Based on an article from our U.S. partners

Growth vs. value investing

When evaluating domestic stock mutual funds, you've likely run across two labels that may be confusing: Growth Funds and Value Funds. Both types of funds seek to provide the best possible returns. The difference is in the approach they take, the way they pick stocks, and the types of markets for which they are best suited.

Growth investing

Growth funds focus on companies that managers believe will experience faster than average growth as measured by revenues, earnings, or cash flow. Growth fund managers also look carefully at the way a company manages its business. For instance, many growth-oriented companies are more likely to reinvest profits in expansion projects or acquisitions, rather than use them to pay out dividends to shareholders.

While growth funds are expected to offer the potential for higher returns, they also generally represent a greater risk when compared to value funds. They tend to do better than the overall market when stock prices in general are rising, while underperforming the market as stock prices fall, taking into account that past performance does not guarantee future results. As a result, investing in growth funds may require a slightly higher tolerance for risk, as well as a longer time horizon.

Value investing

The goal of value funds is to find proverbial diamonds in the rough; that is, companies whose stock prices don't necessarily reflect their fundamental worth. The reasons for these stocks being undervalued by the market can vary. Sometimes a company or industry has fallen on hard times. Other times a poor quarterly earnings report or some external event can temporarily depress a company's stock price and create a longer-term buying opportunity. In searching for these companies, managers look for what many experts call a "margin of safety." This means that the market has discounted a security more than it should have and that its market value, the price at which it is trading, is less than its intrinsic value, the present value of its future cash flows. One example would be a stock that is trading at $90, but whose intrinsic value is $100.

In general, value funds focus on perceived safety rather than growth, often investing in mature companies that are primarily using their earnings to pay dividends. As a result, value funds tend to produce more current income than growth funds, although they also offer the potential for long-term appreciation if the market recognizes the true value of the stocks in which they invest.

Growth vs. value – a quick reference

	GROWTH FUNDS	VALUE FUNDS
Characteristics	Focus on companies with above average rates of growth in earnings and sales. These stocks tend to have above-market price-to-earnings and price-to-sales ratios, as the rapidly growing sales and earnings justifies a higher-than-average valuation.	Focus on companies with lower-than-average sales and earnings growth rates. Holdings generally feature stocks with lower price-to-earnings and price-to-book ratios. Stocks generally have higher dividend yields. Fund can potentially capitalize on turnaround situations.
Risks	Growth may not always be realized. Price-to-earnings or price-to-book ratios may decline due to unforeseen events.	Market may have correctly priced underlying companies, in which case they may never realize their intrinsic value.

Are there funds that offer a little of both?

Funds that invest in both growth and value stocks are called blended funds. Blended funds tend to exhibit many of the characteristics of both growth and value funds – potential for capital appreciation, current income, low price/earnings ratios, as well as stocks that often reinvest revenues back into business operations.

Many managers of blended funds pursue a strategy known as Growth at a Reasonable Price (GARP). Managers of these funds tend to focus on growing companies, but are also highly value conscious paying close attention to traditional value indicators like the price-to-sales, price-to-earnings, and price-to-growth ratios to ensure they are reasonable.

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