Segal Rogerscasey Canada

INVESTMENT Insight

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Growth vs. Value – Only a Part of the Story in Large Capitalization Equity Management

The concepts of growth and value have become widely accepted differentiators in the world of large capitalization equity management, with many investors having separate allocations to each as a central part of their structure. Importantly, however, we note that embedded in those broad descriptors are sub-styles that can have a substantial influence on results in the near term with the potential for unintended consequences for those unaware of these differences.

To demonstrate the impact of various sub-styles on performance, Segal Rogerscasey analyzed performance data for growth and value sub-styles over a 10-year period. This *Investment Insight* discusses the results of that analysis.

Relative Differences between Styles and Sub-Styles Examined

To analyze the relative performance of growth and value styles and sub-styles, we used the eVestment Alliance database for the trailing 10 years ending in 2012 as a representative sample. This database defines several sub-styles (described in the table below) and asset managers, then selects a sub-style most representative of the manager's approach.

We note here that there were several weaknesses in the data set. We looked at each year separately and linked them for this exercise, meaning that although there were 827 Large Cap managers in 2012, they were not in all cases the same managers evaluated in 2003. Survivorship bias could play a role. The database relies upon non-audited manager-provided returns. As indicated earlier, categorization of individual managers to specific sub-styles is determined by the manager and is not audited or verified. The database does not prohibit style selection changes nor does it quantitatively define styles based upon specific quantitative measures that could be applied to refine categorization. We would add, however, that there are no widely accepted

Investment Manager Growth vs. Value Sub-Styles

Style and Sub-Style	Description
Growth:	
Aggressive Growth	Stocks that have exhibited strong price momentum or growth. Stocks tend to be highly volatile, have high betas, and portfolio turnover tends to be high.
Traditional Growth	Stocks that have strong earnings growth prospects. Price is important, but a manager will "pay up" for a promising stock.
Growth at a Reasonable Price (GARP)	Stocks that are cheap relative to their earnings prospects. Earning growth is important, but so is price.
Value:	
Relative Value	Stocks that are cheap relative to industry peers or to that specific stock's history.
Traditional Value	Stocks that have been oversold relative to their intrinsic value and are considered cheap relative to their future prospects or assets.
Deep Value	Stocks that trade at deep discounts to any valuation metric, such as price to book or dividend yield. Stocks tend to be turnaround stories and may have limited liquidity.
Benchmark Driven/Core	Combination of value and growth stocks tend to be closer to the benchmark in terms of exposures.

Source: eVestment Alliance

definitions of these style characteristics and attempts at further quantification would also be subject to criticism. Despite these shortcomings, the significance of the variations is sufficiently illustrative for our purposes.

In Table 1, each sub-style is color-coded according to its position versus other styles during every year from 2003 to 2012, from darkest green, which represents the best-performing sub-style for the year, to darkest red, representing the worst performing sub-style.

Table 2 shows our calculations of Average Annualized Return, Standard Deviation[1] and Information Ratio (IR) using the S&P 500® Index as the base return. We chose the S&P as opposed to more factor-based comparisons because our objective was to deduce how styles rotate over time and how that might impact the volatility of a program built without consideration of sub-styles.

[1] Standard deviation is a measure of the distribution of results around the average (mean). In a normal distribution, one standard deviation above and below the mean includes about 67 percent of all samples.

Table 1: Relative Performance of Managers by Sub-Styles

Investment Style	Number of Managers 2012	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Aggressive Growth	49	15.12	(1.01)	17.93	33.67	(39.76)	18.56	6.81	9.34	9.89	33.68
Traditional Growth	178	15.78	0.28	17.37	35.39	(38.00)	15.33	9.68	8.27	11.28	30.09
Growth At Reasonable Price (GARP)	95	15.05	0.13	15.81	30.62	(34.61)	11.32	11.90	8.35	11.53	30.01
Benchmark Driven/Core	162	15.95	1.82	14.90	27.29	(35.25)	7.86	15.26	8.60	12.58	28.72
Relative Value	84	16.04	(0.36)	14.78	28.62	(35.55)	6.20	17.71	8.71	14.47	31.87
Traditional Value	148	15.73	1.29	15.45	29.51	(34.12)	4.44	18.60	8.15	16.25	32.82
Deep Value	111	15.56	0.38	15.22	26.80	(35.96)	3.34	19.90	8.56	16.00	31.87
	Highest to Lowest	0.99	2.83	3.15	8.59	5.64	15.22	13.09	1.19	6.36	4.96
	Agg Growth - Deep Value	(0.44)	(1.39)	2.72	6.87	(3.80)	15.22	(13.09)	0.78	(6.11)	1.81
	Trad Growth - Trad Value	0.06	(1.01)	1.91	5.89	(3.88)	10.89	(8.91)	0.12	(4.97)	(2.73)
	GARP - Relative Value	(0.99)	0.50	1.03	2.01	0.94	5.12	(5.81)	(0.36)	(2.94)	(1.85)
	S&P 500®	16	2.1	15.1	26.5	-37	5.5	15.8	4.9	10.9	28.7

Source: eVestment Alliance, Segal Rogerscasey analysis

Table 2: Statistical Analysis

Investment Style	Max	Min	Stand Dev	Annual Arithmetic Average Return	IR (Using Arithmetic)	Annual Geometric Average Return
Aggressive Growth	33.68	(39.76)	20.79	10.42	0.25	8.21
Traditional Growth	35.39	(38.00)	19.90	10.55	0.35	8.53
Growth At Reasonable Price (GARP)	30.62	(34.61)	18.20	10.01	0.40	8.35
Benchmark Driven/Core	28.72	(35.25)	17.84	9.77	0.66	8.14
Relative Value	31.87	(35.55)	18.74	10.25	0.71	8.48
Traditional Value	32.82	(34.12)	18.64	10.81	0.88	9.10
Deep Value	31.87	(35.96)	18.87	10.17	0.52	8.36
S&P 500®				8.85		7.11

Source: eVestment Alliance, Segal Rogerscasey analysis

Analysis

A number of interesting observations can be drawn from the data for the 10-year period examined.

First, it is quite clear that not only do Growth and Value rotate over time, but the sub-styles also alternate. In some cases, these differences are quite stark. For example, examine 2006 when the median Deep Value manager outperformed median Relative Value by over 200 basis points (bps) and then proceeded to give that advantage back plus more the following year. Similarly, in 2003 Aggressive Growth exceeded Traditional Growth by over 350 bps, gave almost 200 bps of that back in 2004, but surged ahead again in 2005. Actually, in those two growth categories there was a continuous back and forth that covered almost the entire decade (which is another argument for rebalancing, by the way). The take-away here is that investors should be keenly aware that simply owning "Growth" or "Value" in active portfolios only tells part of the story. Certainly all of the sub-styles tend to move with other similar styles, but some substantial differences occur along the way.

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A second observation was that style definitions were somewhat predictive of volatility. Aggressive Growth was most volatile and Deep Value was third most (Traditional Growth was second). Growth was generally more volatile than Value, and Core was the least volatile of all. This was further confirmed when examining the relative ranking of each style during each year, as Aggressive Growth placed first or second best in five of the 10 years studied, but was also ranked worst or second worst during the other five years.

"Style definitions were somewhat predictive of volatility."

We also note that the degree of difference between Growth and Value also changed significantly throughout this time frame. In 2012, for example, the difference between the best strategy and the worst was less than 100 bps. In 2006 and 2007, however, there was over 1300 bps and 1500 bps, respectively, between best and worst, with a dramatic reversal of fortunes for Value vs. Growth. Please note that this brief is not intended to address the age-old debate of the superiority of Growth vs. Value; while we will leave that for another time, we are of the view that both have a place for most investors.

Benchmarking Performance

After this examination of relative differences between the styles and sub-styles, we then considered the data in the context of the broad benchmark.

Of the Growth styles, the risk (defined as volatility relative to the index) versus return trade-off was best for GARP, but no Growth strategy had a superior IR when compared to any of the Value strategies (or Core). Traditional Value turned in the highest IR at 0.88, which is quite a contrast to Aggressive Growth at 0.25. When looking at the entire period and just focusing on returns, however, there were only modest differences between the sub-styles, with a slight nod to Value. It was the higher volatility that caused most of the Growth strategies, not surprisingly, to fall short in the risk/return space.

When looking at average annualized returns over the period, the median manager in each style classification exceeded the S&P 500®, but Traditional Value outperformed the others. On average, this was a good time period for active managers. It is notable that the superior result for Traditional Value was principally derived from getting out of the gate well (second and first relative place in 2003 and 2004, respectively), and modestly better downside protection in 2008 (best style) and second best return in 2011 when several styles were negative. Excess return for the active managers occurred very consistently: In seven out of the ten years, over 70 percent of the styles exceeded the S&P 500®. In 2003, 2004, 2005 and 2009, at least six out of seven styles exceeded the benchmark (seven out of seven for 2005 and 2009). GARP managers were most consistent on the Growth end, exceeding the benchmark 70 percent of the time, and Relative Value achieved this distinction in the Value camp, winning 70 percent plus one tie year.

After the auspicious beginning, 2011 and 2012 were a struggle for active managers. None of the seven styles significantly outperformed the index in either year, going 0 for 12 with two virtual ties.

Conclusion

Clearly, there is information embedded in the data that is explanatory in assessing the nature of the observations:

- When it is a good time to take risk, take it aggressively,
- Value tends to provide some element of downside protection in negative years, and
- Reversion to the mean may be the most powerful force in investing.

There are also some myths that are contradicted by these numbers:

- Active managers tend to underperform in roaring bull markets (look at both 2003 and 2009),
- Growth and Value are flip sides of the coin, and
- Greater risk (defined by larger standard deviation) begets higher returns.

"While the larger concepts of Growth and Value are dominant influences, sub-styles also play a significant role in determining an investor's outcome."

In the end, at least with this data set for this time frame, it is clear that while the larger concepts of Growth and Value are dominant influences, sub-styles also play a significant role in determining an investor's outcome. This certainly would seem to argue for those other powerful forces in investing — having a program that is diversified across styles and sub-styles, and rebalancing regularly. ■

Questions? Contact Us.

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