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Growth vs. Value – Which Stocks Outperform?

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Value stocks are those with relatively 'cheap' valuations from the perspective of price to earnings or other measures. For example, if the stock market is trading at 20 times earnings and a stock is trading at 15 times, it would be considered value. Conversely, growth stocks trade at higher valuations due to investor expectations that earnings will grow at a faster rate than the overall market (technology, biotechnology, etc.). The chart below comes from National Bank's Technical Analyst, Dennis Mark, and shows the ratio of the NASDAQ (growth stock index) to the Dow Jones (value stock index). The sharp drop on the left corresponds to the bursting of the dotcom bubble ~23 years ago – notice the NASDAQ has outperformed the Dow Jones since then with extreme outperformance during COVID (2019 – 22). The fundamental factor driving this outperformance was historically low interest rates.

Interest rates are used by the market to discount a company's future earnings – as rates approached 0% during COVID, investors paid more for companies that may have earnings at some point in the future. This trend reached extremes during the pandemic with investors bidding up speculative stocks to irrational levels (meme stocks, stocks without earnings, etc.). Rising interest rates popped the speculative COVID bubble (just like they popped the dotcom bubble) and created an environment where value stocks are outperforming growth stocks for the first time in ~20 years. How long will it last? History has shown that investing-style periods (value vs. growth) occur over many years and we've recently emerged from a 20-year cycle that favored growth stocks.

Source: NBF, REFINITIV

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