The Case for Aggressive Growth

Why aggressive growth should be a part of every investor's portfolio

History demonstrates that equities have provided the highest long-term returns among major asset classes. Equities also surpass other asset classes in their capacity to offset long-term inflation, especially considering that a large portion of equity returns comes from capital appreciation which is not taxable until realized.

More specifically, many studies demonstrate that aggressive growth equity investment style has proven to be the most rewarding style over the long term.[1] Besides providing a long-term superiority of returns, the aggressive growth style can be viewed as one of the best hedges against inflation – which is an important consideration as we enter into what we believe will be a period of prolonged high inflation. A look back at the worst period of inflation in U.S. history demonstrates that the aggressive growth style was the only equities investment style to stay ahead of inflation. Between 1972 and 1980, the aggressive growth style returned 130% versus an advance of 95% for the Consumer Price Index (CPI).[2] *See Golden Eagle Strategies' paper: The Aggressive Growth Advantage.*

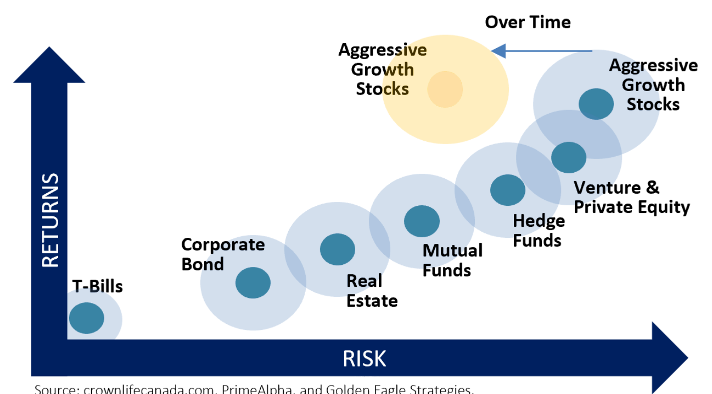
While the performance data provides a clear and compelling rationale for investing in aggressive growth, investors sometimes opt for less volatile asset classes. While volatility-mitigating investments may be prudent when cash assets are needed, all portfolios would benefit from having a portion of assets invested in aggressive growth. Why? Because this asset class drives wealth creation over time, as volatility smooths out, and also preserves wealth during periods of high inflation.

A BROAD VIEW: ASSET CLASS COMPARISON

Investors have many investment choices beyond traditional asset classes. When evaluating investment options, investors should consider a number of important criteria.

Risk Versus Return

In the chart to the right, we map asset classes based on risk and return similar to the Capital Asset Pricing Model (CAPM) which describes the relationship between systematic risk, expected return for assets, and cost of capital. Investors expect to be compensated for risk, the time value of money, and the cost of money. The higher the risk, the higher the reward.



Source: crownlifecanada.com, PrimeAlpha, and Golden Eagle Strategies.

For example, the T-Bill at the lowest risk profile has less than a 1% return rate. While it is true that aggressive growth stocks can be more volatile, the style has returned 31%, 23%, and 16% annually over the past 5, 10, and 15 years respectively.[1] **For investors seeking superior returns with a longer investment time horizon, aggressive growth becomes ever more attractive on a risk-adjusted basis.** When investing, however, there are additional considerations beyond returns and risk. Liquidity and ease of access are also key.

Liquidity Considerations

When considering products such as private equity, venture capital, real estate, and certain hedge funds, hold time must be factored in as they are either closed-ended funds with a long-term hold of up to 14 years or have 3-5 years terms with early withdrawal penalty fees. An illiquidity premium is the additional return expected for the additional risk of tying up capital in a less liquid asset. During periods of financial crisis, investors may need to liquidate high-performing investments to provide cash liquidity and hold onto what could be under-performing investments in their portfolios due to liquidity terms. Therefore, illiquid investments must provide excess performance relative to liquid investments to compensate for the illiquidity. Plus, vehicles in illiquid asset classes often struggle to deploy all their capital, creating the possibility of being underleveraged.

Ease of Access

Most investors seeking a broader set of quality investment products cannot access them due to high minimum investment requirements and the complexity of investments. Private equity and venture capital are broadly considered the most restrictive in terms of investors ability to access these types of investments. This is followed by hedge funds and real estate. For many hedge funds, the minimum investment could be $1 Million or higher which is out of reach for most investors. Additionally, they are often complex instruments and may require a higher level of due diligence. The most accessible asset class is direct public equity stocks or ETFs, however, accredited investors can access niche alternative equity strategies that can provide differentiated and tailored solutions for portfolio construction that outperform direct stock or index investing.

Asset Class Comparison

In summary, the following chart compares returns, risk, liquidity, and ease of access across each asset class.

	Returns	Risk / Volatility	Liquidity	Ease of Access
Bonds/Fixed Income	*low*	*low*	*high*	*high*
Mutual Funds	*medium*	*medium*	*high*	*high*
Stocks (S&P 500)	*medium to high*	*medium to high*	*high*	*high*
Aggressive Growth Stocks	*high*	*high*	*high*	*high*
Hedge Funds	*medium*	*medium*	*medium*	*low to medium*
Real Estate	*medium to high*	*medium to high*	*low*	*low*
Private Equity / Venture	*high*	*high*	*low*	*low*
Private Credit	*medium*	*low to medium*	*medium*	*medium*

When looking to maximize returns, the highest performing asset classes are stocks, private equity, and venture capital. Of these three, stocks are the easiest to access and most liquid. Within stocks, aggressive growth has produced the highest returns historically.[1] While the risk profile of aggressive growth stocks is slightly higher than stocks as a whole due to higher volatility, volatility is reduced when investing with a long-term time horizon (as illustrated in the risk versus return chart).

ASSET ALLOCATION AND THE CASE FOR EQUITIES

As you see above, every investment comes with different characteristics. Asset Allocation insulates portfolios from the volatility of a single investment through diversification. Even for very conservative investors who may be tempted to avoid stocks, some exposure to stocks can help maximize returns as well as offset inflation. Every Investment portfolio should have some stocks/aggressive growth no matter their risk profile, age, or goals to provide a balanced portfolio that provides for growth or as an inflationary hedge. Below are three case studies of how investors use equities/stocks/aggressive growth in their portfolios.

Case 1: Endowment, driving returns for the portfolio: An example of return profiles across asset classes comes from the $53.2 billion Harvard University Endowment, which has one of the best endowment investment teams. In looking at Harvard's asset allocation over the past two years, it becomes clear that public equities are a critical driver in wealth creation for the portfolio – generating double digit returns each year. Private equity also generated significant returns, however private equity deals can be difficult to source and are much less liquid than public equities. Compared to the average investor, Harvard has a significant advantage in sourcing deals given their brand recognition and the large investment team that they employ. Coming in third on the list each year is hedge funds, but in both cases returns for this class are notably lower than public and private equity.

Endowment Performance
FISCAL YEAR 2021

Asset Class	June 30, 2021 Allocation	Investment Return
Public Equity	14%	50%
Private Equity	34%	77%
Hedge Funds	33%	16%
Real Estate	5%	13%
Natural Resources	1%	(1)%
Bonds/TIPS	4%	3%
Other Real Assets	1%	1%
Cash & Other	8%	---
Total	**100%**	**34%**

Endowment Performance
FISCAL YEAR 2020

Asset Class	June 30, 2020 Allocation	Investment Return
Public Equity	18.9%	12.2%
Private Equity	23.0%	11.6%
Hedge Funds	36.4%	7.9%
Real Estate	7.1%	-0.5%
Natural Resources	2.6%	-6.2%
Bonds/TIPS	5.1%	8.2%
Other Real Assets	1.3%	-17.5%
Cash & Other	5.6%	---
Total	**100%**	**7.3%**

Source: https://www.harvardmagazine.com/2021/10/harvard-endowment-surges-11-3-billion-university-surplus

Case 2: Individual Investors, able to access returns that are liquid: Let's look at Fidelity's product "Fidelity Fund Portfolios—Diversified". For individual investors, returns are generated by stocks in a traditional stock/bond portfolio. Fidelity allocates 85% to stocks to achieve the highest possible returns in its aggressive growth portfolio, but even in the most conservative portfolio, 20% of assets are allocated to stocks.

Fidelity Asset Allocation	Domestic Stock	Foreign Stock	Bonds	Short Term (Cash)
Conservative	14%	6%	50%	30%
Balanced	35%	15%	40%	10%
Aggressive Growth	60%	25%	15%	0%

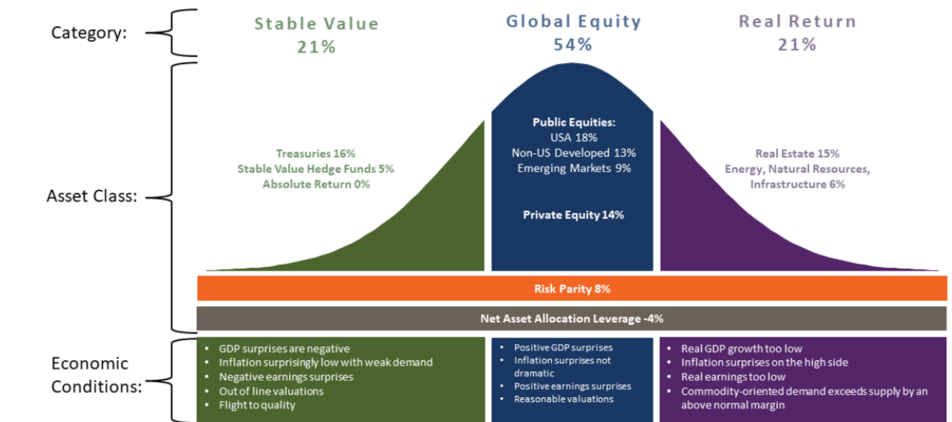
Source: https://www.fidelity.com/mutual-funds/fidelity-fund-portfolios/overview

When compared to the endowment model, Fidelity portfolios consist only of stocks and bonds. Endowments diversify their return drivers with a mix of public equities, private equity, hedge funds and real estate. These categories combined average approximately 80%, which is comparable to Fidelity's aggressive growth approach. Allocation to private equity, hedge funds and real estate can be harder for most investors to access.

Case 3: Pension, utilizing aggressive growth stocks through economic and market environments: Teachers' Retirement System, the largest pension plan in the United States, allocates assets using *The TRS Diversification Framework* "to provide a long-term, risk-adjusted return through all economic and market environments".

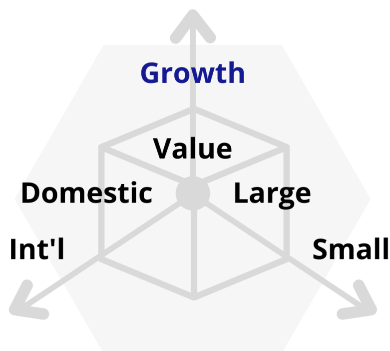
The Framework groups assets into multiple portfolios, each designed to perform well in a different economic environment.

“Global Equity” represents the majority of Trust assets at 54%, and consists of public equities (30%) and private equity (14%). “Stable Value” includes treasuries (16%) and hedge funds (5%) and “Real Return” consists of real estate (15%) and energy, natural resources, and infrastructure (6%). Again, public equities play a central role in terms of portfolio construction for wealth creation.



Source: https://www.trs.texas.gov/Pages/investment_diversification_framework.aspx

HOW SHOULD INVESTORS LOOK AT THE WORLD OF EQUITIES



Within stocks, there are several categories to evaluate: growth versus value, domestic versus international, and large to small market cap.

Domestic versus International

Overall, the U.S. stock market has generated the highest returns among the major stock markets over the past 10 years as detailed below. It is the most prosperous, innovative, and politically stable country in the world which has propelled the U.S. stocks markets ahead of all major stock markets for years. Furthermore, the U.S. stock market already has global exposure, given approximately 40% of the S&P is foriegn sourced income.

S&P 500	363%
NASDAQ Composite	500%
European-Asia markets	69%
Vanguard Emerging Markets Fund	35%
MSCI BKF (Brazil, Russia, India, China) ETF	54%

Growth versus Value

While company size is an important consideration for many investors, the investment style has a greater impact on returns. Traditionally, investment styles are defined as growth, value, and blended (growth + value). **Growth stocks** are those companies that have the potential to outperform the overall market over time because of their future potential. **Value stocks** are typically defined as companies whose stock price is currently trading below the company's underlying value. The expectation is that buying undervalued companies will generate a

superior return over time. Whether growth or value stock investing strategy is better is a perennial debate. According to the following historical data, there is a clear winner.

Growth of a $100 Investment From 1958-2021	
Aggressive Growth Funds	**$170,100**
Growth Funds	$72,400
Value Funds	$26,700
S&P 500	$55,700

Golden Eagle Strategies has constructed investment style indices that date back to 1958. As seen in the table on the left, a $100 investment in aggressive growth funds would have grown to approximately $170,100 before taxes. The same $100 investment in the S&P 500 would have grown to approximately $55,700. Of all investment styles, the aggressive growth style has proven to be the most rewarding over the long term.[3]

In other words, the Capital Asset Pricing Model (CAPM) does work. It holds that there is a reward for risk – especially when measured over time. This advantage still holds when looking at recent history. Aggressive growth bested all investment styles in the last 5 years with an annualized return of 30.9% vs 18.5% for the S&P. This story is the same when looking at 10 and 15 years – aggressive growth delivered annualized returns of 22.6% and 16.4%, respectively, versus just 16.6% and 10.7% for the S&P.[3]

WHY SHOULD INVESTORS INVEST IN AGGRESSIVE GROWTH? PRO'S AND CON'S TO CONSIDER

Inflation Hedge: A look back at the worst period of inflation in U.S. history during the 1970s explains why aggressive growth investing is a great hedge against inflation. Inflation spiked from 3.3% in 1972 rising to 12.5% in 1980. Over that period, the Consumer Price Index (CPI) advanced by 95%.[2] The aggressive growth category was the only style, among growth and value, to stay ahead of inflation with a return of 130%. By comparison, S&P 500 investors suffered during this period in real terms as the return for this index captured only two-thirds of the inflation rate.[1]

The U.S. has again entered a period of high inflation which many project will persist for years to come. It is important to note that the current inflationary period is different in many ways than that of the 1972-1980 era where interest rates rose along with the inflation rate during this period. The 10-year Treasury Bond peaked at 15.1% whereas the 30-year T-Bond reached a peak at 17.7%.

Today the current yield on the 10-year T-Bond is an anemic 2.7% with inflation running around 14%, according to findings by Golden Eagle Strategies. Bond investors are being eaten alive and have lost 12% of purchasing power in the past year when a more accurate rate of inflation is considered (a 14% inflation rate combined with a 1.7% yield on the 10-year T-Bond equates to a real loss in the capital of 12.3% per year before taxes).

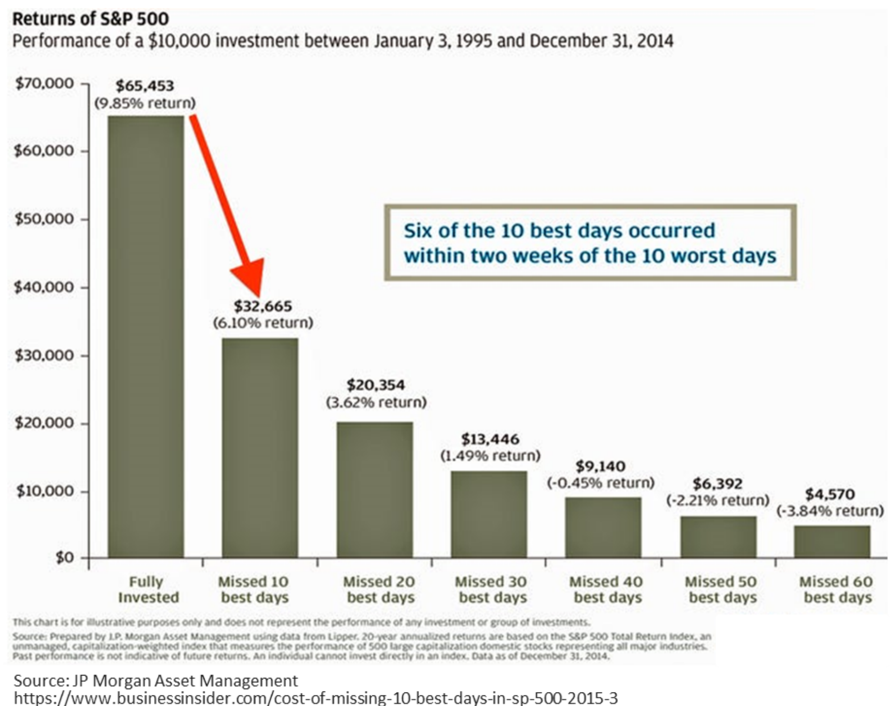
Volatility as Opportunity: Many investors shy away from high-growth stocks because they are unaware of their superior historic returns and are afraid of volatility. Those who understand volatility see it as a market opportunity. Consider the high returns posted for aggressive growth over time:

- Volatility means the fastest-growing stocks go to higher highs than ever before.
- This means more stocks achieve gains of 100% or more in any year than ever before.
- This means that volatility offers greater potential for high returns.

Volatility becomes irrelevant over time in building wealth. The most prudent entry approach is to invest consistently, taking a long-term horizon because time smooths out volatility. Another is to buy an asset after a decrease in value. For example, aggressive growth has recently gone through the worst downturn since 2008. Pursuing both is optimal.

De-Risking Volatility: Investors often associate the reduction of risk with diversification, but risk can also be reduced by investing over the long term. Over any 10-year period since the S&P was introduced in 1926, the market has provided a positive return 94% of the time, and over 11 years the return has been positive 100% of the time.

It is extremely challenging to predict short-term swings in the market and even harder to do so consistently. The key is to stay invested. Market lows often result in emotional decision-making. However, some of the most significant one-day upswings in the market occur during these volatile periods.



Source: JP Morgan Asset Management
https://www.businessinsider.com/cost-of-missing-10-best-days-in-sp-500-2015-3

CONCLUSION

Most investors understand the stock and bond portfolio mix. As the sophistication of investors increases so does the sophistication of asset classes utilized, portfolio management, asset allocation, and risk management. What we have found across all investors, however, is the following:

- Almost all investors have a significant allocation to stocks which serves to drive returns.
- Not only are equity returns notably higher than fixed income, but the compounding of those returns result in exponential wealth creation over time.
- Within equity investing, aggressive growth has historically outperformed growth and value.
- Because aggressive growth stocks are accessible to most investors, they can mirror the gains by larger, sophisticated investment teams, such as those who run endowments.
- Accredited investors can also access niche alternative equity strategies that can provide tailored solutions for portfolio construction that outperform direct stock or index investing.

In summary, depending on your investment goals, aggressive growth can provide for wealth creation, inflationary hedge, and/or portfolio diversification. However, in this asset class it is important to remember that time horizon is key. When investing in stocks, and especially aggressive growth stocks, it is critical to take a long-term view in light of increased volatility in this class**.** Time smooths out volatility and allows returns to compound. Historically, by adopting this approach, the aggressive growth equity investment style has proven to be the most rewarding style over the long term.

[1] *Investment Style Index (1958-20210) consists of Weisenberger Mutual Fund Report, Frank Russell Company, Golden Eagle Strategies research*
[2] *Bureau of Labor Statistics*
[3] *Aggressive Growth Fund Index consists of top performing publicly traded aggressive growth funds based on Golden Eagle Strategies research*