44.32)	46.29	26.38	(1.65)	15.81	35.74	11.90	(0.20)	7.33	25.27	13.38
Russell Mid Cap Value	(1.42)	(38.44)	34.21	24.75	(1.38)	18.51	33.46	14.75	(4.78)	20.00	13.34	3.13
Growth/Value Rtn Differential	12.85	(5.88)	12.08	1.63	(0.27)	(2.70)	2.28	(2.85)	4.58	(12.67)	11.92	10.25
Russell 2000 Growth	7.05	(38.54)	34.47	29.09	(2.91)	14.59	43.30	5.60	(1.38)	11.32	22.17	15.76
Russell 2000 Value	(9.78)	(28.92)	20.58	24.50	(5.50)	18.05	34.52	4.22	(7.47)	31.74	7.84	7.14
Growth/Value Rtn Differential	16.82	(9.62)	13.89	4.58	2.59	(3.46)	8.78	1.39	6.09	(20.42)	14.33	8.62

Data as of 9/30/2018. Source: Morningstar

## About Mesirow Financial

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The Russell 1000 Growth Index is a broadly diversified index predominantly made up of growth stocks of large U.S. companies. The Russell 1000 Value Index is a broadly diversified index predominantly made up of value stocks of large U.S. companies. The Russell 2000 Value invests in stocks in the Russell 2000 Value Index, a broadly diversified index predominantly made up of value stocks of small U.S. companies. The Russell Midcap Growth Index measures the performance of those Russell Midcap companies with higher price/book ratios and higher forecasted growth values. The stocks are also members of the Russell 1000 Growth Index. The Russell Midcap Value Index measures the performance of those Russell Midcap companies with lower price/book ratios and lower forecasted growth values. The stocks are also members of the Russell 1000 Value Index. Mesirow Financial refers to Mesirow Financial Holdings, Inc. and its divisions, subsidiaries and affiliates. The Mesirow Financial name and logo are registered service marks of Mesirow Financial Holdings, Inc. © 2018, Mesirow Financial Holdings, Inc. All rights reserved. Some information contained herein has been obtained from sources believed to be reliable, but is not necessarily complete and its accuracy cannot be guaranteed. Any opinions expressed are subject to change without notice. Advisory Fees are described in Mesirow Financial Investment Management, Inc.’s Form ADV Part 2A. Mesirow Financial does not provide legal or tax advice. Advisory services offered through Mesirow Financial Investment Management, Inc. an SEC registered investment advisor. Securities offered by Mesirow Financial, Inc. member FINRA and SIPC.

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