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Growth versus Value

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There is no right or wrong when considering the valuation of a company today with its potential returns in the future. Sometimes, expensive companies do well and at other times those trading cheaply perform well. The factors that influence whether a company trading on a price-earnings (P/E) ratio of 22 today performs better than a company trading on 13 can be specific to the company, its industry, its management, but is most likely to be driven by investors' whims on a year-to-year basis in our view.

The best investments over the longer term are companies that focus on managing their businesses and do not focus too heavily on quarterly profit targets and pleasing analysts. If you consider Microsoft for example, its P/E ratio in 2001 was 32 and currently trades at 28. This was neither cheap in 2001 and it is definitely not cheap today with the MSCI World index average at around 16.

Over the intervening twenty-year period however, the Microsoft share price has risen over 10 times compared to 290% for the MSCI Developed World index. (Both are very respectable returns by the way). And this is not the only example of a company trading on higher P/E ratio at the turn of the century and providing returns significantly ahead of the broader market. Coca-Cola, Colgate, Diageo, Apple, Nestle, Proctor & Gamble, and Pepsico are further examples of how the current P/E ratio a company trades on does not provide any greater insight into its future stock market performance than a high dividend yield gives comfort.

Investing is about research and retesting your thesis continually. Understanding the dynamics at play in the global economy allows Tacit to focus our research efforts on specific longer-term ideas that we believe will add significant value to client portfolios under our stewardship. The current valuation of these ideas is important to us, but we are not slavish to any one metric. Having enough exposure to future growth, whether in a low-risk or high-risk portfolio, is vital as this is what ultimately provides positive inflation adjusted returns.

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