

Exchange Traded Funds

Growth for contrarians

Initial Opinion

Growth investing is contrarian again

The Wall St. consensus is that vaccines/reopening will cause a big reallocation from growth to value...evident from positioning & flows (Chart 1). But without a structural economic shift, only a brief rotation is possible, not a sustained rebalancing (Chart 2).

That's why investors should own both growth & value. We initiate coverage of 6 growth ETFs; for investors who want low-cost, liquid exposure to familiar benchmarks, the highest-rated fund in our model is the Schwab US Large Cap Growth ETF (SCHG, 1-FV).

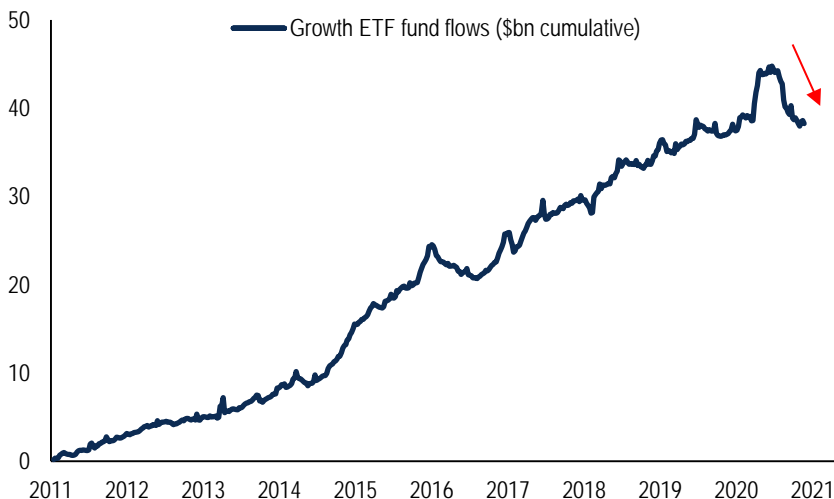
Four reasons to rethink Growth benchmarks

There are also good reasons to look beyond familiar ways of finding growth stocks:

1. **Diversification:** conventional benchmarks allocate 40% to the five mega-cap FAAMG stocks, a risky proposition (Chart 4);
2. **Profits:** cheap liquidity & hapless regulators goaded M&A "gluttons" into flattering their fundamentals; we favor tighter links between R&D and profits;
3. **Future tech:** Moore's Law is ending (Chart 5); growth investing means looking for future tech (AI, ML, quantum) and for applications beyond the IT sector;
4. **Secular growth:** growth defensives may see more outflows as the economy rebounds; we favor stocks that can win across the whole business cycle.

We highlight iShares Exponential Technologies (XT, 2-FV) as one of a class of products that closely tracks the BofA Efficient Growth strategy ([link](#)) and meets the criteria above.

Chart 1: Growth investing is contrarian again



Source: BofA Global Research, Bloomberg; cumulative fund flows for SCHG, IWF, VUG, XT, SPYG, IWW

23 November 2020

Exchange-Traded Funds
United States
Other Financials

Jared Woodard
Investment & ETF Strategist
BofAS
+1 646 855 2600
jared.woodard@bofa.com

Elias Lanik
ETF & CEF Strategist
BofAS
+1 646 855 2359
elias.lanik@bofa.com

Pooja Saksena
ETF Strategist
BofAS
pooja.saksena@bofa.com

Jordan Young, CMT
Technical Research Strategist
BofAS
jyoung29@bofa.com

Table 1: Growth ETF ratings

Ticker	Rating	Price
SCHG	1-FV	120.97
IWF	2-FV	226.86
VUG	2-FV	239.13
XT	2-FV	52.73
SPYG	3-FV	52.70
IWW	3-FV	60.81

Source: BofA Global Research

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Growth investing is contrarian again

The Wall St. consensus is that vaccines and reopening will spark a big reallocation from deflation to inflation assets, e.g. growth to value, US to EM, bonds to commodities; the view is evident among [fund managers](#) and fund flows (Chart 1).

Without a structural economic shift, a brief rotation from growth to value is possible, but a sustained rebalancing is unlikely. 80% of growth vs. value is explained by broad macro trends (Chart 2), and as we argued recently ([link](#)) a vaccine-fueled return to bearish budget austerity & secular stagnation is not a game-changer for asset allocation.

That's why investors should own both growth & value. We initiate coverage of 6 growth ETFs; for investors who want low-cost, liquid exposure to familiar benchmarks, the highest-rated fund in our model is the Schwab US Large Cap Growth ETF (Table 2).

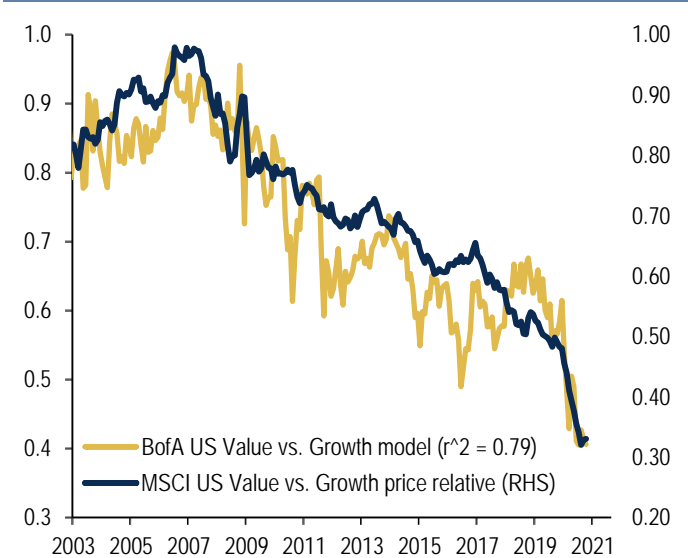
Table 2: Growth ETFs – Ratings/Scores/Factors

Ticker	Name	Rating	Total Score	Efficiency				Technical		Fundamental	
				Expense ratio	NAV tracking difference	Bid/Ask spreads	Daily value traded (\$mn)	Price momentum	Sortino Ratio	EPS Growth (12m trailing)	% Underperform stocks
SCHG	Schwab U.S. Large-Cap Growth ETF	1-FV	96	0.04%	0.05%	0.04%	60.4	8.5%	1.25	14.0%	3%
IWF	iShares Russell 1000 Growth ETF	2-FV	52	0.19%	0.29%	0.02%	328.5	7.9%	1.19	14.0%	5%
VUG	Vanguard Growth ETF	2-FV	51	0.04%	0.07%	0.03%	222.7	8.0%	1.30	10.6%	5%
XT	iShares Exponential Technologies ETF	2-FV	45	0.47%	0.28%	0.09%	11.6	9.7%	1.03	21.0%	12%
SPYG	SPDR Portfolio 500 Growth ETF	3-FV	39	0.04%	0.03%	0.02%	122.1	8.2%	1.15	11.3%	5%
IWW	iShares S&P 500 Growth ETF	3-FV	30	0.18%	0.23%	0.03%	121.6	8.2%	1.15	11.3%	5%
Average		-	52	0.16%	0.16%	0.04%	144.5	8.4%	1.18	13.7%	6%

Source: BofA Global Research, Factset

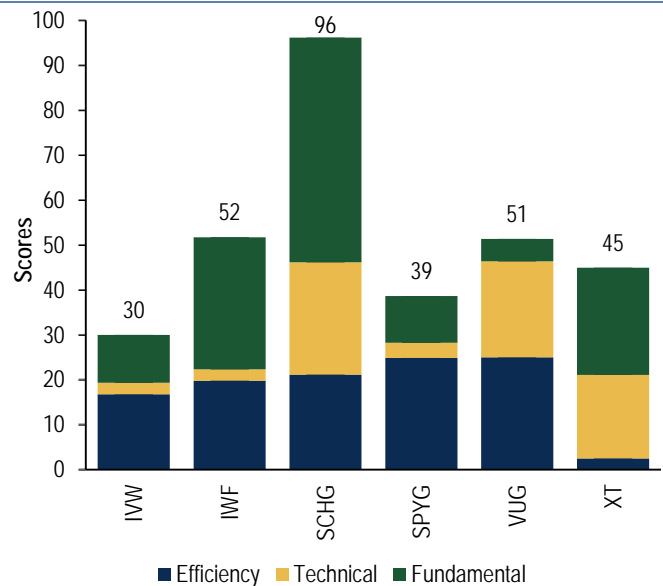
Chart 2: Growth vs. value is a macro trade

Inflation, interest rates, and the business cycle explain 80% of returns



Source: BofA Research Investment Committee, Bloomberg; model = 10yr Treasury yield, 5y5y inflation breakeven, & ISM PMI

Chart 3: Growth ETF model scores



Source: BofA Global Research, Factset

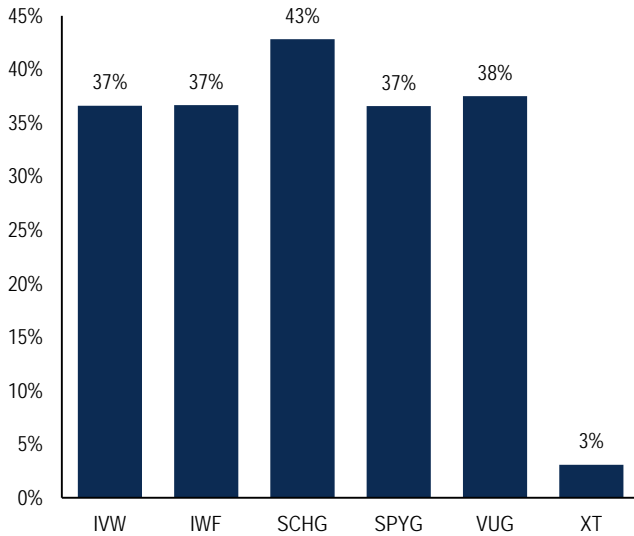


4 reasons to rethink Growth benchmarks

There are also good reasons to look beyond familiar ways of finding growth stocks:

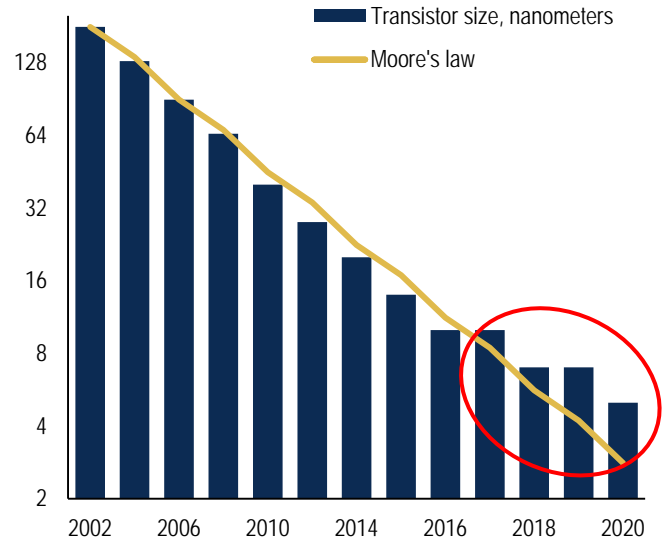
1. **Diversification:** conventional benchmarks allocate ~40% to the five mega-cap FAAMG stocks. That’s risky in any market, but never more so than when those same companies are under increasing regulatory & [political scrutiny](#) (Chart 4);
2. **Profits:** for years, cheap liquidity and hapless regulators have goaded mature, dominant firms into becoming M&A “gluttons” to flatter their fundamentals; but as we have argued this year, risk-adjusted returns are far better from companies that rely on R&D rather than M&A to generate profits (e.g. BofA Efficient Growth - [link](#));

Chart 4: Many growth indexes are just FAAMG-trackers in disguise



Source: BofA Global Research, Bloomberg

Chart 5: Investing for the end of Moore’s Law



Source: BofA Global Research, Linley Group, TSMC, Samsung et al.

3. **Future tech:** Moore’s Law – the prediction that computing power would double every two years – held true and was a big driver of productivity; but as transistor size reaches its limits (Chart 5), growth investing means looking beyond incremental software-driven gains, toward future tech (AI, ML, quantum computing, advanced materials), and for applications beyond the IT sector alone; again, more diversified sector exposure will be important (Chart 6);
4. **Secular growth:** defensive growth stocks were the biggest winners from safe-haven flows in 2020, but they may see heavy outflows as the economy rebounds; we favor secular winners, and note that some growth ETFs achieved positive returns even around recent vaccine announcements (Chart 7).

We highlight iShares Exponential Technologies (XT, 2-FV) as one of a newer class of products that seeks growth driven by innovation. XT most closely tracks the BofA Efficient Growth strategy and looks more diversified, less accounting-driven, and better poised to benefit from future tech across the business cycle (Table 3).

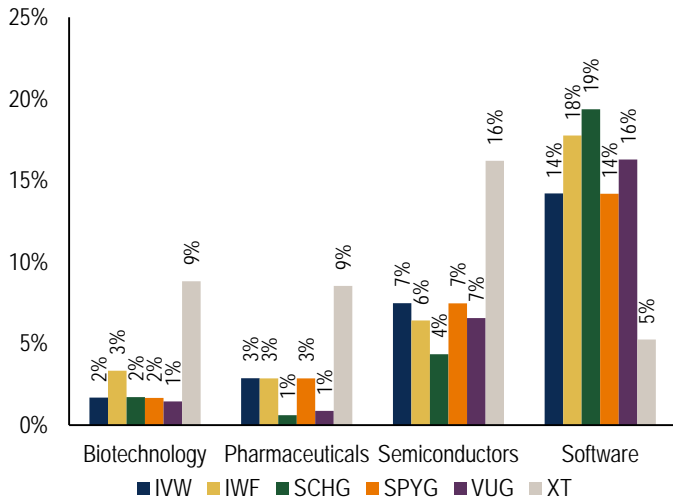
Table 3: Growth ETFs for future tech

	VUG	IWF	IVW	SCHG	SPYG	XT
CAGR vs Efficient Growth	-1.5%	-2.6%	-3.2%	0.0%	-3.0%	0.0%
% FAAMG	38%	37%	37%	43%	37%	3%
% Future Tech	25%	20%	22%	26%	22%	39%
Rank: Correlation vs Efficient Growth	3	4	5	2	6	1

Source: BofA Global Research, Bloomberg; *% future tech* shows representation of key stocks in our [thematic research](#)

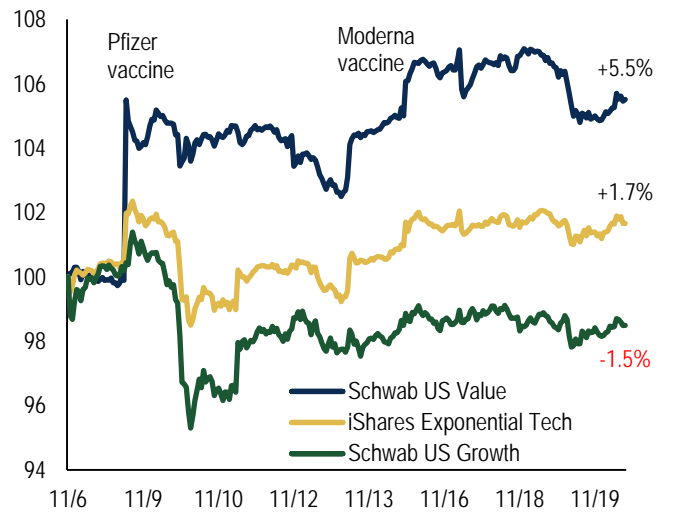


Chart 6: Key industry exposures among growth ETFs



Source: BofA Global Research, Bloomberg

Chart 7: Even in a rotation to value, some growth ETFs outperformed



Source: BofA Global Research, Bloomberg

Stocks mentioned

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
SCHG	SCHG US	Schwab ETF	US\$ 120.04	1-FV
IWF	IWF US	iShrs R1000 Grth ETF	US\$ 225.46	2-FV
VUG	VUG US	Vanguard Growth ETF	US\$ 237.36	2-FV
XT	XT US	iShares Expo Tech	US\$ 52.88	2-FV
SPYG	SPYG US	SPDR Portfolio ETF	US\$ 52.29	3-FV
IVW	IVW US	iShares S&P 500 ETF	US\$ 60.36	3-FV



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