MACKENZIE Investments

Growth & Value: Your questions, our answers

The case for growth investing

Richard Bodzy

Portfolio Manager,
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Over the last decade, growth outperformed value. But will the recent resurgence of value investing signal the beginning of the end for growth's leadership?

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Portfolio Manager,
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Putnam Investments, sub-advisor to the Mackenzie US All Cap Growth Fund, believes value's recent outperformance is a short-term trend and that growth investing will continue to outperform over the long term. We asked the fund's portfolio managers, Richard Bodzy and Greg McCullough, to discuss the long-term advantages of growth and how the fund is positioned in the current market environment.

Q | Why should investors still bet on growth investing?

Growth companies are largely responsible for driving innovation. Many of the companies held by the fund are spending on R&D to solve real problems. Across technology, healthcare, consumer and industrials, companies that can deliver innovative products and services are growing. We see great opportunities as we look ahead and have positioned the portfolio to benefit from what we think are the lasting economic shifts we've seen over the last six-plus months. This includes broad themes like increased digitization, increasingly direct sales channels and the benefits of scaled, capital-light business models. Industries like healthcare and parts of the industrials and consumer landscape are ripe for technological change and we want to own the businesses that are enabling this change. We work to identify those businesses that we believe can do so with high returns on investment, so we can continue to deliver strong potential returns for investors.

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Q | How are you managing the portfolio through periods of strong value performance?

Calling the market direction or style leadership over the short term is not our strength, nor is it our goal.

Value may outperform for short periods of time (typically when it gets too cheap on a relative basis); however, we believe that an investor with any appreciable time horizon should bet on growth. Historically, those companies with the largest profit declines during a recession see the biggest rebounds in subsequent years. Company reports and forward earnings per share estimates point to a similar experience this cycle, with earnings for cyclicals expected to outpace other groups in 2021-22, following a -48% decline in 2020[1]. However, we believe that when the full 2020-22 period is reviewed in combination, results for pro-cyclical stocks will trail TECH+ (technology, media, telecommunications) and non-cyclicals quite substantially.

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Q | Value style managers aim to avoid value traps. What does a growth manager aim to avoid most?

It's often a case that pockets of the market are overheated with valuations ahead of themselves and that is certainly true today. We generally will avoid valuation extremes but we're fully cognizant that unique businesses with strong financial characteristics will trade at premiums to the market.

We spend the majority of our time analyzing business quality, market structure and the underlying growth drivers for our businesses and the potential candidates for our portfolio. Our hope is that we can put together a portfolio of businesses that can grow intrinsic value at an above market rate.

Q | How does your process give you an edge to ensure you're identifying and investing in true themes/businesses rather than fads?

While bottom-up research is the primary focus of the team, identifying overarching themes has helped us pick companies with strong secular tailwinds to their growth. We take the time to identify larger trends and movements at the market and industry level that hold ongoing promise for investment. We call these areas of potential within the broader market context "themes." We believe that themes are key to understanding which companies will excel and why. The presence of a theme increases our conviction in both the level of growth that a company may achieve, but also the duration and durability of that growth.

To identify these themes, we analyze global trends, problems and potential solutions – for example, the rise of e-commerce and payment processing or the emergence of 5G and the "Internet of Things". The themes are multi-year in nature and are supported by data. We use our expertise to blend those themes with the bottom-up work we've done on individual companies. The resultant list of companies will fit both our highly selective fundamental criteria and have exposure to durable secular growth themes. We believe the companies that we own should deliver high, durable growth without requiring widespread economic acceleration.

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Q | What characteristics separate the companies you own from other growth companies and how do you minimize risk taken in the portfolio?

The aim of the strategy is to minimize the impact of economic fluctuations by investing in secular growers with defensible moats and high, sustainable returns. We will continue to focus our investments in companies with: 1) high and long-duration growth potential, 2) high and/or improving capital returns potential, and 3) an ownership culture.

The growth profiles for many of the companies held in the strategy are supported by long-tailed themes, and we explicitly take prior-cycle downside capture into account within our risk framework. One of the things we obsess over is the vulnerability of the businesses we buy. A big part of our process is to look at how businesses have performed through difficulty in the past and stress that on the front end. We want to avoid surprises. It's how we vet our ideas, how we discuss them with the analysts on our team, and a big part of the conversation we have with management teams at the companies themselves. Our desire to own high-quality businesses with a narrow range of outcomes has benefited relative returns. This framework has served the strategy well in the past, and we would expect it to continue to do so into the future.

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1 Source: Credit Suisse Research Report. Published 11/28/20.

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