Growth is Where the Growth is

As self-evident as the title may be, at TimesSquare we are often asked why our investment strategies focus on growth stocks. Simply put, that's where we believe better performance will be. In our view, over long time periods—such as the next 10 years—growth stocks will have significant future returns, especially among smaller capitalizations.

In our team's 30 years of investing in small cap stocks, we certainly have seen periods when value stood taller than growth. However, when we consider how small growth compares to small value overall in the past, present, and future, we continue to see a compelling case for small growth.

How has small growth compared with small value in the past?

Despite the Russell 2000® Value Index outperforming the Russell 2000® Growth Index in a few recent periods, over the last 10 years growth proved to be superior:

	Annualized 10-year total return
Russell 2000 Growth	**7.16**
Russell 2000 Value	**6.76**

Source: FTSE Russell

Furthermore, when expanding the evaluation period back to January 1995 and analyzing the monthly returns, growth stocks outperformed value in 61% of the trailing 10-year periods.

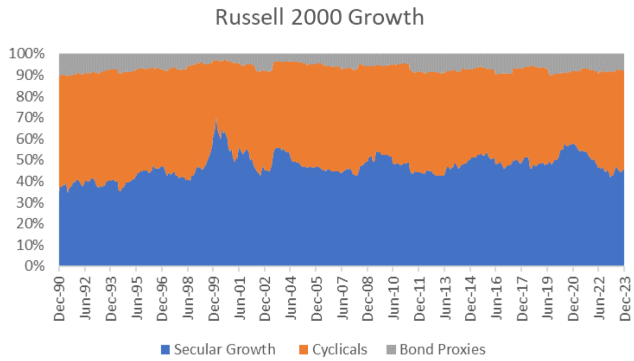
How consistent have growth and value been?

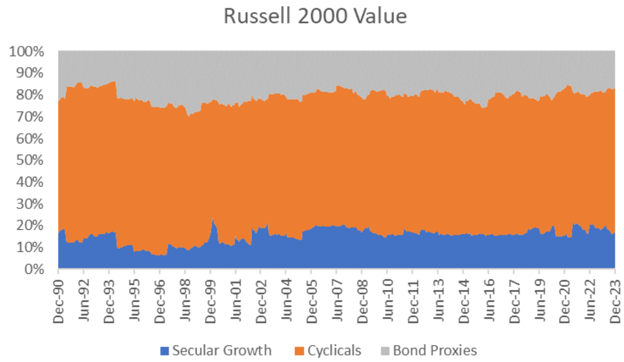
For the most part, comparisons of fundamental valuations have been consistent between growth and value among small caps over the years. That should be expected because the memberships of the growth and value indexes are rebalanced annually by FTSE Russell based on its composite value score that considers book-to-price, medium-term earnings forecasts, and past sales per share growth[1].

[1] More details on FTSE Russell's methodology are available at https://www.ftserussell.com/products/indices/russell-us

When we look at some of those comparisons, two stand out—the distribution of economic sectors and forecasted growth. For this analysis, we group the sectors into three broad categories:

- Secular Growth Communication Services, Health Care, and Information Technology
- Cyclicals Consumer Discretionary, Energy, Financials, Materials, and Industrials
- Bond Proxies Consumer Staples, Real Estate, and Utilities

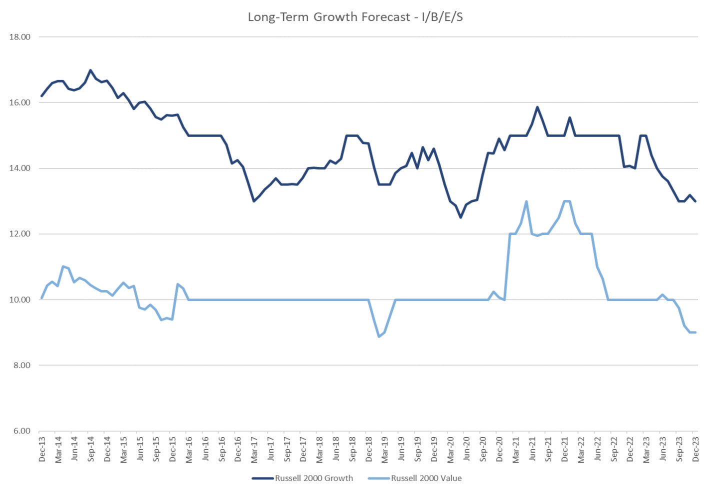




Source: Jefferies

Small cap growth stocks strike a balance between secular growth and cyclicals, with limited exposure to those stocks traditionally trading like bonds. That's in stark contrast to small cap value's typically high exposure (currently two-thirds) to cyclicals. As long-term investors, we believe our portfolios should emphasize secular growth companies and we tend to avoid those tied to fluctuations in commodity prices, monetary policies, global GDP rates, and other influences that may be short term in nature.

Small cap growth stocks also appear more attractive than value stocks on a prospective basis. When considering any potential investment, we evaluate a company's potential to increase its earnings. In our experience, key drivers of future stock price returns are that company's earnings strength and its ability to improve them. This is another area where growth has shown and continues to show an advantage over value among small caps.



Source: Jefferies

What's the case for the future?

It's hardly a secret that investors want to discern where the market puck is going, not merely where it's been. Looking a decade or so forward, we believe stock price rewards will be earned by innovative companies—innovative in the way they operate, innovative goods or services they offer, or innovative in the ways they adapt to change. Among small caps, we find far more of those opportunities in Health Care and Information Technology than in Financials, which aligns with the growth universe far more than value:

Weight on 12/31/23	Russell 2000 Growth	Russell 2000 Value
Health Care	22%*	9%
Information Technology	21%	6%
Financials	6%	27% *

**Largest Sector in that Index (Source: FactSet)*

Consider the market focus on Generative Artificial Intelligence in 2023. While we believe some aspects were overestimated—bordering on mania at times—we do not deny the long-term economic influence GenAI and the related aspects it may have, or its effect on stock prices, well beyond today's early stages. While this is just one example, it highlights the opportunity set growth stocks provide and why we believe they are better positioned than value stocks to reward long-term investors.

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