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The Growth vs. Value Conundrum in 2024

Choice between value and growth as interest rates decline is not clear-cut.

In the world of investing, the eternal debate between growth and value continues to captivate the minds of investors. As we navigate through 2024, the question looms large: Will growth once again reign supreme over value, especially in the backdrop of the widely anticipated decline in interest rates? The answer, it seems, lies in the peculiar turn of events witnessed in 2023.

VALUE AND GROWTH DEFINED

Investors have long held distinct definitions for value and growth stocks. Value stocks are typically characterized by well-established companies with stable profits, trading at a discount to their intrinsic worth. These companies often boast reliable, sustainable business models, frequently paying dividends due to their consistent cash flows. Think banks, healthcare companies, and industrials.

On the flip side, growth stocks are perceived as entities with the potential to outperform the market in the future, even if they may currently be unprofitable or expensive. These stocks are riskier and more volatile, with a focus on innovation and future growth prospects. Think Information Technology and Consumer Discretionary.

WHEN RATES RISE OR DECLINE?

One prevailing theory that has shaped investor sentiment is the notion that rising interest rates are detrimental to growth stocks (relative to value stocks). The rationale behind this is rooted in the calculation of stock prices, which factor in the present value of future earnings. This calculation relies, in part, on interest rates to discount those future earnings to their present value. As interest rates rise, the present value of future earnings decreases, impacting growth stock prices more negatively.

The corollary to that theory is that value stocks (versus growth stocks) are more resilient during periods of declining rates. Why? Well, the theory goes that companies with established track records of profitability, solid fundamentals, and dividend payments have predictable cash flows and may benefit from lower borrowing costs, potentially enhancing their financial performance.

NOT TRUE IN 2023

However, the events of 2023 threw a curveball at this established theory. Despite a continuous increase in interest rates throughout the year, US growth stocks experienced significant outperformance versus US Value Stocks. In fact, the S&P 500 Growth Index, dominated by tech-heavy companies, outpaced its Value Index counterpart by a notable 7.82 percentage points, dividends included. This stark contrast to the expected performance during a period of rising interest rates raises the pivotal question: Was growth's outperformance an exception or a new norm?

The intrigue deepens when we consider the anticipated decline in interest rates for 2024. According to conventional wisdom, this should herald another favorable year for growth stocks relative to value. Yet, the lessons from 2023 remind us that markets are unpredictable, and historical patterns may not always hold.

THE MAGNIFICENT 7

Enter the "Magnificent 7" — industry giants Amazon, Apple, Alphabet, Meta, Microsoft, NVIDIA, and Tesla. In 2023, these behemoths played a significant role in concentrated market leadership, contributing to 90% of the S&P 500 gains by the year's midpoint. The dominance of these tech giants challenges traditional sector diversification strategies and raises questions about the sustainability of such concentrated market leadership.

THE RESILIENCE OF STOCKS

However, the landscape is far from one-dimensional. Growth stocks have displayed remarkable resilience in the face of both rising and declining interest rates. Traditionally perceived as more vulnerable during periods of rate hikes, the events of 2023 challenged

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"Don't look for the needle in the haystack. Just buy the haystack!"

- JOHN BOGLE

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this perception. The focus on future growth prospects and a willingness among investors to tolerate higher valuations have positioned growth stocks as dynamic assets that can adapt and flourish, even when faced with headwinds such as rising interest rates.

Similarly, value stocks have proven their resilience in both rising and declining interest rate environments. During periods of rising rates, well-established companies with stable profits, often found in the value category, have demonstrated their ability to navigate economic challenges. Further, during times of declining interest rates, value stocks can benefit from lower borrowing costs, potentially enhancing their financial performance. The focus on intrinsic value and consistent dividend payments can make value stocks an attractive choice for investors seeking stability and a reliable income stream, highlighting their ability to adapt to various economic scenarios.

STRIKING A BALANCE

As investors navigate the complex terrain of declining interest rates, the key lies in striking a balance. Diversification remains a cornerstone of sound investment strategy. A well-balanced portfolio that combines both value and growth stocks can help mitigate risks and capitalize on opportunities across different market conditions.

The reality is that the debate between value and growth investing in a declining interest rate environment is not a clear-cut choice. The lessons from history remind us to approach market dynamics with flexibility and an open mind. Ultimately, the best strategy may lie in a nuanced approach that considers the unique strengths and potential pitfalls of both value and growth investing in the ever-changing financial landscape.

The market performance witnessed in 2023 prompts us to approach 2024 with cautious optimism, recognizing that the market's twists and turns may defy conventional wisdom. As we grapple with these uncertainties, one thing is certain — the world of investing is a fascinating journey where adaptability and a keen eye for emerging trends are the keys to success.

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