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Value and Growth Investing: Review and Update

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ategies, on
average, outperform growth investment strategies. The reward to value investing is

more pronounced for small-capitalization stocks and is present in equity markets outside the United States as well.

The reasons for the superior performance of value investing, however, are controversial. Some researchers attribute the higher returns to the higher risk of value stocks; other researchers contend that the rewards to value investing stem from cognitive biases underlying investor behavior and the agency costs of delegated investment management.

We summarize and bring up to date the academic empirical research on value and growth investing. The bulk of current research stopped short of the late 1990s, a period that was not kind to value stocks. When the data through 2001 are considered, however, value investing still outperforms growth investing. During the 1990s, the performance of growth stocks rocketed, prompting speculation that value investors were an endangered species. The careful examination of the data that we present suggests that the differences among equity asset classes with respect to their performance in the late 1990s were not grounded in fundamental patterns of profitability growth. A more plausible interpretation is that investor sentiment reached exaggerated levels of optimism about the prospects for such "growth" opportunities as telecommunications, media, and technology stocks. This interpretation is consistent with evidence that investors tend to focus on past growth and extrapolate too far into the future. Growth-oriented investments in the late 1990s were not accompanied by a corresponding increase in risk.

We also examine the performance of value and growth investing in the 1990s. We refine value and growth investing strategies and compare their performance to a value-weighted market portfolio. The results show that value investing outperformed growth investing by 5 percentage points per year. The results were also obtained when we compared value investing to a market portfolio of cap stocks and to the



Han Qu and Simon Zhang provided research assistance. We thank Clifford Asness and Jason Karceski for their comments. Given the unavoidable limits on time and space, this article is not meant to be an exhaustive review of existing research; we apologize in advance to authors of related works who have been overlooked in this discussion.

Related Research Data

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