VALUE VERSUS GROWTH

By William H. Gross | July 30, 2024

A game of Monopoly in Deer Valley, Utah, decades ago taught my family much about me and, in turn, taught me about myself and the game of high finance in the real world. As I crushed them one by one, I became a “Bad Dad”, at least for the night because of my hoots and hollering as the dice led them to bankruptcy and I to the crown. “Monopoly King” for the night led to the “Bond King” much later based on its lessons.

Actually, the rules are quite simple. Early in the game property is King and toward the end cash sits on the throne. Changing the mix at the right time makes all the difference. Buying the right properties is important although not critical. Orange surprisingly is the best investment while the blues with Park Place alluringly seem a must to buy if available. Not so. In the investment world growth versus value seems a similarly obvious choice but in the long term they are not either, shown by the classic study available in my “Ibbotson Classic Yearbook” (1927-2014). Value -- defined by stocks with a low book-to-market ratio -- handily beats growth by a minimum of 4% on average annually over the period, although surprisingly with a higher standard deviation. In today’s world, think Verizon versus the Magnificent Seven decades forward. It’s basically the same as buying healthy stocks with low P/Es, versus overpaying for growth with multiples 2 and 3 times greater. Reflect on Cisco in 1999/2000, now flat for 25 years versus 5X appreciation (plus dividends) for Coke over the same time period. You can cherry-pick exceptions but the initial valuation plus higher dividends for value stocks, dominates low but increasing dividends for growth. Apple puts all stocks to shame over the same period but then there are few Apples in the market basket. Monopoly makes a great time–honored point about the importance of diversification by owning orange/red/even railroad properties that have high rents and throw off cash during periods of unlucky rolling.

Monopoly also teaches today's investors about our financial system. Passing go and collecting $200 is much the same as the Fed increasing the money supply and total credit over time. Because Monopoly's rules cannot raise the $200 amount, it is much like a central bank employing the gold standard. And because this is so, the game eventually ends with a monopolistic winner. Today, the Fed and other central banks create whatever credit is required to keep the game going. Too much credit creation, however, creates inflation. While Milton Friedman was correct by asserting that inflation is always and everywhere a monetary phenomenon, his problem in the ensuing years was defining money. It was not just M1, M2, or M3 but credit hidden in the shadow banking system --increasing annually near double digits over the many years since 1971 after Nixon's abrogation of the gold standard.

There are many other lessons on that Monopoly board but no space in this Outlook to detail them. One caveat though: if in fact artificial intelligence-related companies can elevate U.S. productivity from its 1-2% historical standard over past decades to 2-3%, then growth versus value can shine. That's a bet though, proving that diversification in value stocks has a place in almost all portfolios. The last few weeks -- short term as it is -- have begun to prove the point.

My value stocks include Verizon, Energy Transfer (ET) and selected regional banks (TFC, KEY, CFG). Tobacco stocks have caught a bid as well but are cyclically expensive for now. Best of luck in your portfolios -- remember value beats growth over the long term unless AI creates a new productivity epoch. You should own some of value and some of growth. There should not be a monopoly of either.