Forget Growth: Here's Why You Should Pick Value Stocks in 2020

Description

All stocks fall into one of two categories: growth or value. Stocks trading at or below their fundamentals are usually considered "value stocks," while stocks priced at a premium to fundamental metrics, based on the expectation for higher *future* cash flows, are considered "growth stocks."

For example, a stock trading at less than its book value per share could be considered a value stock. Investors in this stock are betting that the market will eventually realize its mistake and re-evaluate the company based on fundamentals.

A good example of this is **BlackBerry**, which currently trades at a price-to-book ratio of just 1.2.

Meanwhile, a money-losing, young technology company may be priced at a multiple of future sales. Investors in these companies are willing to take the risk of potential failure and compromise on cash flows and dividends in the hope that the company grows into market domination.

Shopify is a great example of a growth stock. The price-to-sales ratio on Canada's hottest tech stock is 25.8 at the moment, far higher than the rest of the stock market.

The pivotal question for every investor is, which strategy is better? The answer depends on your investment objectives and prevailing market dynamics.

Investment objectives

Before you can weigh the performance of either growth or value stocks, you must consider your investment objectives and financial situation. If, for instance, you depend on the income from your investments to meet daily expenses and generate passive income, you probably need a stable company with steady cash flows and a cheap valuation.

But if you're a young saver with a larger-than-average risk appetite and no need for current income, you can take a bet on exciting growth stocks and nascent technology companies to build wealth over time.

So, the choice between value and growth stocks boils down to your need for capital protection or wealth creation. Once you've made your decision, you can move on to the data.

The data

Academic research and public data seem to suggest that value stocks have severely underperformed growth stocks since the 2008 global financial crisis. However, the research seems to focus on American stocks, which are more likely to be capital-light technology companies.

In Canada, value stocks have outperformed growth stocks and are on a par with the general stock market. The average annual return of **iShares Canadian Value Index ETF** over the past 10 years is 7.29%, while **iShares Canadian Growth Index ETF** and the TSX 60 index have delivered 6.8% and 7.24%, respectively.

Canada's stock market has been dominated by financial and energy stocks, so these results shouldn't be surprising. However, the country's emerging tech sector could reverse this trend. If Canada lives up to its ambition of being a tech-powerhouse, on par with the U.S., investors can expect growth stocks to perform better over the next 10 years.

Foolish takeaway

Canadian investors must pick either growth or value stocks depending on their personal investment objectives and outlook for the Canadian economy. Over the past decade, value stocks have outperformed growth stocks and may be better suited to most investors.

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