



The Era of Growth

Why growth investing has been outperforming value and why it is likely to continue

About the author



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Mark Shattan is the founder and Chief Investment Officer at GrowthLine Capital. Mr. Shattan was formerly a portfolio manager at Jennison Associates where he managed a \$3 billion growth portfolio and was a co-manager of the flagship \$65 billion large cap growth strategy. Prior to Jennison, Mark was a chief investment officer at Goldman Sachs Asset Management, managing a \$7 billion equity strategy and a team of 7 people. He has 22 years of professional investing experience and 18 years of experience as a growth portfolio manager, earning a four star Morningstar rating for the past 3, 5 and 10 years. Mark is a West Point Graduate and former U.S. Army Officer.

About GrowthLine Capital Partners LP

GrowthLine Capital is a long/short equity, high return-seeking growth hedge fund that invests in companies benefiting from disruptive change that can become multiples of their current size. The fund invests across all market caps, geographies and sectors with a typical focus on US based companies generally more than \$1 billion market cap. The fund will typically have 15-25 long positions and 15-25 short positions, with gross exposure ranging from 90% to 150% and net exposure typically ranging from 50% to 90%.¹

We are in an era of disruptive change where fortunes are being created and destroyed. GrowthLine employs a bottom-up research process to capitalize on this and utilizes an internally developed “Growth Cycle Investing” framework for both longs and shorts that focuses on mapping companies along the adoption curve. All growth companies go through this cycle, from early adoption to maturity, yet most of them will fail. This dynamic provides experienced growth investors meaningful long and short opportunities.

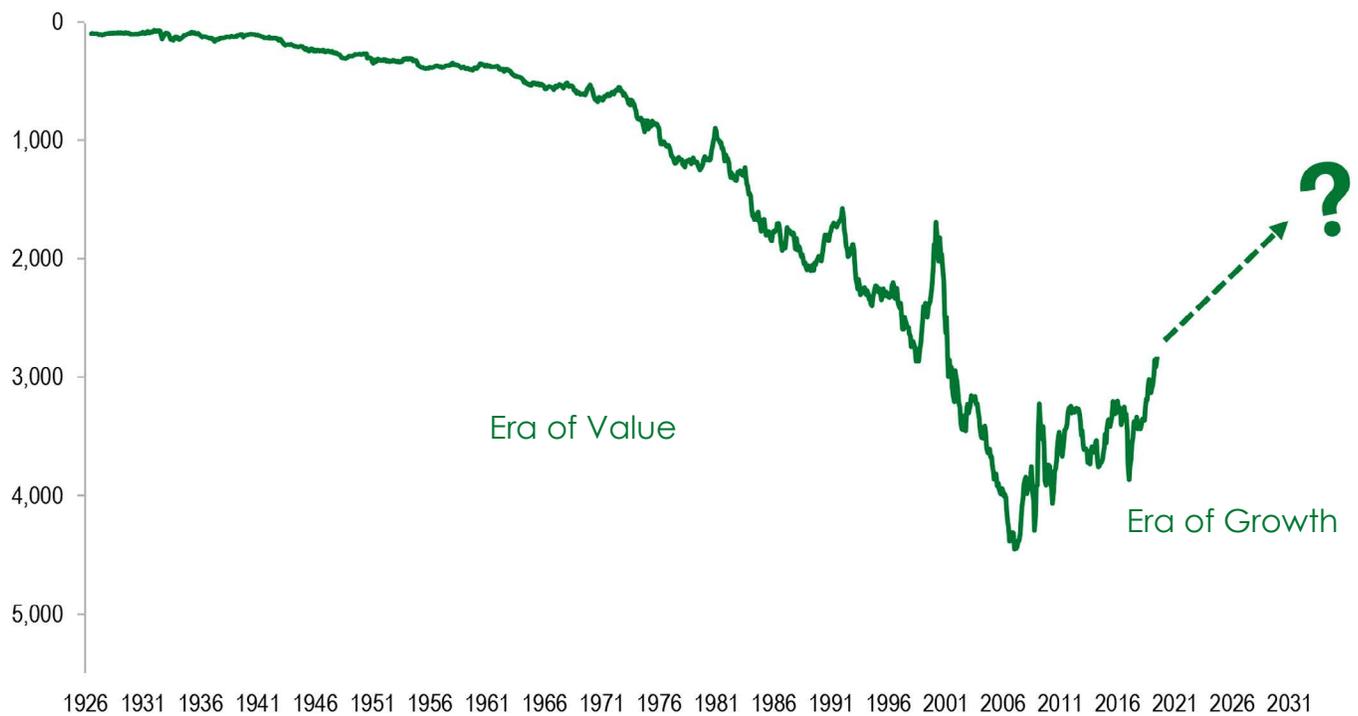
Founded in 2019, GrowthLine Capital is a 100% veteran owned firm.

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¹ Please see important information at the end of this whitepaper about portfolio construction.

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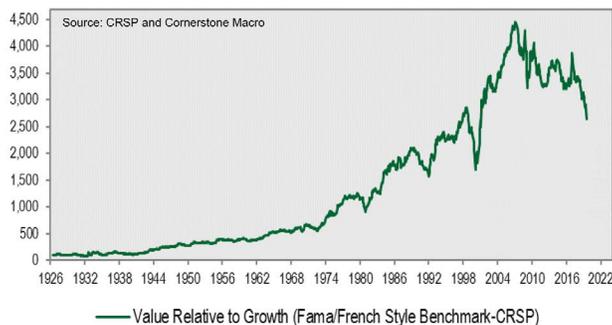
Source: CRSP and Cornerstone Macro

Growth relative to Value 1926 – 2019
(Fama/French Style Benchmark-CRSP)

August 2019

A common question heard in our investor meetings is how to think about the recent outperformance of growth stocks relative to value stocks. Stocks generally categorized as growth have outperformed value quite handily for the past decade. A natural reaction to this decade of outperformance is to expect some measure of mean reversion and a period of reversal of comparative performance.²

However, putting this recent performance in a longer historical context is helpful. Below is the plot of the performance of growth stocks versus value stocks going back to 1926. This data comes from the Chicago Booth Business School’s Center for Research in Security Prices and uses the Fama/French style benchmarks. From this longer perspective, we can see that while the past decade has certainly been led by growth, the past century has been led by value. In fact, it wouldn’t be much of a stretch to characterize the past century’s market performance as the ‘Era of Warren Buffett.’ A good investing strategy during this period was to buy and hold value stocks, while occasionally tilting toward growth stocks; or, as the strategist Francois Trahan once wrote, it was best to “live in value and vacation in growth.”



To anticipate a mean reversion back to the century long trend, one must believe that the conditions that created the trend remain in place. To assess those conditions,

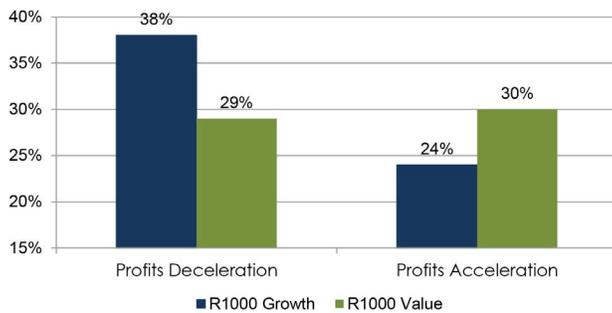
we must first define what we are analyzing. Value, in general, means something is less expensive relative to an alternative. For shares of companies, investors agree to pay a lower price for some versus others typically for two reasons. The first is that the company is less likely to make itself more valuable over time; in other words, it grows more slowly. The second is that its outlook is less predictable. Companies with less certain futures are often tied to some cyclical forces outside of their control, like interest rates for banks, oil prices for energy companies or economic growth for industrial equipment makers. Value stock indexes are largely comprised of these slower growing and cyclical companies.

When there is a macro tailwind, value stocks tend to outperform. The logic is reasonably straightforward. With less of an ability to grow on their own, a macro or cyclical tailwind helps the company’s business activity accelerate and the lower valued shares seem like an especially good bargain. This contrasts with traditional growth companies whose fortunes are more tied to innovation and expansion of end markets and generally are less affected by macro winds. In other words, companies like Netflix do not worry too much whether the ten-year Treasury bond is yielding 2% or 3%, but JP Morgan certainly does.

Looking at the history of how growth and value stocks performed in different economic environments provides some evidence that value stocks do indeed tend to outperform growth during stronger economies. The chart below examines the performance of the Russell Value and Growth benchmarks during periods when corporate profits are accelerating or decelerating. The table below it shows the average annual performance in periods relative to absolute levels of GDP.

² For additional important disclosures regarding this whitepaper, please see the last page hereof.

Russell 1000 Growth Index vs Russell 1000 Value Index



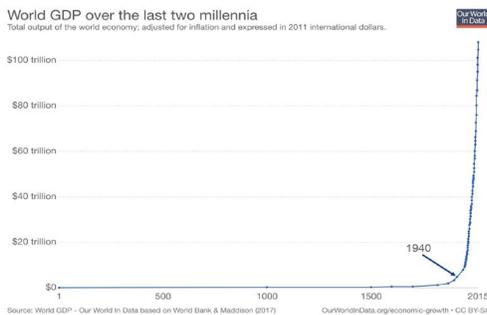
Source: BofA Merrill Lynch

GDP

	Above 2.75	Below 2.75
R1000G	8.9	10.6
R1000V	12.7	8.5

Source: Jefferies, Factset

With robust and accelerating economies helping value stocks disproportionately, the 'Era of Warren Buffet' makes sense given the extraordinary economic boom the world experienced since the end of World War II. The chart below is quite remarkable, as the past century witnessed the greatest explosion of economic growth in human history.

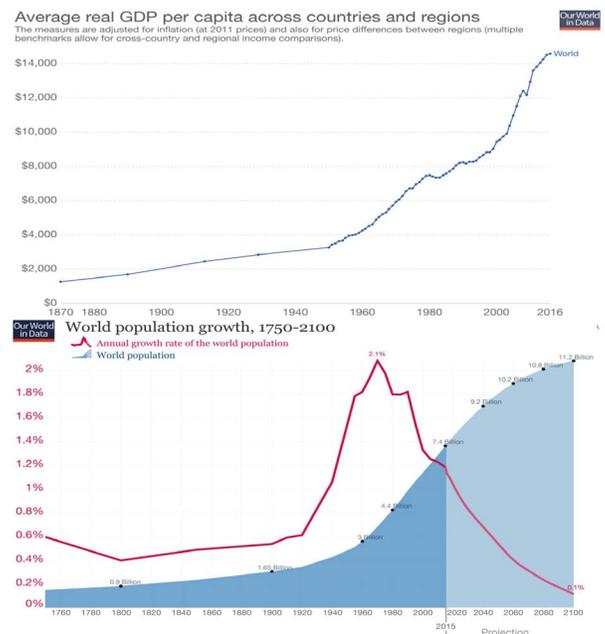


To understand why this happened and whether it is likely to continue, we look to the basic drivers of economic growth. At a high level, GDP growth is driven by two factors: the number of people and the productivity per person. Economists have made careers modeling and predicting productivity with multifactor equations, but at its most basic level, it comes down to just those two inputs.

$$\text{GDP} = \text{Population} \times \text{Productivity/Person}$$

Population is the easiest to model and predict. The past century, in particular the last 50 years, has seen an explosion of population growth like never before. The post World War II spread of peace, capitalism, and improvements in healthcare all led to extraordinary growth in the pool of people able to work, creating a persistent tailwind for economic growth. Looking forward, however, the prospect for economic growth driven by an increase in the labor force is not great. Global population growth of approximately 1.1% today is half of what it was at its peak in 1963 and most forecasts predict a continued deceleration.

Productivity also boomed during this post war period as capitalism spread and more women entered the labor force. The end of the Cold War in 1989 and the entrance of China into the World Trade Organization in 2001 further boosted the spread of capitalism. The impact of bringing China and the former Warsaw Pact countries, roughly one third of the world's population, into the global market economy accounts for the second major acceleration in the chart below.



The good news is that now the vast majority of the world has seen a significant improvement in productivity and commensurate rise in the standard of living. The bad news for future economic growth is that we do not get to do that again.

With population growth faster than any time in history combined with tremendous growth in productivity, we witnessed the most positive economic environment in human history. For companies and stocks that do better with cyclical tailwinds, it is hard to imagine a better scenario.

However, the prospects for robust, sustained economic growth are different than what we have just experienced. The portion of the GDP equation driven by population is just half of what it was 50 years ago and continues to decelerate. While social factors will continue to impact labor participation, the demographic tailwind in the last half of the 20th century is now more of a headwind. Productivity gains will certainly continue, though the ability for step function improvements like those we have experienced will be harder to come by as most of the world is already participating to some degree in the global market-based economy.

Of course, we will still have economic cycles with periods of accelerating and decelerating growth. If an investor anticipates an acceleration of economic activity, then tilting toward traditional value stocks makes sense. However, slow population growth and limited opportunities for meaningful productivity gains will likely lead to shorter and to less frequent periods of robust, accelerating economic growth. Those conditions are dissimilar to what drove the last century of value investing dominance. The conditions that we now face favor growth investing.

Welcome to the “Era of Growth.”



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