Thursday November 27th, 2014

Growth vs. Value

Among investors, there has been a perennial debate between those who adhere to Value, and those guided by Growth. As staunch believers in the former, we have opined on the topic several times in the past. While the merits of both philosophies can be debated at length, we think it is worthwhile to look at performance differences over the long term to gain a better perspective.

We are able to track the relative performance of Growth versus Value investing by comparing a pair of "style indices" called the Dow Jones Canada Select Indices. Both are well diversified and cover 90% of the Canadian stock universe, though only large-cap and mid-cap companies. To classify the companies into either of the two camps, Dow Jones considers their trailing price-to-earnings ratio, forward price-to-earnings ratio, trailing earnings growth, forward earnings growth, price-to-book ratio, and dividend yield.

Over the past year, it has been evident to many that Growth has outperformed Value, as illustrated in the table below. We generally expect that in strong markets, Growth-oriented investors will outperform those that take a Value approach, while the opposite should be true in normal and weak markets. Considering that the S&P/TSX has done well in the last twelve months, we are not surprised to see that Growth has shined: over the past year, Growth has generated a total return of 21.3%, compared to 10.7% and 13.7% for Value and the S&P/TSX Composite, respectively.

Total Returns	Dow Jones Canada Select Growth	Dow Jones Canada Select Value	S&P/TSX Composite
1 Month	1.3%	0.0%	1.0%
3 Months	1.5%	–3.7%	-2.2%
6 Months	7.9%	1.0%	0.2%
Year to Date	19.3%	7.7%	10.5%
1 Year	21.3%	10.7%	13.7%

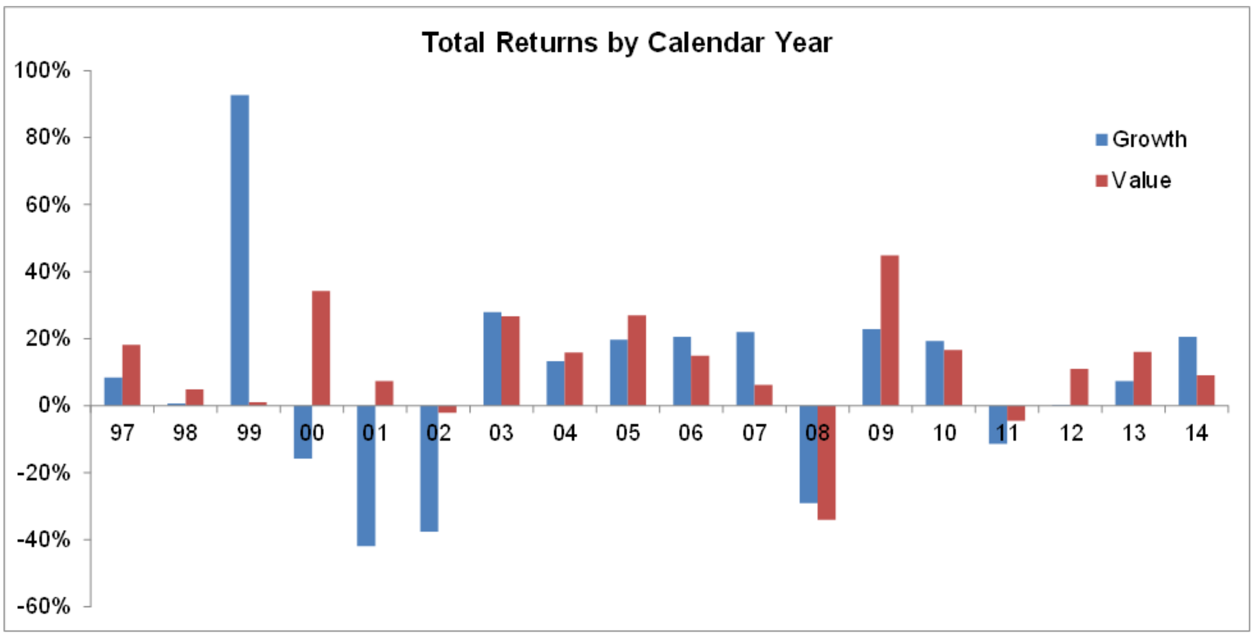
As at November 7, 2014

One of the core tenets of value investing is having a long-term horizon. It is a discipline that helps investors counteract (or ignore) short-term performance volatility. After all, it is not fleeting outperformance that defines a successful investor, rather it is the ability to create value over extended periods of time and differing economic conditions. When we evaluate the longer-term track record of the Canada Select twins, we start to see why this principle is an insightful one. As the returns below illustrate, Value has outperformed both Growth and the broader market (as measured by the S&P/TSX Composite) over the long term.

Total Returns *(Annualized)*	Dow Jones Canada Select Growth	Dow Jones Canada Select Value	S&P/TSX Composite
2 Years	12.4%	14.5%	13.0%
5 Years	7.1%	10.4%	8.5%
10 Years	7.9%	9.1%	7.8%
Since Inception*	3.9%	10.8%	7.2%

As at November 7, 2014
** Inception Date: June 30, 1997*

In fact, since the inception of these two style indices 17 years ago, Growth has generated a cumulative return of 93% (3.9% annualized) while Value has returned a staggering 496% (10.8% annualized)! For context, the S&P/TSX Composite returned 233% (7.2% annualized) over the same time frame. As seen in the chart below, there are pockets of time when Growth trumps Value, such as during the Dot-Com Bubble at the turn of the century. But, by and large, these periods never seem to sustain for longer than a year before Growth eventually relinquishes its lead.



Source: Bloomberg
Stub periods: 1997 (July 1 – December 31); 2014 (January 1 – November 7)

We think there is an important lesson to learn from this graph. It is apparent that the volatility in Growth investing is far more pronounced than that of Value. Impressive run-ups, such as the one in 1999, tend to be followed by multi-year declines. Value, on the other hand, tends to do a better job of protecting capital on the downside. Declines in the Value portfolio tend to be less frequent and smaller in amplitude.

Ultimately, this approach makes up a large part of our investment philosophy. We believe that by managing the volatility over the short term, we can achieve better long-term results for our clients. We are not looking for home runs, but rather safe, consistent singles and doubles. For our part, we will stick to what we do best, and what is tried and true. History has certainly shown this to be a prudent strategy.

Inevitably, the age-old debate will trudge on around us, but for patient, long-term investors like ourselves, our mandate is clear.

The Sionna Team

Sionna Investment Managers 8 King Street East, Suite 1600 Toronto, Ontario M5C 1B5
For further information, please email Kelly Battle at kelly_battle@sionna.ca or call (416) 203-2732