The 5 Key Elements You Should Be Looking for in Your Next Growth Stock

Description

It’s a prosperous time to be investing in growth stocks, as the **iShares S&P 500 Growth Index (ETF)** (NYSEARCA:IVW) is outperforming the **iShares S&P 500 Value Index (ETF)**(NYSEARCA:IVE) by an impressive 21% to 8% margin.

That’s largely because the market is being led by mega-cap growth stocks such as **Facebook Inc.** (NASDAQ:FB), **Apple Inc.** (NASDAQ:AAPL), **Amazon.com, Inc.** (NASDAQ:AMZN), **Netflix, Inc.** (NASDAQ:NFLX). and **Alphabet Inc.** (NASDAQ:GOOG)(NASDAQ:GOOGL), appropriately named the “FAANG” stocks for the first letter of each companies name.

This may have you wondering what you should be looking for in your next growth-style investment.

A rising tide lifts all boats

The one thing all the FANGG stocks have in common is they operate in industries that are experiencing above-market growth. Social media, smartphones, e-commerce, internet search, and online streaming are all growing well above the pace of domestic and global GDP.

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Looking for the next big thing?

You may want to consider **Tesla Inc.** (NASDAQ:TSLA), which is making an aggressive push into electric and self-driving vehicles.

Or you could look to the marijuana industry, which is expected to grow above 20% and become legal next summer; **Canopy Growth Corp.** (TSX:WEED) and **Aphria Inc.** (TSX:APH) have outperformed as of late.

You want to find a company that is taking market share from competitors

A growing market is one place to look, but sometimes equally good opportunities can be found where a company is taking market share in a more mature market and outpacing the competition.

Recent examples of this can be found in the case of **NVIDIA Corporation** (NASDAQ:NVDA) and **Advanced Micro Devices, Inc.** (NASDAQ:AMD), which have seen their respective shares multiply, while market leader **Intel Corporation** (NASDAQ:INTC) has languished behind.

Translating opportunity into top-line growth

When investing in growth stocks, it’s absolutely critical that your company operates in a growing market or is taking market share from competitors, as it will ultimately translate to increases in sales, or what’s commonly referred to as “top-line growth.”

Converting growth into profits

If management is doing their job, this top-line growth will translate into growth in your company's earnings per share (EPS).

If your company employs an ample amount of what's called "financial leverage," as is the case with **Air Canada** (TSX:AC)(TSX:AC.B), it will see its EPS grow by some multiple of its sales growth.

Dividend growth, the ultimate return

Ultimately, as a shareholder, you want to see all that growth translated into dividends that can be re-invested, so you can take advantage of compounded interest.

Be careful with stocks that have high dividend yields; while a high payout today may seem tempting, it will come at the expense of future growth. That's because a higher dividend today means less cash is retained by the business to reinvest in research and development, capital expenditures, or even mergers and acquisitions.

A company that pays a dividend is telling investors that it has shareholders' interests in mind, but with growth stocks, you'll want to see a payout ratio below 35% in most cases.

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Conclusion

Much has been made of Warren Buffett and the success of value investing over the past 15 years — a phenomenon which has many in the market chasing their tails lately as the growth style outperforms.

Investing in companies that are growing at an above-market pace will never be out of style. Keep these five key factors in mind when you are looking for that next big stock.

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