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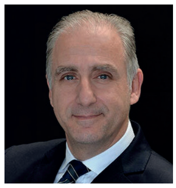
NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS

Value and growth: two sides of the same coin?

Deep understanding of companies and viewing ESG as a key input underpin both investment styles



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Value and growth strategies tend to be viewed as opposite ends of the investment spectrum. But are they really so different?

Shared philosophies

"Finding good companies comes down to knowledge," says Carl Auffret, manager of DNCA's European growth approach. "Both value and growth investing are about getting to know a company over time, building your confidence in it and buying or selling when the time is right."

For DNCA, this means multiple meetings with companies, in person, at their headquarters and at other sites. It means following all a company's actions, calling management to ask for more detail and listening carefully to explanation.

"It sounds simple, but it requires a disciplined and thorough approach" says Isaac Chebar, manager of the European value strategy at DNCA, an affiliate of Natixis Investment Managers.

Of course, the execution of a value and growth portfolio will differ and the portfolios will look distinct. But many elements of stock selection are shared. For example, DNCA believes the macro environment should not influence stock selection in either strategy.

It also believes in simple, long-only management, where the investor is a long-term partner of companies in the portfolio and reaps capital gains as the company performs well and grows its share price. It further believes that both strategies should ignore benchmarks and, critically, view ESG as a key component of value creation and risk mitigation.

Value: finding hidden catalysts

Value is often distilled to: buy low, sell high. In practice, finding value is more nuanced and, for DNCA, is only perceptible to investors who have an unrivalled understanding of a company.

Analysis carried out by Chebar and his team includes the quality of the management, historical cashflows and, importantly, the balance sheet. Chebar avoids companies with high leverage levels, which have high debt servicing costs and are constrained from making acquisitions when opportunities arise. "The balance sheet is really important," Chebar says. "If a company has a low cash buffer for debt repayments, we are effectively working for the bondholders. And we are not bondholders."

DNCA's value team also shuns companies whose cashflows are dependent on the macro-economic environment, whether that be commodities inflation or war.

The emphasis on debt and cashflow, allied to a long-term outlook for its value portfolio, means DNCA can fully diversify its portfolio across sectors, including cyclical sectors.

Key takeaways:

- Both value and growth investing are about getting to know a company over time, building confidence in it and waiting for the right time to buy or sell.
- Active equity management of growth stocks is about finding high-quality companies that are undervalued relative to their revenue growth and earnings. For value investing, quality is also a factor but valuations and return to mean are most important.
- DNCA believes in simple, long-only management, where the investor is a long-term partner of companies. It views ESG as a key component of value creation and risk mitigation.

"We don't like value as a term," says Chebar. "We preferred 'undervalued assets' or a 'conservative approach' to investing." Value for DNCA is about finding assets that are undervalued at a certain time and will be recognised by the market later.

Chebar screens the market for companies in which the market has unjustifiably lost faith. "Sometimes the market gets confused between volatility and risk premium," he says.

Most companies are susceptible to short-term impacts, such as restructuring, management changes, market changes, pandemics and wars. Chebar says: "You buy when the market puts a high risk premium on the stock, wait until other investors recognise the catalyst for change and hold until the risk premium reduces again and market rerating occurs."

A rerating can come in many forms, many of them not obvious to the market. This is where following a company over long periods and keeping open lines of communication is a key advantage.

A conservative approach to growth investing

Just as DNCA's definition of value is "conservative investing", so is its philosophy for growth investing.

It demands that a company has grown its sales consistently by at least 5% a year and is likely to do so for many years ahead. Sales growth must be like-for-like, stripping out foreign exchange movements, M&A activity and other one-off events.

"We are looking for true growth," says Auffret, "and 5% true growth a year is tough to achieve. You need to be highly competitive, focused on taking market share, launching new products and tackling new geographies. That's hard."

What connects all these growth attributes is the quality of the management. And, again, assessment of the quality of management can only come through knowledge and strong communication channels.

Growth portfolios are necessarily narrower than value portfolios, with a handful of high-growth sectors – such as healthcare, technology, specialty chemicals – dominating the portfolio. Auffret says: "There is a natural sector bias. It's logical because there is very little growth in oil, financials, media, telcos." Price is important because the premium on high-growth sectors can rise to unreasonable levels.

As well as topline growth, companies must improve profit margins without cutting capex or marketing to gain entry to DNCA portfolios. DNCA also looks for companies operating with high barriers to entry, such as strong brands or superior technology.

Finally, as with the value approach, DNCA insists that even growth companies have strong balance sheets, in order to survive crises and be able to play opportunistically in M&A markets.

ESG is a key driver of both value and growth

In the value portfolio, ESG is becoming a key part of a company's rerating journey. Ignoring ESG can derail that journey. "Poor ESG practices in companies' products and activities can wreck value," says Chebar. "Our portfolio approach focuses on transition, pushing companies to change for the better, and do it in a consistent way over time."

Chebar prefers to help companies to improve rather than exclude them for ESG failings. Improvement is largely achievable through good governance, which is central to DNCA's selection of both value and growth companies.

In growth portfolios, governance has particular importance for attracting and motivating staff. "Without recruiting the best talent you can find and keeping it, you can't grow," says Auffret. For example, companies operating in the pharmaceuticals and biotech sectors need to attract R&D talent, while luxury brands need to recruit ambitious and skilled marketing staff.

To some extent, ESG is a natural component of a growth portfolio, Auffret believes. "The environment part is relatively easy because our sector bias steers us away from highly polluting sectors and towards low-carbon emission sectors," he says.

Value and growth more similar than contrasting

The perception is that value and growth are completely different ways of investing. "But active management can actually take similar approaches to both," says Auffret.

While their execution and portfolio composition differ, both value and growth approaches to European stocks share the same aim. "That is, to produce market-beating risk-adjusted returns over the long term," says Chebar.

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