Growth vs. Value Investing: Which is Best?

There are two schools of thought within the investment community as to whether higher returns can be achieved by investing for "growth" or by investing for "value."

Value Investing

Those who espouse value investing favor purchasing stocks with higher than average dividend yields and relatively low market value indicators, such as price-to-earnings, price-to-book, and price-to-sales ratios. Value investors rely heavily on their analytical judgment as to whether or not a stock is mispriced; if a stock is underpriced, it's a good buy; if the stock is overpriced, it's time to sell.

Value investors typically buy stocks that have been beaten down in price because the companies they represent, although basically sound, are going through a period of adversity. This strategy calls for selling these shares after they have risen in price as a result of the underlying company having overcome its difficulties. The principal risk in this approach is that the price of the security may not reach its anticipated value.

Growth Investing

By comparison, growth-style investors are more apt to subscribe to the "efficient market" hypothesis, which maintains that the current market price of a stock reflects all the "knowable" information about a company and inherently represents the most reasonable price at that given point in time. In other words, it could be said that "growth investors look for good companies – not good stocks."

Thus, those in the growth camp seek optimum investment performance by investing in quality companies with higher than average earnings growth rates, regardless of the current market valuation of the company's stock.

Which Approach Is Best?

For some time many common stock funds have been divided according to their investment style, either "growth" oriented, "value" oriented, or a "blend" of the two. This has provided an opportunity to study the performance records of mutual funds using “growth” or “value” as their primary investment strategies.

As for which strategy achieves the highest returns, most studies show that this largely depends on the specific period over which the two styles are compared. As always, the future is never clear.

Because investing involves risk, including the possible loss of principal, an individual investor must understand the strengths and weaknesses of each investment approach and choose that with which he or she is most comfortable. The guidance of financial professionals can be of great help in making this decision.