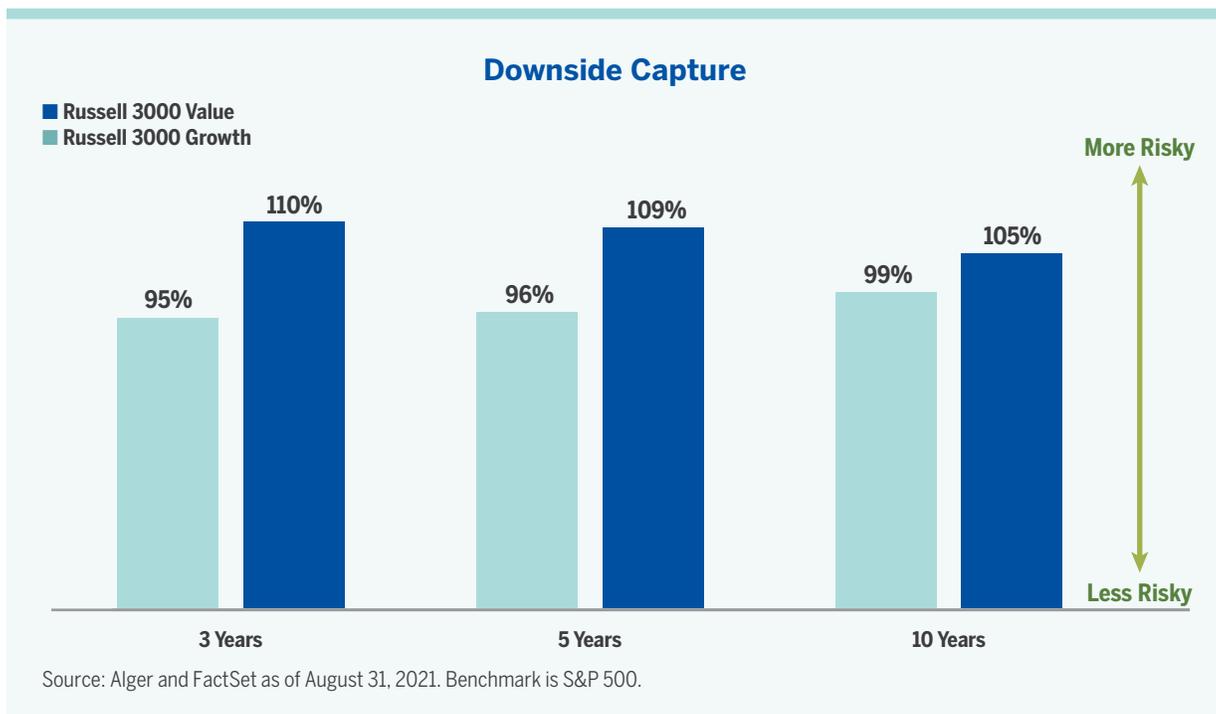


Identifying Risk

Many people view growth stocks that have relatively high shorthand valuation multiples, such as price-to-earnings, as more risky. But recent history suggests this may not be the case. What might investors be missing?



- Growth stocks, defined as the Russell 3000 Growth Index, have exhibited lower downside capture than value stocks, as defined by the Russell 3000 Value Index, over the past three, five and ten years. This means that growth stocks have performed better in down markets than value stocks, a key characteristic that many investors view as indicative of having lower risk.
- There may be several reasons why growth stocks exhibit less risk, including lower levels of financial leverage or debt; and lower levels of operating leverage or higher margins. Perhaps most importantly, growth stocks may potentially benefit from secular trends as opposed to cyclical drivers of fundamental growth. Compare a company that makes construction cranes (i.e., value) with a social network company (i.e., growth). The former is likely to have more financial and operating leverage and be more sensitive to economic conditions than the latter, in our view.
- This dynamic may make value stocks riskier despite their lower valuations. At times, we believe growth stocks may face challenges of investors wrestling with matters such as future market share gains and the appropriate rate at which to discount back future cash flows, but growth stocks also may have underappreciated characteristics, such as those described above, that may potentially mitigate their risk, particularly with respect to down markets.



Price-to-earnings is a ratio for valuing a company that measures its current share price relative to its earnings per share

Downside capture ratio measures a portfolio or market index's performance in down markets relative to a benchmark. It is calculated by taking the portfolio or market index's downside return and dividing it by the benchmark's downside return. A down-market is defined as those time periods in which market return is less than 0.

The S&P 500 Index is a stock market index tracking the performance of 500 large companies listed on stock exchanges in the U.S.

The Russell 3000 Growth Index is a stock market index that measures the performance of the broad growth segment of the U.S. equity universe

The Russell 3000 Value Index is a stock market index that measures the performance of the broad value segment of the U.S. equity universe.

Investors cannot invest directly in any index. Index performance does not reflect deductions for taxes. Note that comparing the performance to a different index might have materially different results than those shown. Past performance is not an indication or a guarantee of future results.

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