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What Is the Difference Between Growth and Value Stocks?

Key Takeaways

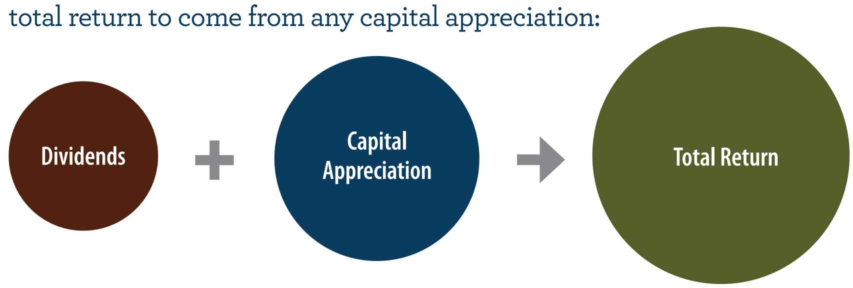
- A growth stock's total return is more likely to come from capital appreciation (including appreciation from buybacks) than dividend income; a greater proportion of a value stock's performance is likely to come from dividend income.
- Long-term investors don't have to choose between growth and value and, in many cases, they may benefit from a combination of the two styles.
- Shorter-term (cyclical and tactical) opportunities to reallocate to growth vs. value, and vice versa, may sometimes arise.

Total Return Composition Differs Between Styles

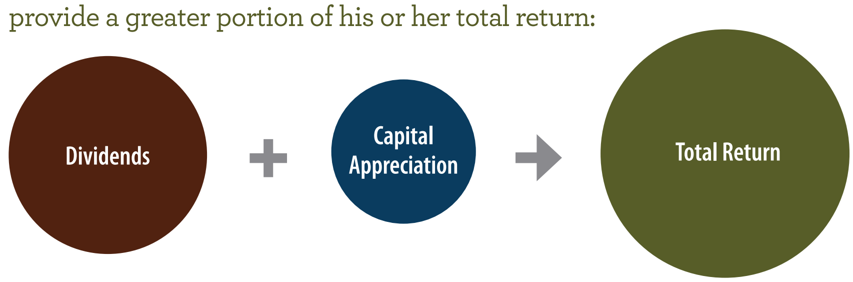
Looking at a stock's total return, determined simply by adding any capital appreciation together with any dividends, can be helpful in understanding the difference between a growth and a value stock.

Capital appreciation includes organic growth, which comes as outside investors purchase shares of company stock, and inorganic growth, as firms repurchase shares of their company stock.

Growth companies usually reinvest profits back into the business to help fund expansion and, therefore, pay little or no dividends. As a result, a growth investor would expect the lion's share of his or her total return to come from any capital appreciation:



Value companies, on the other hand, tend to be more established and, for one reason or another, are trading for less than their intrinsic value. Because they may have been around for a while, these companies are more likely to pay a dividend, so an investor would expect dividends to provide a greater portion of his or her total return:



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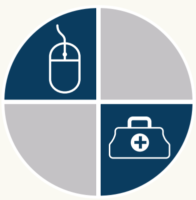
Growth vs. Value in Brief



Growth companies are typically associated with companies that are increasing revenue or earnings faster than the average company for their respective industry or the overall market. While many growth companies are younger and still expanding, there are mature companies that can be classified as growth-oriented when they experience growth from a new product cycle or favorable market, economic, or policy conditions. Although sectors do not normally fit perfectly into growth or value styles, some that lean in the growth direction are Technology and Health Care.

Value companies have been traditionally characterized as having higher dividends and cheaper valuations. In some cases they are considered "unloved stocks." Value is sometimes mistaken for just low-quality, out-of-favor stocks. We view value investing as reaching an investment decision by looking at the underlying value of the business and finding stocks trading for less than their intrinsic value. Two sectors that often lean in the value direction are Financial Services and Utilities.

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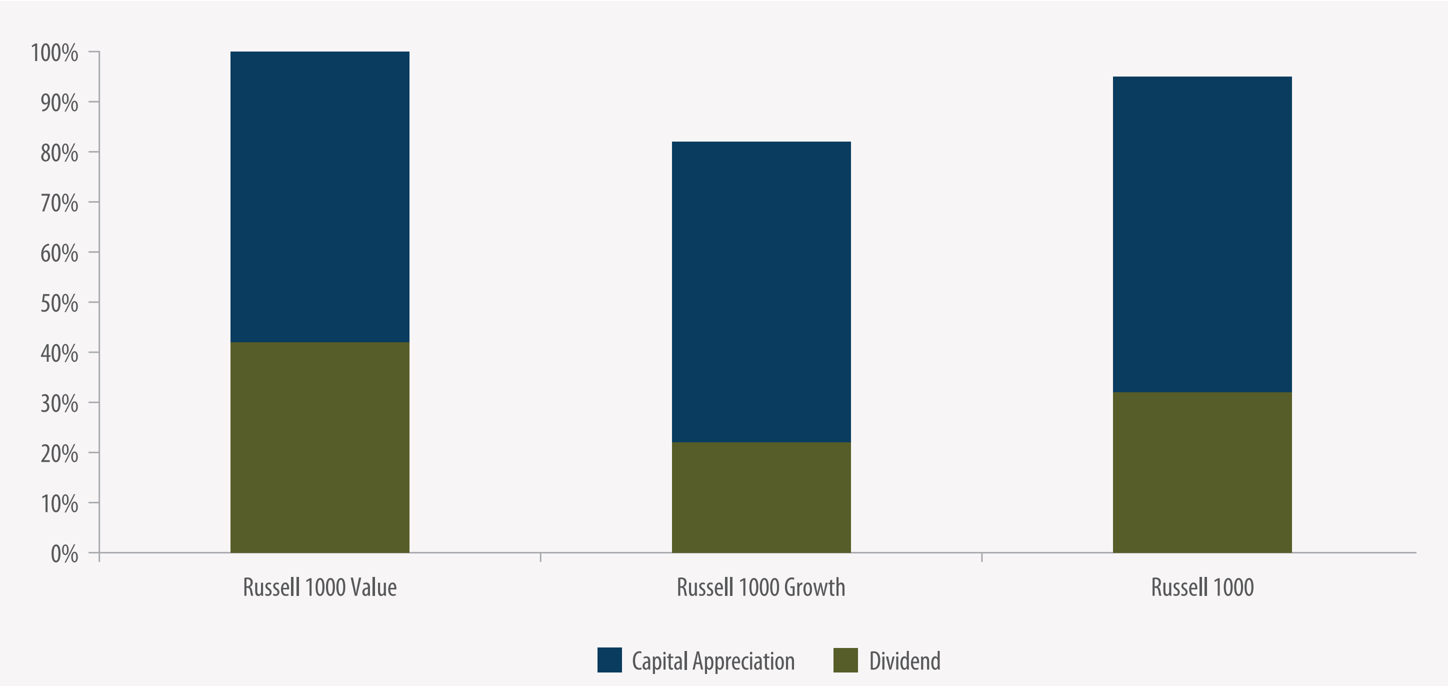
As the chart below shows, growth investors have been willing to accept a greater portion of their total returns in the form of (sometimes irregular) capital gains while value investors have usually received a greater share of their returns from (typically more regular) dividend payments.

Total Return Sources Have Varied Between Growth and Value

(1998–2018)



Source: Wells Fargo Investment Institute

For illustrative purposes only. Does not reflect the performance of any investment. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.

Is the Difference Important Over the Long Term?

In his 1992 Berkshire Hathaway shareholder letter, Warren Buffet had this to say about growth vs. value:

"In our opinion, the two approaches are joined at the hip: Growth is always a component in the calculation of value, constituting a variable whose importance can range from negligible to enormous and whose impact can be negative as well as positive."

After choosing to include stocks in a portfolio, an investor may consider several types of stocks. Global stocks can be classified in a variety of ways. At the highest level, they are typically defined by market capitalization and style (growth or value). Further classifications can include economic sector, industry, and dividend yield, to name just a few.

While our sector views may at times imply a bias toward growth or value, our view is that investors don't have to choose between one style or the other and, in many cases, they may benefit from a combination of the two. Value- and growth-oriented investments have had periods of wide dispersion—2018 was a prime example as growth stocks handily outperformed value, while in 2016, value outperformed growth.

Many indexes combine growth and value stocks. This strategy, called "blend" or "core," can exhibit characteristics of both styles of investing. Additionally, growth stocks can become value stocks, and vice versa, so funds that delineate between the two may trade more frequently than a blend or core fund.

Even over longer periods, as shown in the chart on page 3, value and growth alternate as performance leaders without one consistently overperforming the other.

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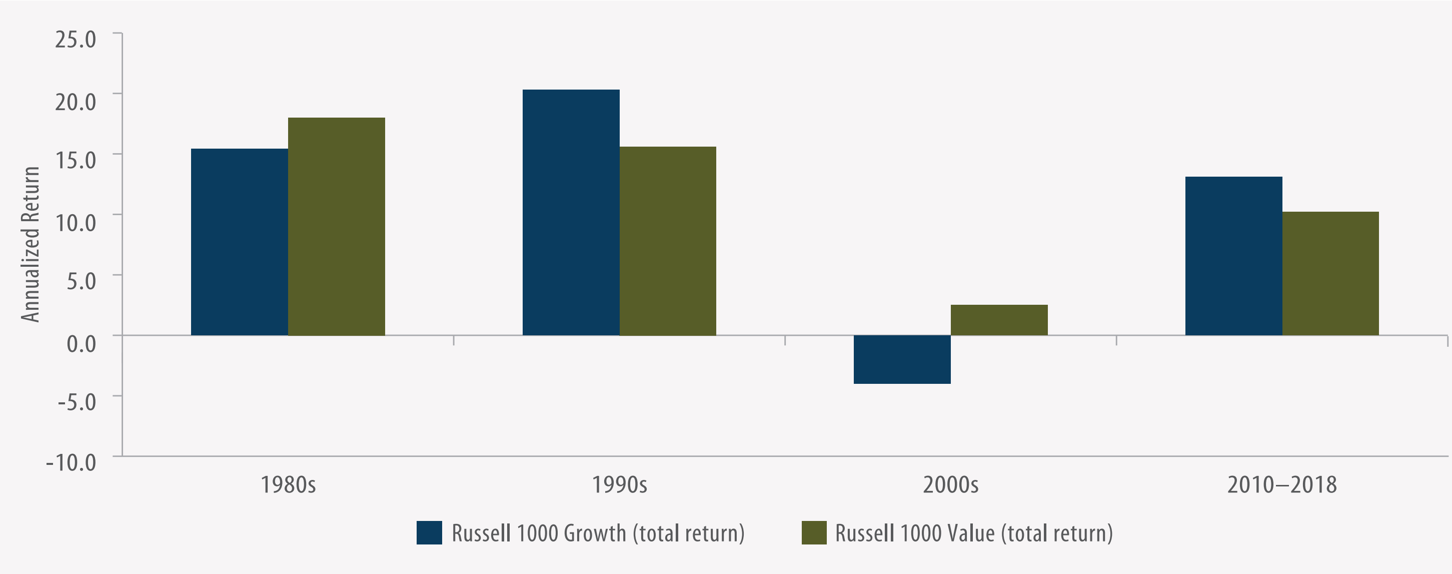
Performance by decade

Performance of Growth and Value Indices (1980–2018)



Source: Wells Fargo Investment Institute

For illustrative purposes only. Does not represent the performance of any investment. Returns assume the reinvestment of dividends and other distributions. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.

The table on the right shows growth and value exhibit high correlations to the core index, which suggests that there is little to no benefit over the strategic time period to classify as distinct strategic asset classes. Correlation is a statistical measure that describes the degree of association between two asset classes. Positively correlated investments tend to move in the same direction, while the opposite is true of negatively correlated investments. The closer a number in the table is to 1, the greater is the correlation.

Looking at Correlation Shows Similarity in Performance

*Growth and Value Indices vs. the Core Index (1998–2018)**

	Russell 1000 (core index)	Russell 1000 Growth	Russell 1000 Value
Russell 1000 (core index)	1.00	0.96	0.93
Russell 1000 Growth	0.96	1.00	0.80
Russell 1000 Value	0.93	0.80	1.00

* Correlation measures the degree to which asset classes move in sync; it does not measure the magnitude of that movement. Index correlations represent past performance. Past performance is no guarantee of future results. There is no guarantee that future correlations between indices will remain the same.

The Story Can Change for the Short Term

While we do not see a benefit in splitting equity allocations into growth and value styles over a strategic (10–15 year) time horizon, we believe tactical (6–18 months) and cyclical (3–5 years) opportunities sometimes exist in these categories. As a result, we provide guidance to investors interested in these time frames. Our central methodology for rating growth and value styles includes:

- Beginning with in-depth, long-term studies of economic changes over time
- Comparing the relationship of economic changes to the relative performance of growth and value stocks in the following period
- Using the relationships identified above and the most recent one-year changes in the key economic factors to estimate the attractiveness of one style vs. the other
- Using favorable, neutral, and unfavorable ratings to reflect the relative level of attraction toward a specific style (relative to the S&P 500 Index, which represents a blend of both styles)

To determine the ideal asset allocation (and equity exposure) to match your investment objectives, risk tolerance, and time horizon, please contact your Financial Advisor.

Risk Considerations

Equity securities are subject to market risk which means that their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Small and mid-sized company stocks involve greater risks than those customarily associated with larger companies. Growth stocks tend to fluctuate more than the overall stock market and growth may not be realized. There are no guarantees that value stocks will increase in value or that their intrinsic values will eventually be recognized. Dividends are subject to change or elimination and both the growth and value types of investing tend to shift in and out of favor and may be subject to style drift. Global/international investing entails special risks such as currency, political, economic, and market risks.

An index is unmanaged and not available for direct investment.

Russell 1000 Growth Index is a broadly diversified index predominantly made up of growth stocks of large U.S. companies.

Russell 1000 Index is a market capitalization-weighted index of approximately 1,000 of the largest companies in the U.S. equity markets.

Russell 1000 Value Index is a broadly diversified index predominantly made up of value stocks of large U.S. companies.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market. Returns assume reinvestment of dividends and capital gain distributions.

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