Value vs. Growth

EDGE is an independent financial firm whose objective advice helps individuals and institutions realize their goals in the areas of investment management and corporate finance. The Edge Research Team's thoughtful and timely reports are based on extensive independent research and analysis of firms, financial developments, and macroeconomic trends.

EDGE Capital Partners
1380 W. Paces Ferry Road
Suite 1000
Atlanta, GA 30327
404.890.7707

AUTHOR
Harry Jones

RESEARCH TEAM
Whit Davis
Stephen Halkos
Howell Hollis
Harry Jones
Brendan Keelan
Elizabeth Mackie, CPA
Jacobi Padgett
Dennis Sabo, CFA
Will Skeean, CFA

Introduction:

At Edge, we are long-term focused and valuation driven in our investment philosophy. Our investment process is focused on fundamentals and forward looking valuation – the price paid for an asset is the primary determinant of future return. Within equities, our focus is no different. We pay attention to quality and fundamentals, but we strive to *avoid* geographies, sectors, and companies priced for perfection.

There is much debate on investment styles of equity managers as whether one should be categorized as value or growth. A value investor could argue Apple is a value stock because it trades at 12x earnings, much less than the market. A growth investor could argue Apple is a growth stock because it has grown earnings at a 25% annualized rate over the last three years, much more than the market. That being said, if Edge was forced to put its equity philosophy in a bucket, we would have to choose value.

While 2015 thus far has been challenging for all equity investors, it has been particularly painful for value investors. We illustrate below a sampling of value and quality vs. growth through various U.S. equity indices as of the August 25th close. On average, growth is outperforming value this year by 7.3% which is a primary factor for why growth has outperformed value in the last 3 years by a 4.4% *annualized* rate.

Value vs. Growth

Category	Index	Performance - Total Return YTD	Trailing 3 Years*	Valuation vs. Expected EPS Growth 2015 Est P/E	2016 Est P/E	Implied Growth
Quality	Dow Jones Industrial Average	-10.6%	8.6%	14.4	13.2	9.1%
Value	Russell 1000 Value (Large Cap)	-11.4%	11.6%	14.8	13.4	10.4%
Value	Russell 2000 Value (Small Cap)	-11.6%	9.9%	17.7	15.9	11.3%
	Average:	**-11.2%**	**10.0%**	**15.6**	**14.2**	**10.3%**
Growth	NASDAQ Composite	-4.0%	15.2%	19.9	17.4	14.4%
Growth	Russell 1000 Growth (Large Cap)	-4.1%	13.3%	18.3	16.4	11.6%
Growth	Russell 2000 Growth (Small Cap)	-3.6%	14.9%	36.6	26.5	38.1%
	Average:	**-3.9%**	**14.5%**	**24.9**	**20.1**	**21.4%**
	Growth Less Value	**7.3%**	**4.4%**	**9.3**	**5.9**	**11.1%**

*Annualized

Source: Bloomberg

Currency headwinds from the ongoing appreciation of the dollar have been significant, which is why such a high quality index like the Dow Jones Industrial Average (DJIA) has been such a poor performer. Only four of its thirty companies have less than 10% of its sales outside the U.S. (Verizon, Home Depot, UnitedHealth, and Travelers). Meanwhile, from a price to earnings perspective, the market is now paying on average nine turns more for growth than value, as the implied expected growth rate for growth stocks is double the growth rate of value stocks in 2016.

It is worth mentioning the valuations and fundamentals of a select group of the largest contributors to the NASDAQ vs. a select group of the largest detractors to the DJIA thus far in 2015. Three of the five largest contributors to the NASDAQ this year are Amazon.com, Facebook, and Netflix. Three of the five largest detractors to the DJIA are Wal-Mart, Apple, and Procter & Gamble.

Value vs. Growth

	Growth			Quality/Value		
($'s in millions)	Amazon	Facebook	Netflix	Wal-Mart	Apple	P&G
Revenues	$95,809	$14,639	$6,112	$485,621	$224,337	$76,885
Net Income	($188)	$2,722	$193	$15,493	$50,737	$6,770
Market Cap	$229,178	$240,453	$44,902	$205,793	$613,898	$189,879
P/E Ratio	N/A	87.1	238.2	13.2	12.4	17.4
P/S Ratio	2.4	16.4	7.3	0.4	2.7	2.5
YTD Performance	59.3%	9.8%	117.6%	-25.5%	-2.5%	-23.2%

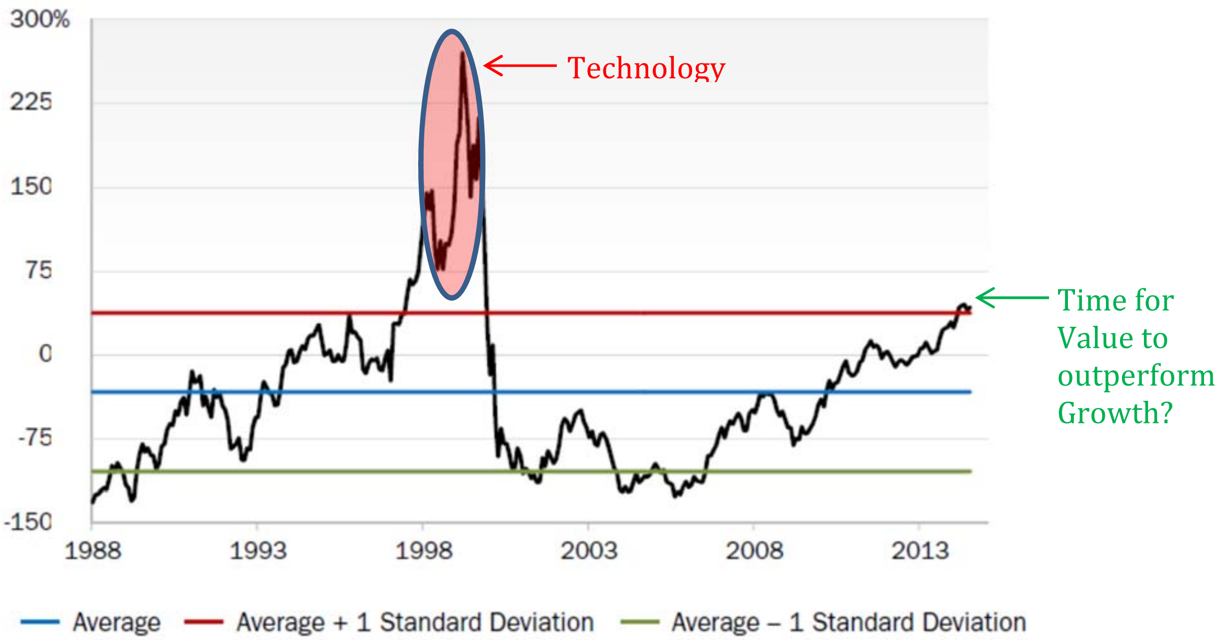
Source: Bloomberg as of 8/26/15 (LTM for Revenues and Net Income as of June 30, 2015)

This exercise is not to pick on these companies. The three growth companies have outstanding growth and are disruptive. Two of the three value companies have slow growth and could be disrupted. The point is to demonstrate the difference in price paid for six high profile companies. In particular, the market capitalizations for Amazon, Facebook, Wal-Mart, and Procter & Gamble are similar; yet the combined profits of Wal-Mart and Procter & Gamble are nearly $20 billion or 9x greater than the combined profits of Amazon and Facebook.

We close with a reminder of the last time we saw the relative performance of growth vs. value exceed a one standard deviation event using ten year rolling returns. It was between 1998 and 2001. Using the NASDAQ composite as a proxy, it took investors who bought at the peak of the bubble 14 years to breakeven.

Value vs. Growth

Russell 3000 **Growth** Less Russell 3000 **Value**: 10YR Rolling Returns as of June 30, 2015



Source: Heartland Advisors