

INVESTMENT UPDATE: YOU'VE EITHER GOT OR YOU HAVEN'T GOT STYLE

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As Frank Sinatra sang, *'you've either got or you haven't got style'*. We would argue that the vast majority of successful investors definitely have it.

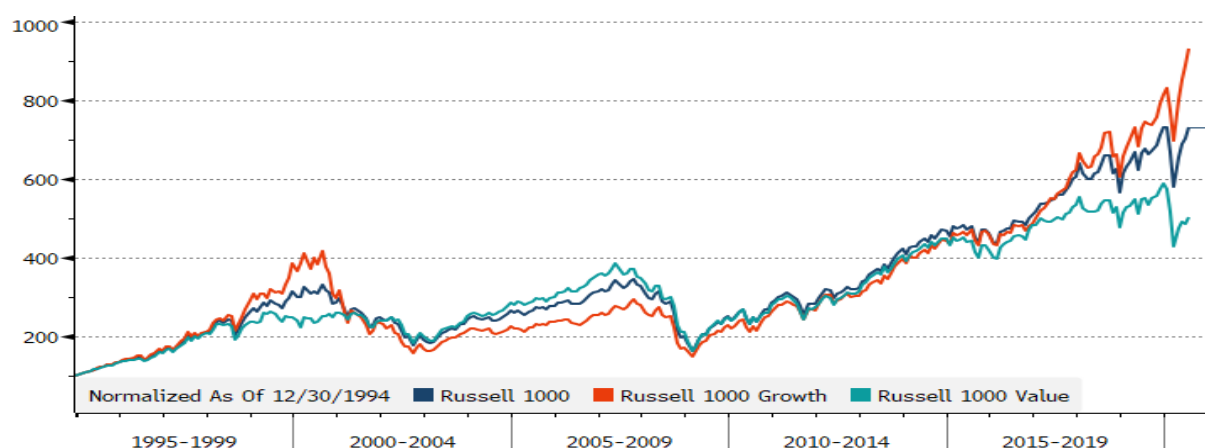
Just as in other walks of life, there are plenty of styles for investors to choose from. The most common are 'growth' and 'value'.

Growth investors target companies they believe can expand rapidly, generating abnormally high profits as they do so. Growth investors are interested in what the company may look like in the future, and – if the prospects are encouraging – are typically not overly concerned with the price that has to be paid today to access that potential. To oversimplify, investors who have a growth style are looking for The Next Big Thing.

In contrast, value investors believe that the price you pay is the key determinant of investment success. Everything has a price, they argue, from the fastest growing companies to those that are struggling. Value investors believe that a good company is not necessarily a good investment: you cannot expect to make money on your investment if you pay more than the company is worth. Investors with a value style are often 'anti fashion' – they have to be willing to go against the herd to find companies that are misunderstood and undervalued.

There are merits to both approaches. The important thing is that, as an investor, you know the style that suits you. The reason for this is perhaps a little philosophical, but its importance is difficult to overstate. It is not enough to buy a stock because you think it is going to go up – to tilt the odds in your favour, you have to have a theory about *why* it should go up. Style is fundamental to developing a robust, repeatable and successful process to answer this question. Investment history is littered with successful investors: whether growth, value or something else, these investors are united by the clarity and consistency of their processes.

Once we understand the importance of style, we can begin to look beyond the ups and downs of headline stock market indices. Most indices contain some stocks that will appeal to growth investors and others that will appeal to value investors. These stocks can be grouped into style-based sub-indices. Looking at these sub-indices shows us that the returns generated by growth or value investors at any given time can be very different from those generated by the market as a whole. Though value has beaten growth over the very long term, as shown by the chart below (which shows indices for US stocks), there are times when growth performs better than value, and times when value performs better than growth.



Source: Bloomberg as at 16 July 2020

The chart also makes clear that the past decade has been one in which growth has performed very much better than value. The extent of this outperformance is extraordinary. The last time growth outperformed to this extent was during the dot com bubble of the late nineties and early noughties when a speculative frenzy drove up the share prices of companies leveraging a nascent technology called the internet.

That's good news if you invested in growth stocks ten years ago, but it should raise a warning flag if you're considering adopting the style today. Though growth is an attractive quality in a company, we believe there comes a time when the price that has to be paid for it can no longer be justified. It is possible that this time is approaching. Measured on a range of indicators, growth stocks now appear very expensive, both in absolute terms and relative to their value counterparts.

The experience of long-term Amazon investors illustrates the potential consequences of investing in expensive growth stocks at the wrong time. Even though it has gone on to become one of the largest companies in the world, rewarding investors with exceptional returns, those who bought shares before the dot com bubble burst had to endure a 94% fall in the share price between December 1999 and September 2001 and would not have broken even until October 2009. Since then, it has been onwards and upwards, and even those investors who bought at the peak in 1999 – and, crucially, who held on through the subsequent collapse – have more than doubled their money.

But how many had the necessary resolve to hold on? Research by RWC Partners shows that, on average, while a common trait of all investors, growth investors have a particularly unfortunate habit of buying after good performance and selling after bad – in other words, buying high and selling low. This is an important reminder of the dramatic impact emotions can have on investment outcomes. It goes without saying that chasing trends, buying high and selling low, is not the foundation of a successful approach to investing.

Just as growth investors might have been sorely tempted by a style makeover in 2001, after a decade of underperformance value investors are currently under a great deal of pressure. Even the tried-and-tested approach of Warren Buffet, the extraordinarily successful US value investor, has recently been called into question.

As ever, it doesn't take long to find a suitable response from among Buffet's many aphorisms and anecdotes: he recalls the story of Wayne Gretzky, arguably the greatest ice hockey player of all time, who was advised by his father to skate to where the puck is going, not to where it has been.

Growth investing has delivered impressive returns over the last ten years, but history tells us that this run of success won't continue indefinitely. Conditions will, at some point, turn in favour of value investing. Though the extreme difference in the valuation of growth and value stocks suggests this point *should* be near, it is impossible to say so with certainty.

That is why we believe it is important to invest in a diversified portfolio of funds, each managed by an individual or a team who has got style, and who knows it. In our view, such managers have the conviction and discipline necessary to ensure that, when conditions favour their approach, they will be well-placed to reap the rewards. Meanwhile, having exposure to a range of styles should increase the chances that at least part of your portfolio is enjoying the limelight at any given time. Armed with a well-diversified portfolio, you should find yourself participating in trends as they emerge, rather than forever chasing the latest fad, and that this holds the key to superior investment returns. Ultimately, we believe having style and sticking with it gives you the best chance of earning consistent, strong long-term returns, whatever the current fashion.

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