

Growth and value investing in share market

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ABSTRACT

Many investors lose sight of what a stock truly represents. Stock is expressed in price. But beyond that it represents a business with assets, earnings and quality of management. Growth and value investing are the two concepts in investment in the share market.

Key words : Growth investing, value investing, intrinsic value of share.

Many investors lose sight of what a stock truly represents. Though it has some price in the market it represents a business with assets, earnings, liabilities and management in a dynamic environment.

The share price is the most visible component of the company. When the market exhibits a different value which is divergent from the investors perception of the underlying business worth, there is an opportunity for investment.

Growth and value investing are the basic concepts in the wonderland of investment in the share market. Let us compare two situations.

Case I : Actor A, a promising new comer with a couple of recent big hits and current toast of the town.

Case II : Actor B, an accomplished and established actor having a bad run at the box office but whose chances of coming back bouncing are quite bright.

Which actor would you bet on to so that next movie will be a hit?

If you choose Actor A then you would belong to growth group Value investors would have likely selected Actor B, the growth group believes that the new actor is promising and continues to deliver new hits in the future. However the value camp believes that the tough times of the accomplished actor are temporary and there may be turnaround soon.

If we come to the pricing of the above actors, Actor A is able to command a high price because of his hit movies where as B's pricing power would have suffered because of his flop movies.

The above analogy can be used to explain concept of growth and value investing in stock markets.

Potential star (Growth) concept.

Growth investors prefer stocks with high growth potential and they are ready to pay high price. Such stocks have above average sales and earnings growth rates which are likely to continue in future. Let us analyze why they are likely to grow in future. The growth may be due to technological innovations and demographic advantages like huge number of potential consumers. For example because of recession in developed markets many international investors have turned their eyes towards emerging economies like India.

Growth stocks are recognized by high price to earnings and price to book value ratios and such companies also likely to plough back their earnings for their future growth. Such companies will have low dividend yield ratios.

Examples of growth stocks may include new private sector bank stocks such as Kotak Mahindra. These have gained above average returns in the last few years and also have higher valuation compared to others.

Value concept.

However value investors invest in fundamentally good stocks whose market prices are less than their intrinsic value. It means stocks with good track records are available at a lesser price than their real value as perceived by investor would be good buys. This type of investor believes that price declines are temporary and these stocks have the potential to come back after sometime such stocks have relatively healthy earnings potential which are underestimated by the market as they have fallen out of favour.

However intrinsic value calculation can be subjective. It may differ from investor to investor. So investor has to be careful and add some margin of safety. Because market under prices the value stocks compared to their fundamentals these are characterized by low price to earnings. However such companies have stable earnings and generally pay good dividends.

Several public sector banks in India can be taken in this category. These are traded at a discount compared to their counterparts in private sector. Some of the public sector Navaratnas qualified as value stocks. The growth investing category includes Philip Fisher-pioneer in this field and Peter Lynch, the legendary investor. Benjamin Graham and David Dodd are pioneers in value investing. Warren Buffet is considered the most successful value investor.

No investment will be without risk. Always risk and return go together. Growth investing is considered to be riskier than value investing because due to unexpected changes in stock as well as market. There may be unexpected corrections in the prices of stocks.

Growth investing can be successful when markets are bullish where as value investing can give better results when markets are going up from slowdown. Value investing is more successful in the long run.

Though growth investing and value investing differ in their strategies of selecting companies, an intelligent mix of both could provide investors diversification benefits and reduce risk.

Many of the successful investors in the world have adopted a mix of both the strategies according to their needs of investment and perception of the market.