Quilter Investors

# Value leaves growth in the dust in 2022

*As CJ Cowan observes, the record-breaking outperformance of 'value' over 'growth' in 2022 provides a vivid illustration of what drives the different approaches along with something of a roadmap for 2023.*

## Value trumps growth in 2022

1

**Record outperformance of value in 2022**

The MSCI World Value Index delivered 6.1% in 2022, outperforming the MSCI World Growth Index by a record-breaking 26.2%.

The last time value stocks outperformed to this extent was during the dot-com crash in 2000. Back then, Amazon's share price fell 80%, making last year's 50% drop look tame.

2

**Understanding the difference**

Company shares are valued based on their future earnings converted into today's terms. Growth stocks are expected to grow their earnings at a rapid pace meaning a large proportion of their earnings potential lies in the future. Growth stocks are most commonly found in the technology sectors but they can reside anywhere.

By contrast, 'value' stocks tend to be in more mature industries. Having already passed their initial growth phase and invested in the infrastructure they need to operate, they're more focused on cash generation and paying attractive dividends to their investors.

Value stocks prospered in 2022, thanks greatly to oil, commodity, defence, energy and banking stocks, all classic value areas that pay generous dividends.

3

**Silver lining for UK investors**

For much of the last decade, the FTSE 100 Index (an index of the 100 largest companies listed on the London Stock Exchange) was criticised for being dominated by 'old economy' stocks. This made it by far the most value-biased regional index, the opposite of the growth-biased US market where global technology giants dominate.

This weakness became a strength in 2022 when the FTSE 100 Index was the world's top-performing major equity index, with a gain of 4.7%.

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CJ Cowan, Portfolio Manager

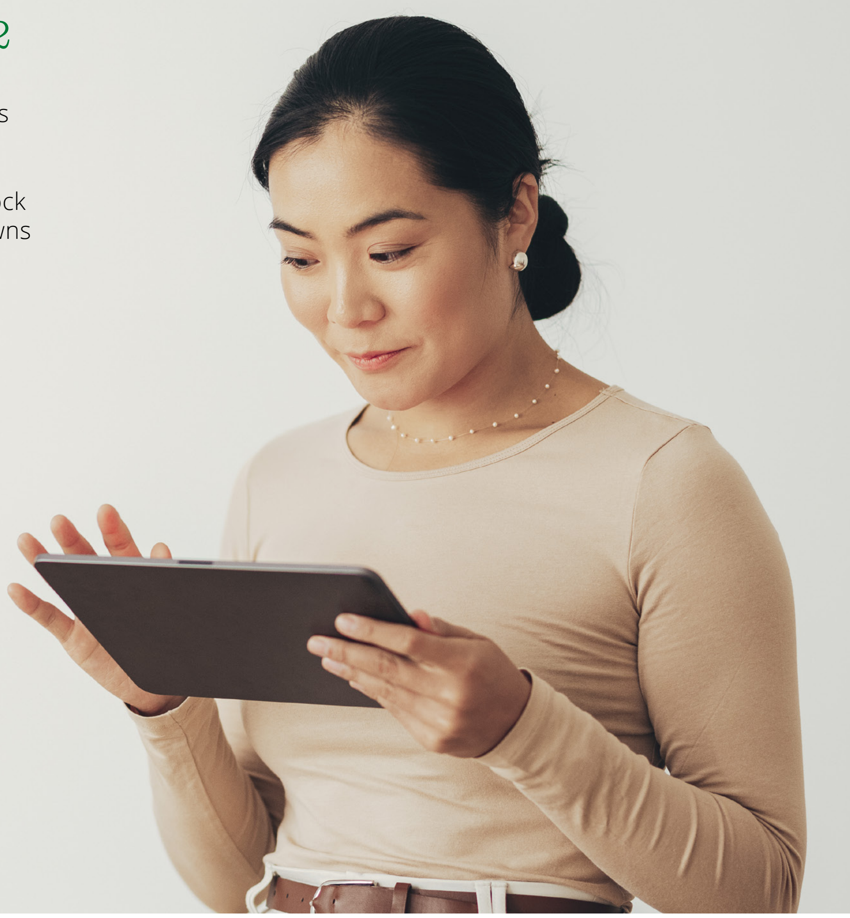
## Chickens come home to roost in 2022

A number of factors contributed to the record-breaking outperformance of value over growth in 2022. Not least was the pronounced outperformance of technology (or growth) stocks in the years prior. This was largely driven by the ultra-low interest rate environment, which saw investors flock to longer-term growth stories. The advent of global lockdowns then provided another huge boost for 'stay-at-home' technology stocks.

Consequently, 2020 proved to be the lowest point for value stocks; they suffered record underperformance relative to growth stocks as technology stocks led the US market rebound from its pandemic-induced crash in March.

Technology stocks were once again among the market leaders in 2021, helping the MSCI USA Index to deliver 28%, although the market rally was more broad-based than in previous years, enabling value to narrowly outperform growth in 2021.

As 2022 unfolded, rising inflation was compounded by the Russian invasion of Ukraine, which drove food and energy prices still higher. This resulted in the most aggressive interest-rate hikes since the 1980s, pulling the rug from beneath growth stocks.



## Tipping the apple cart

There are two things that derail valuations for growth stocks and both occurred in 2022, leading to the record outperformance of value over growth during the year.

The first is a rise in interest rates and, as in the case of 2022, a meteoric rise in inflation. This is because the future earnings that underpin the valuations of growth stocks when inflation is subdued and the cost of borrowing is virtually nil, suddenly become a lot less valuable when inflation and interest rates are galloping higher. The same rising interest rates also result in rising, risk-free returns on cash, which reduces the appeal of more speculative investments that might pay-off in the future.

The second thing that causes growth stocks to decline, is a major change in their expected profits growth due to industry changes or a change in the economic backdrop. This came to pass for the 'stay-at-home' technology stocks that had boomed in 2020 as the post-covid re-opening of economies reversed the direction of travel for many. Meanwhile, a clampdown by the Chinese government in the same year derailed China's entire technology sector.

## Signs of growth

Although 2022 was a tough year for technology stocks, resulting in a major re-pricing of value relative to growth, we're already starting to see signs of growth stocks creeping back as the market narrative has changed from fears of rising interest rates to the hope that inflation has now peaked in the West. This means that the time for central banks to 'pivot' from raising interest rates to combat inflation, to reducing them to support the economy, could be that much closer.

Even so, higher interest rates are here to stay for the time being, certainly until central bankers are convinced the inflation 'genie' is back in the bottle. This means that in today's challenging economic environment, the predictable cashflows offered by higher-quality, income-generating value stocks will continue to be highly prized by investors.

### *Key takeaways*

- Value stocks outperformed growth stocks by a record-breaking amount in 2022.
- Rising interest rates and major changes to expected profits both impacted growth stocks last year.
- Growth stocks should do better when central banks start reducing interest rates to support the economy.

## *Important information*



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