MARKET INSIGHTS

MACKENZIE Investments | CONFIDENCE IN A CHANGING WORLD

Mackenzie Bluewater Team | April 2017

Growth or Value: Where Do We Go From Here?

Dina DeGeer
Portfolio Manager
Mackenzie Bluewater Team

David Arpin
Portfolio Manager
Mackenzie Bluewater Team

Han Tacoma
Investment Director
Equities

Key Takeaways

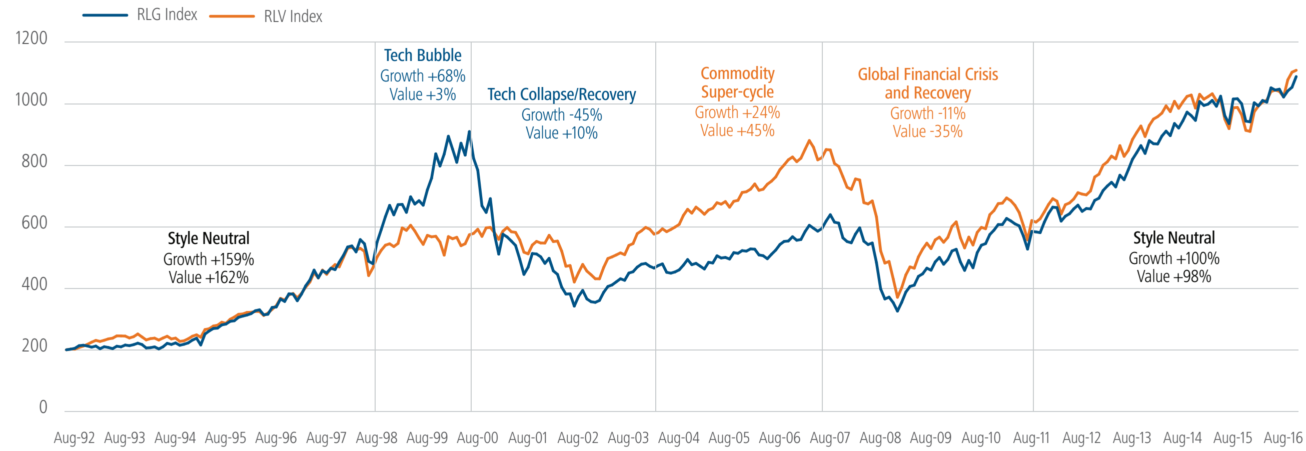
- Based on the muted diversion between styles in the U.S. over the last seven years, the Mackenzie Bluewater Team does not see compelling evidence for a near-term mean reversion based outperformance of either style.
- Since 1992, each style has had one well-defined period of significant relative outperformance followed by an equally material downturn.
- When style indexes are created, each company in the underlying index is classified as either pure growth, pure value, or else they overlap both. This wrinkle leads to concentration primarily in three sectors that are unique to each style.

We have received a number of inquiries from investors about the impact of investment style (growth versus value) and whether we have a strong opinion as to the relative performance of the two styles going forward. The short answer is: We do not. But it's important to outline our thinking on why we don't have a strong opinion either way.

The long-term chart below shows the performance of the Russell 1000 Growth and Value Indexes for the US market. Two strong "style markets" stand out over the past 25 years:

1. In the late 1990s, growth stocks, fuelled by the technology bubble, outperformed value stocks in a period of speculative excitement linked to the promise of the "new economy". The tech bubble peaked in 2000, after which technology valuations rapidly came back to more normal levels and the market shifted to a value focus.
2. Subsequent to the technology bubble, we were in a strong value market. A China-driven commodity super cycle saw a barrel of oil spike from below US$20 to a high of more than US$140, resulting in the energy sector rallying over 300%.

The global financial crisis and the collapse of the US financial sector ushered in a more "style neutral" market, with both growth and value providing strong performance during the post-crisis recovery.



Source: Bloomberg and Mackenzie Investments at January 31, 2017

The simplest way to think about the relative performance of growth and value is by assuming, as the chart above suggests, that style performance tends to revert to the mean. Unfortunately, this isn't particularly helpful, as when looking at the post-crisis period, the gap between growth and value has been quite muted. This suggests to us there is no compelling advantage for either style (see table below).

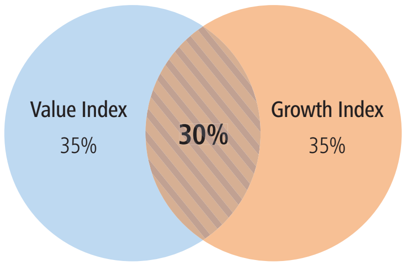
	2010	2011	2012	2013	2014	2015	2016	CAGR
Growth	15%	1%	13%	31%	11%	4%	5%	11%
Value	13%	-2%	14%	29%	11%	-6%	14%	10%
+/–	2%	3%	-1%	2%	0%	10%	-9%	1%

Source: Bloomberg and Mackenzie Investments at January 31, 2017

There is another way to think about growth and value which we find somewhat more helpful now. If you look at the periods of strong growth and value performance, you will see the emergence of sector concentration within the respective styles.

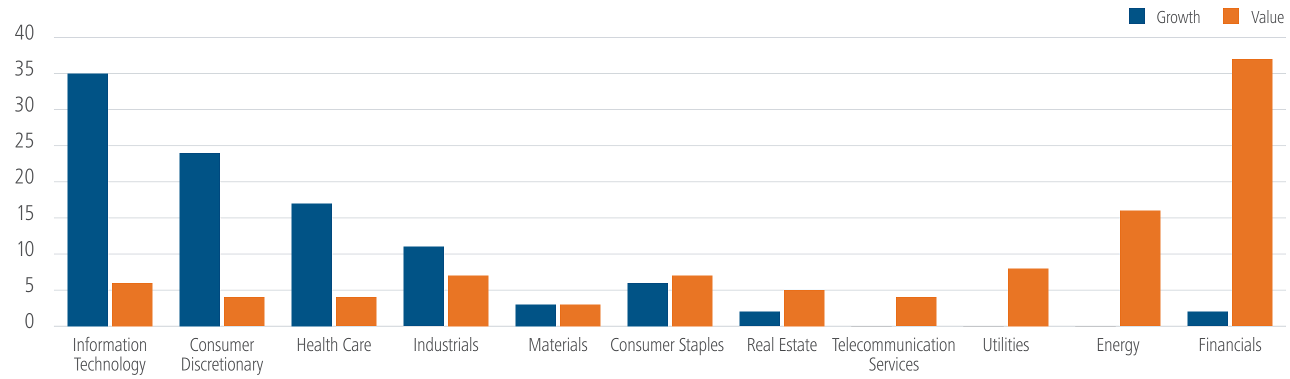
Growth outperformance during the technology bubble and collapse was, naturally, centered on the technology sector. The mid-2000s value outperformance occurred during a period of strong energy sector performance and was followed by the global financial crisis, which hinged on the collapse of the US financial sector. These facts lead us to consider whether there is a significant difference in sector exposures between the Russell Growth and Value Indexes.

Undergoing the analysis, we find an interesting wrinkle in style index construction. When style indexes are created, each company in the underlying index is classified as either pure growth, pure value, or else they overlap both (i.e., companies are included in both the growth and value indexes).



From a relative performance standpoint, a company that is in both indexes will at least partially, or fully, cancel itself out. For example, spreading the weight of Apple 50/50 between the growth and value indexes would leave no relative performance impact on either index. The chart below shows the sector weights of the growth and value indexes, excluding the "blended style" companies.

How Growth and Value are spread out across the Sectors



Russell 1000 Growth and Value Indexes, Source: Bloomberg at January 31, 2017

It is apparent that there are large differences in sector weights between the two investment styles and, unsurprisingly, the technology, energy and financial sectors are among the sectors with the biggest weight differences. This matches up perfectly with the "sector story" nature of the periods of relative growth and value strength outlined above. It seems reasonable to assume that, if we are heading into a period of strong growth or value performance, then we should expect very different relative sector performance going forward. A strong growth period should see strength in the Technology, Consumer Discretionary, and/or Healthcare sectors, while a strong value period should see outperformance of Financials and/or Energy.

Given the significant differences in rates of return between growth and value styles in the past, it is understandable that advisors are curious about the path forward. Based on the muted diversion between styles over the last seven years, the Mackenzie Bluewater Team does not see compelling evidence for a near-term mean reversion based outperformance of either style. Irrespective of which style outperforms going forward, it may be worth noting the sector concentrations of each style. This is an interesting side effect that investors may wish to consider when creating well-diversified portfolios.

For more information about the Mackenzie Bluewater Team, please contact your financial advisor.

50558 3/17