Value, Growth and Momentum

The oldest rule in investing is the simplest: Buy low; sell high. Over the last several years, that has been easier said than done. Brightworth takes a long-term disciplined approach to investing with an emphasis on managers who understand that longterm performance is determined by fundamentals of value, growth and time arbitrage.

*Value* investing starts with determining a security’s intrinsic value, buying it when the price is lower by a pre-determined margin, because eventually its price and value will merge. We recently spoke to this thesis at our annual investment summit [1]. *Growth* investing is different as it endeavors to find securities whose value will increase rapidly (future price) because the growth in company earnings is not baked into the current price. Thus the choice is not really between value and growth, but between value today and value tomorrow.

There is another form of investing called momentum. *Momentum* investing suggests that stocks whose prices have increased for a period of time will continue to increase. The question is, how much longer? Momentum does not require analysis regarding the present or future value of a particular stock.

Historically there have been times when stock market valuations depart from the fundamentals of value and growth. When that happens, investors need to be careful to avoid buying into the excesses and also to look for the opportunities that mispricing creates. An extreme example of this phenomenon occurred in the late 1990s when technology and
internet stocks skyrocketed. Value investors, were ridiculed for not participating. Many active
money managers (including Warren Buffett) underperformed the broad stock market for
several years because they would not buy stocks that they thought were either significantly
overpriced or could not be properly valued. We all know the rest of the story and how a
disciplined approach paid off over time.

In 2011 we saw a similar phenomenon as a small number of companies drove the returns of
the indices. For example, in the S&P 500 Index the top 30 contributors were up 19.3 percent.
If you remove these 30 stocks, the other 470 stocks of the index were down -5.1 percent. Last
year investors sought what they perceived to be the safest and most stable stocks (and a few
hyper growth stocks like Apple). Companies with the largest market caps and the highest
dividend yields generally performed well, while virtually all other stocks lagged. It is interesting
that investors would bid up the prices of utility stocks, some of the most regulated companies,
with the least upside potential to grow when the economy turns. During times like last year
when a small number of the largest stocks drive the market weighted indices, active
managers will often lag. A capitalization weighted index like the S&P 500 (where the largest
stock is about 4 percent and the largest 10 stocks make up 20 percent of the total) is by
definition impacted the most when momentum for the largest stocks is strong. Active
managers purposefully do not emulate the broad market. By strategically buying solid stocks
at good prices that are not part of the current herd mentality, disciplined active managers are
able to position their portfolios to take advantage of the dislocations between price and value
and allow time arbitrage to work.

During stressful periods, investors from time to time will cause the market to temporarily
“forget” the fundamentals. When emotions are high, making rational decisions becomes
harder. This is especially true when many of those investors still vividly remember the volatility
they experienced in 2008 and early 2009, and the losses they locked in by panicking and
selling near the bottom. At Brightworth, our diversified, disciplined approach continues to be
an effective osture, buffering our clients from making big mistakes. After all, investment
success doesn’t come from “buying good things,” but rather from “buying things well.”

1 The Most Important Thing, Howard Marks

Authors:
rpadron
Categories:
Having the retirement that I want [2]
Corporate Professionals/Executives [3]
Making the most of my working years [4]
Professional specialists/service providers [5]
Business Owners [6]
Read More [7]

Source URL: https://www.brightworth.com/insights-news/value-growth-and-momentum

Links
[5] https://www.brightworth.com/categories/professional-specialistsservice-providers