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Value Investing is an exciting opportunity for investors

- **Nimesh Shah**, MD & CEO, ICICI Prudential AMC compares it on a like to like basis with the growth investing strategy

Among the numerous strategies conceptualized for stock selection, over the years, two strategies have emerged to be among the most popular – growth investing and value investing. Both these investment styles are based on a stock's P/E multiple. The key difference between the two is the price at which the stock is available. While a growth stock will be available at a relatively higher P/E multiple, a value stock will be available at a low P/E with the potential of significant gains over time.

About value investing

Value investing is an investment strategy that seeks to buy stocks of companies that have been undervalued by the market. The basic theme of this investment strategy is buying stocks at less than their intrinsic value as it generally involves buying securities whose shares appear underpriced by fundamental analysis. Value investing focuses on the business and its fundamentals rather than external influences on the stock's price. It does so as it believes that the market overreacts to good and bad news, resulting in stock price movements that are not in sync with the company's fundamentals. The result is an opportunity for investors to profit by buying when the stock is underpriced.

Genesis

Benjamin Graham is considered the father of value investing. He along with David Dodd, both professors at Columbia Business School advocated the concept of 'Margin of Safety' which is the cornerstone of value investing. This concept was first introduced in Security Analysis, a book co-authored by them in 1934. Margin of safety is the difference between the market price and the calculated (intrinsic) value of the stock.

Recognizing value stocks

Important stock indicators considered for value investing are price to earnings (PE) ratio, price to book value (PB) ratio, P/E / (projected growth in earnings) or PEG ratio factors and dividend yield ratio. Lower the number, better the opportunity in terms of value investing. However, recognizing a value stock is the key to value investing. There appears to be some confusion even among fund managers in recognizing value stocks. For instance, is a stock available at a P/E multiple of say 15 a value stock? To recognize true value, one needs to take a step back and ask oneself, 'Based on the stock's fundamentals, am I getting say, Rs 100 worth of assets at say, Rs 70?' If the answer to this question is in the positive, then in all likelihood, one has spotted a value stock. Usually value stocks are available during times of controversy or a mishap that the market has not assessed in terms of its impact. As against this, growth investing would imply that a stock is available at a reasonably high P/E multiple but with the potential of growing even more or faster than the overall market growth over a period of time. However, since the margin of safety is compromised in this case, the risk levels move up.

Value investing in India

Value investing is one of the most popular investment themes globally. For instance, the proportion of assets in Value Funds and Growth Funds is nearly equal. As against this, in India, the proportion of assets in Value Funds is merely 10% of assets invested in Growth and other strategies. While most investment gurus would proclaim India to be a growth market where growth investing is the most suited investment style, the truth is that Indian markets offer a good opportunity to use value investing. In fact, value investing can be successfully applied in all types of markets – developed or high growth ones such as India or China. The contention for this view is that the investing strategy is not impacted by the type of market in order to be successful but by factors such as market sentiment, knowledge levels, industry life cycles, etc.

Using the mutual fund route

Value picking is an art which is acquired with long term investment experience. This necessitates retail investors to preferably use the mutual fund route to invest in value funds to profit from this investment strategy. However, investors should keep in mind that the fund manager of a value fund expects the fund's investors to stay invested for the long term till the market recognizes the value of the stock and price discovery takes place. This requires patience, which would eventually lead to reasonable gains.

In conclusion, value investing focuses more on the investor's cost; lower the cost, higher the margin of safety. The key to profit from this investment style is to stay with the investment for the long term.