Municipal Employees' Retirement System of Louisiana

Growth vs. Value Education

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Starting Point – P/E

$$\frac{P}{E}$$

- The most common way to value a stock is based on its P/E Multiple (Stock Price/Earnings per Share).
- Stocks that are "expensive" have high P/E multiples.
- Stocks that are "cheap" have low P/E multiples.
- Think of this analogous to home values "price per square foot."

Valuation

- Why buy "expensive" stocks? -------→ **GROWTH** ---------→ Investors are willing to pay a high price because they believe the stock will grow faster (appreciate more) than the overall market.

- Why buy "cheap" stocks? ----------→ **VALUE** ---------→ Investors may believe the stock is mis-understood or undervalued and will rebound (i.e. reversion to mean).

Representative Growth and Value Stocks

Growth	Value
facebook, Apple, Microsoft, Google, The Home Depot	Johnson & Johnson, ExxonMobil, J.P.Morgan, verizon, Pfizer

- **Growth stocks** –tend to be clustered in industries like Technology, Healthcare, and Consumer Discretionary.
- **Value Stocks** –tend to be clustered in industries like Finance, Industrials and Consumer Staples.

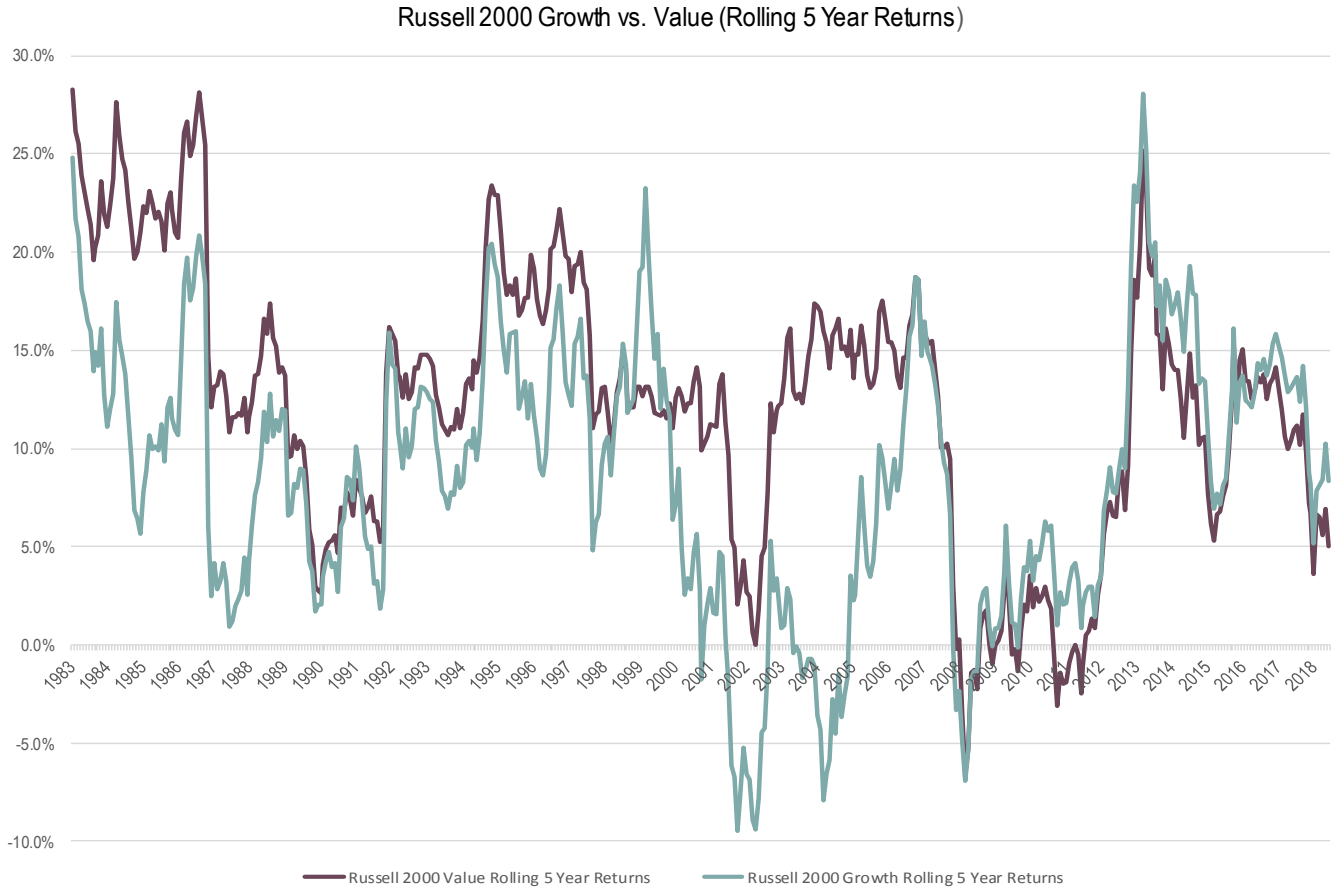
Characteristics

	Growth	Value
Valuation (P/E)	High	Low
Reinvestment Rate	High	Low
Growth Rate	High	Low
Sensitivity to Economy	High	Low
Dividend Yield	Low	High

- **Growth** companies are generally more expensive to buy (higher Price/Earnings multiple) but come with higher growth potential.
- They are generally more sensitive to the cyclicality of the economy. Many growth companies pay no (or minimal) dividend because they typically reinvest heavily back into the business.
- **Value** companies are generally cheaper (lower Price/Earnings multiple) and are frequently in more mature industries or regulated industries or industries less sensitive to overall economic growth.
- Often these companies pay a higher percentage of profits (dividend yield) to shareholders.

Why Plans Have Exposure to Both Growth and Value Strategies

- Outperformance between growth and value goes through cycles
- Most institutional pension plans have exposure to both growth and value strategies.



MERS U.S. Equity Exposure

Investment	Market Value[1]	% of U.S. Exposure	Tilt toward…
Northern Trust S&P 500 Index	$150.2 mm	57%	Core (both growth and value)
Northern Trust S&P 400 Index	$60.7 mm	23%	Core (both growth and value)
Barrow Hanley Small Cap Value	$51.1 mm	20%	Value

- MERS has three U.S. equity strategies across the market cap spectrum: large-cap, mid-cap, and small-cap.
- The two index funds are considered core strategies that have mixture of growth and value stocks.
- The Barrow Hanley Small Cap Value strategy is a value strategy.
- The System has no dedicated U.S. growth equity strategies.
  - This is partially balanced by two growth oriented non-U.S. equity strategies.

[1] As of March 31, 2019.

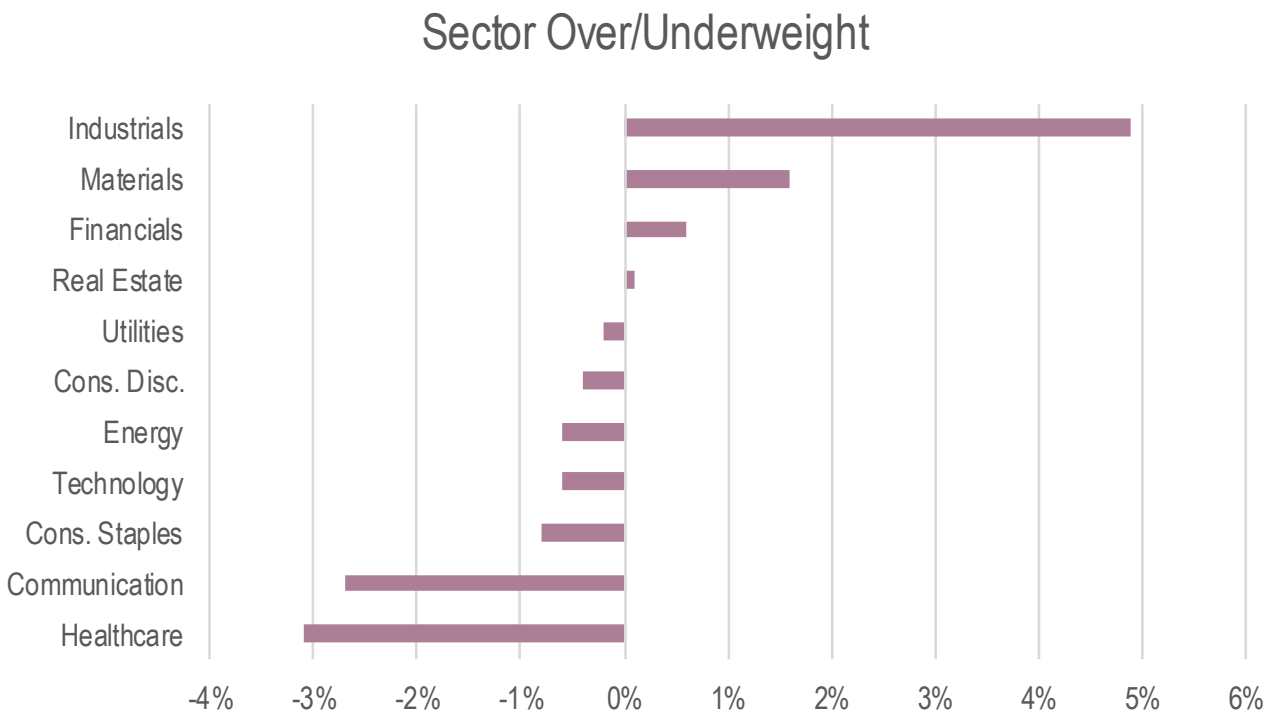
MERS U.S. Equity Characteristics[1]

	MERS U.S. Equity	Benchmark[2]	Tilt toward…
Valuation (P/E)	19	20	Value
Price to Book	2.8	3.3	Value
Growth Rate	11	13	Value
Dividend Yield	1.7	1.9	Growth

- MERS U.S. equity exposure has slight tilt towards more value characteristics.

[1] As of March 31, 2019.
[2] Russell 3000 Index – broad representation of all U.S. stocks

MERS U.S. Equity Characteristics[1]



- MERS is overweight sectors like industrials, materials and financials. These sectors are typically associated with value investing.
- MERS is underweight sectors healthcare and technology. These sectors that are typically associated with growth investing.

[1] As of March 31, 2019.

Recommendation

- We recommend adding growth exposure to U.S. equity through the addition of an active U.S. small cap growth manager.
- We recommend reducing the exposure to Barrow Hanley Small Cap Value to achieve balance between growth and value.

Timeline

- One meeting – compare/contrast four possible candidates (lead by Meketa). Identify two finalists.
- One meeting – interview two finalists in person.