The Third Option – Value and Growth

Value investing versus growth investing is a decades old debate, one that has quietly raged since Benjamin Graham's first "value" stock picks in the early 20th century.

The traditional argument squares off two strategies in each corner of the ring, to fight it out over issues such as risk, valuation, investor temperament and global market forces. But is this fight still relevant? Was it ever a true contest at all?

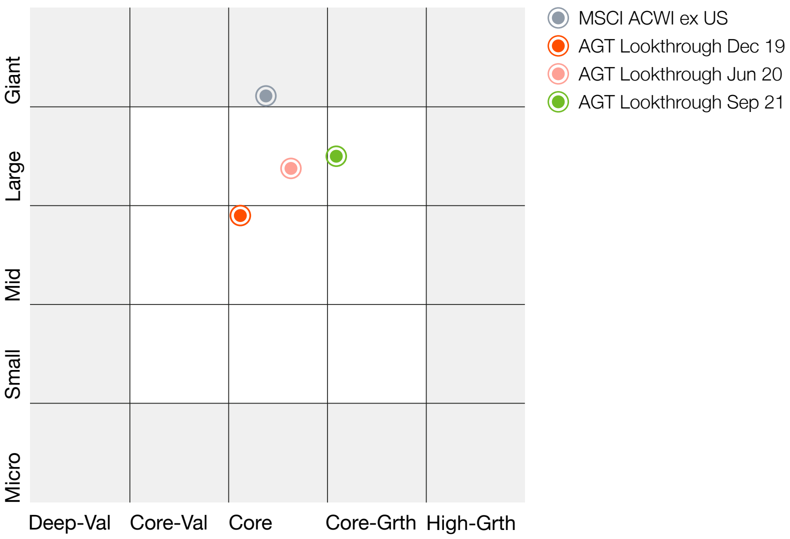
In the red corner…

Depending on who you ask, "value investing" is defined as seeking returns on relatively "low risk" investments in stocks that are undervalued. For one reason or another, the market value of the stock does not reflect its intrinsic value. Value investing is tied in many people's minds to low growth, often challenged, businesses that the myopic market has cast aside and put on sale.

> We want to buy good quality companies trading at a discount, where we will benefit not only from closing the discount gap, but from long-term growth.
>
> **Joe Bauernfreund**
> Chief Investment Officer

By comparison, "growth investing" conjures an image of savvy investors picking the next billion-dollar superstar in modern, high-tech sectors. The aim of growth investing is to pick companies that will outstrip their competition, growing at above average rates and rewarding their investors with their high performance.

LOOK-THROUGH HOLDINGS-BASED STYLE MAP



Note that the look-through portfolio analysis is based on listed underlying holdings only.

Source: Morningstar

The Morningstar Style Box classifies an investment fund or index in terms of investment style (x-axis) and the market cap of the holdings (y-axis). Such analysis for AGT is complicated by our investments in holding companies and closed-ended funds, which have underlying equity investments.

The movement of the AGT look through portfolio over time, across the size and style spectrum, emphasises both AVI's freedom to have courage in its convictions, the opportunistic nature of our investment style, and how we are not wedded to specific styles or factors in terms of underlying holdings.

Of course, as is always the case with such things, neither of these typologies quite hold. They are caricatures. This however has not stopped their proliferation across all areas of the investment world. Clients and allocators often reference such terms, whilst the press commentary is rife with the debate about "value" vs. "growth". Even this author's tongue slips from time to time and asks a fellow fund manager "are you more value or growth?"

'Goliath versus Goliath'

The conversation around growth and value investing is dominated by the narrative of competition. Performance versus valuation, risk versus safety, us against them.

A recent AIC report entitled "Has value had its day?" laments the widespread "cavalier references to the rivalry between growth and value investment styles" – but fails to address a fundamental issue. Value and growth investing are not two rival camps, spouting incompatible investment theses, divided by insurmountable ideological barriers.

"You haven't given me a third option"

Asked in a webinar whether Asset Value Investors are value or growth investors, CEO Joe Bauernfreund responded that "we are neither".

He could very easily have argued that we are both. Or that the question itself no longer makes sense.

People think of us as value investors, which to an extent is true. We are interested in buying companies trading at a discount to their realisable value. But we are not interested in buying companies that are cheap for a reason – zombie business or operationally challenged companies.

We will not invest in companies where we don't see the long-term potential for substantial growth in value. We want to buy good-quality companies trading at a discount, where we will benefit not only from closing the discount gap, but from long-term growth.

THE THIRD WAY

So how do you follow this third way, treading between the two camps? Is it possible to find attractive quality companies, growing at above average rates but undervalued by the market?

Obviously, if these companies were easy to find then they would not trade below their intrinsic value for long. Companies in high growth sectors are under constant scrutiny by analysts and such an opportunity would be snapped up immediately.

But these companies do exist. Often hidden beneath ownership structures that obscure the value of the stock from easy evaluation. It requires time and effort to peel away the layers to see what is underneath.

A simple screening process will overlook the hidden value behind these sometimes complex structures and most analysts will simply miss them entirely.

If you unearth a company that incorporates the characteristics of both "value" and "growth", it can be complicated to understand at first glance. So, let us examine this with an example.

Finding the balance

Value-growth investing is a nuanced game, relying on your ability, patience, and diligence to find that golden opportunity. A company that is undervalued by the market, but with long-term prospects that would excite any hard-core growth investor is the archetypal "value-growth" stock. Ardent value investors will claim it for their own, pointing at the fundamental undervaluation. Growth investors will retort that the value is in the long-term potential to outstrip the market. We are staking a claim to both.

The full insight can be found at **www.aviglobal.co.uk/insight/the-third-option-value-and-growth/**

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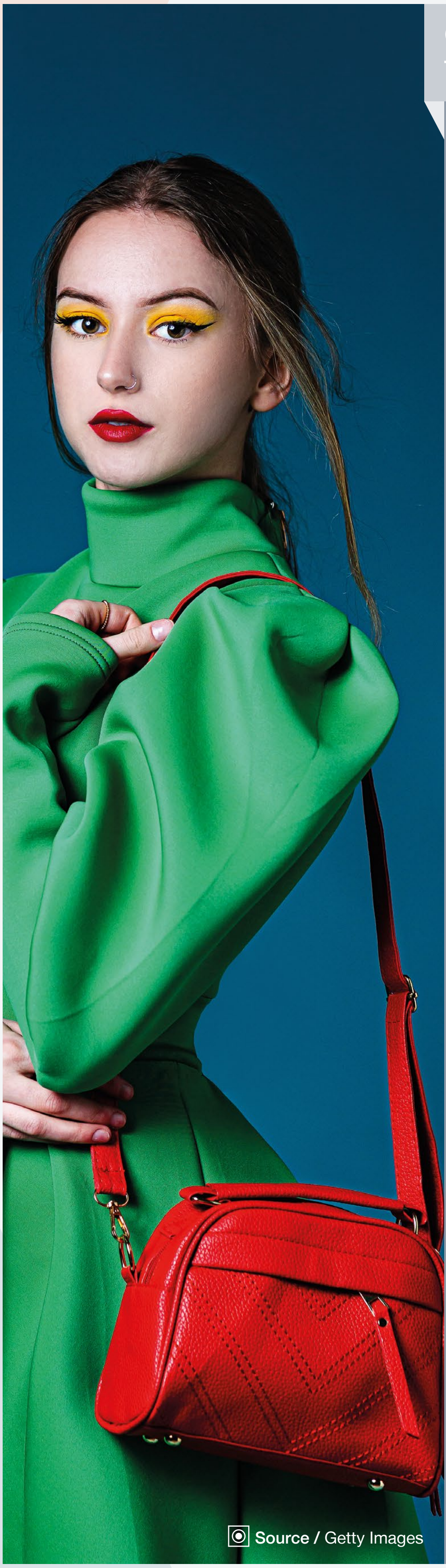

Source / Getty Images

CHRISTIAN DIOR / THE THIRD OPTION

Christian Dior ('CDI') is a French listed mono-holding company through which Bernard Arnault controls LVMH, the European luxury goods conglomerate.

Since the formation of the current group structure in 2017, CDI typically traded at or around NAV. However, during the COVID tumult CDI's discount widened out to c.25%. AGT took advantage of this and built a position at a dislocated discount.

Reframing the "value" vs. "growth" debate as an analytical style, not a statistical factor, buying a company on a discount is value investing in its purest form – you are buying something for less than it is worth. At AVI we take advantage of situations where the discount widens, and invest at points of pessimism, earning a return once the discount narrows.

However, this is only part of the equation – the other side being growth. Through CDI we have exposure to LVMH, one of Europe's highest-quality companies. LVMH owns a collection of unique brands with intangible qualities that cannot be replicated. This brand equity translates into high demand for their products, pricing power, and attractive margins and returns on capital, having compounded EPS at 13% since 2000. This is not the type of cigar-butt business you are likely to find in a so-called "value" investor's portfolio.

This combination of unusual and unloved structures, and high-quality underlying assets, typifies that growth-value approach. We want to buy assets for less than they are worth, and then watch the assets grow in value.