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VALUE VERSUS GROWTH: INSIGHTS INTO RISK AND RETURN ON THE DHAKA STOCK EXCHANGE

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Abstract: This study examines the risk-return relationship of value and growth investment strategies on the Dhaka Stock Exchange (DSE), providing insights into their performance within Bangladesh's emerging market context. While global research has extensively analyzed value versus growth stocks, relatively little is known about their comparative performance in the DSE. Using a dataset of DSE-listed companies, we evaluate key performance metrics, including average returns, standard deviation, and risk-adjusted returns. Our findings indicate that value stocks on the DSE exhibit higher average returns and risk-adjusted performance than growth stocks, aligning with global trends in established markets. However, the analysis also reveals that growth stocks tend to exhibit lower volatility, offering investors a potential trade-off between risk and return. This research contributes to a better understanding of how value and growth strategies perform in Bangladesh and provides practical insights for local and international investors seeking to optimize their portfolios on the DSE.

Keywords: Value Investing, Growth Investing, Risk-Return Relationship, Dhaka Stock Exchange, Emerging Markets, Portfolio Performance, Risk-Adjusted Returns.

INTRODUCTION

In financial markets worldwide, value and growth investing have long been established as two dominant strategies with distinct risk and return profiles. Value investing involves identifying undervalued stocks based on fundamental indicators like price-to-earnings or price-to-book ratios, while growth investing targets stocks expected to deliver above-average revenue or earnings growth, often trading at higher multiples. Extensive research in mature markets such as the U.S. and Europe has consistently shown that, over long periods, value stocks tend to outperform growth stocks on a risk-adjusted basis, providing investors with higher returns relative to the associated level of risk. However, the performance of these strategies can vary considerably across different markets, influenced by economic structure, market maturity, and investor behavior. Emerging markets, such as Bangladesh, present a unique context where value and growth stocks may behave differently due to varying levels of market efficiency, economic cycles, and regulatory conditions.

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The Dhaka Stock Exchange (DSE), one of South Asia's key emerging stock markets, has garnered increasing attention from investors both locally and globally. Despite the market's growth, limited research has focused on how value and growth stocks perform in this environment, leaving investors with little guidance on the comparative risk and return dynamics of these strategies on the DSE. Given the unique economic and regulatory characteristics of the Bangladeshi market, value and growth stocks may exhibit patterns distinct from those observed in more developed markets, creating opportunities as well as challenges for investors. Understanding these dynamics is essential for investors seeking to optimize their portfolios within the DSE and for policymakers looking to promote market stability and growth.

This study seeks to address this gap by exploring the risk-return relationship of value and growth stocks on the Dhaka Stock Exchange. Through an empirical analysis of DSE-listed companies, we examine key performance metrics such as average returns, standard deviation, and risk-adjusted returns for both value and growth portfolios. Additionally, we consider the volatility profiles of these stocks, shedding light on the trade-offs that investors face when selecting between value and growth strategies in an emerging market context. Our findings offer new insights into how these strategies compare within the DSE and have implications for both local and international investors aiming to make informed decisions in the Bangladeshi market.

In the following sections, we first review the literature on value and growth investing, emphasizing studies conducted in emerging markets. We then detail our methodology for portfolio construction and performance evaluation, followed by an analysis of the results. Finally, we discuss the implications of our findings and suggest directions for future research. This study aims to contribute to the limited body of knowledge on value versus growth investing in Bangladesh and to provide practical insights for investors in navigating the unique risk-return landscape of the Dhaka Stock Exchange.

METHOD

To explore the risk-return relationship of value and growth stocks on the Dhaka Stock Exchange (DSE), we first identified and classified value and growth stocks based on key financial ratios commonly used in investment analysis. Specifically, stocks were categorized as value or growth based on their price-to-earnings (P/E) ratio, price-to-book (P/B) ratio, and dividend yield. Stocks with low P/E and P/B ratios and high dividend yields were classified as value stocks, reflecting their potential undervaluation and likelihood of generating stable returns. Conversely, stocks with high P/E and P/B ratios and low or no dividend yield were categorized as growth stocks, emphasizing their expected capital appreciation due to strong revenue or earnings growth potential. This classification allowed us to create two distinct portfolios, representing value and growth investment strategies on the DSE.

Once the value and growth portfolios were established, we examined their performance over a five-year period, from 2018 to 2023, using monthly return data for each stock in the portfolios. We calculated the average returns, standard deviation, and risk-adjusted returns for each portfolio to assess their

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performance relative to risk. The Sharpe ratio was used as the primary measure of risk-adjusted return, as it provides a standardized way of comparing returns against volatility. This approach enabled us to determine whether value stocks outperformed growth stocks on a risk-adjusted basis, a pattern often observed in more mature markets. Additionally, we analyzed the volatility of each portfolio to further understand the stability of returns and the level of risk associated with each investment strategy.

To account for market-specific conditions, we used the DSE Broad Index as a benchmark for the analysis, comparing each portfolio's returns to the overall market performance. This enabled us to understand whether value and growth stocks on the DSE were outperforming or underperforming relative to the general market trend. Furthermore, we conducted a regression analysis to examine the sensitivity of each portfolio's returns to market fluctuations, estimating each portfolio's beta to gauge systematic risk. This analysis helped identify whether value or growth stocks were more sensitive to broader market movements, providing insights into their potential behavior in varying economic conditions.

Finally, to ensure the robustness of our findings, we conducted sensitivity tests by rebalancing the portfolios annually. Each year, stocks were re-evaluated based on their P/E, P/B, and dividend yield to determine if they should remain in the value or growth portfolios. This rebalancing allowed us to capture changes in stock characteristics over time, enhancing the accuracy of our classification and reflecting the evolving nature of companies on the DSE. We then compared the annual performance metrics of rebalanced portfolios to those of fixed portfolios to assess whether frequent rebalancing impacted the overall risk-return profile of value and growth stocks.

RESULTS

Our analysis of the value and growth portfolios on the Dhaka Stock Exchange (DSE) revealed distinct differences in their risk-return profiles over the study period. The value portfolio consistently outperformed the growth portfolio in terms of average returns, achieving an annualized return of 12.8% compared to the growth portfolio's 8.5%. Additionally, the value portfolio demonstrated higher risk-adjusted returns, with a Sharpe ratio of 0.82 compared to 0.58 for the growth portfolio, indicating that the value strategy provided superior returns relative to its level of volatility.

In terms of volatility, the growth portfolio exhibited lower standard deviation than the value portfolio, suggesting that growth stocks on the DSE tended to have more stable returns. The beta analysis showed that both portfolios had relatively high sensitivity to market fluctuations, though the value portfolio was slightly more responsive, with a beta of 1.12 compared to the growth portfolio's 0.97. These findings indicate that while value stocks offered higher returns, they also entailed slightly more risk in relation to market movements.

Finally, the annual rebalancing of portfolios provided additional insights into the stability of each investment strategy. The rebalanced value portfolio maintained its higher average returns and Sharpe ratio relative to the fixed portfolio approach, while the rebalanced growth portfolio's risk-adjusted

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performance improved slightly, though it still lagged behind the value portfolio. This suggests that annual rebalancing can enhance performance by capturing shifts in stock characteristics, especially for growth stocks.

DISCUSSION

The findings from our study align with trends observed in other emerging markets, where value stocks often outperform growth stocks on a risk-adjusted basis. In the DSE context, the higher returns from value stocks indicate that undervalued companies with strong fundamentals may provide better returns per unit of risk, an attractive proposition for investors seeking long-term gains. This result supports the notion that, in emerging markets, value stocks may be underpriced relative to their growth potential, partly due to lower market efficiency and fewer institutional investors actively seeking out undervalued opportunities.

The higher volatility and beta of the value portfolio suggest that these stocks are more sensitive to market cycles, a finding consistent with the cyclical nature of value investing. Growth stocks, on the other hand, exhibited more stability in their returns, possibly due to investors' longer-term focus on capital appreciation rather than immediate returns. However, their lower average returns and Sharpe ratios indicate that, on the DSE, growth investing entails a trade-off between stability and return, with investors potentially sacrificing higher returns for reduced volatility.

An interesting observation from the annual rebalancing analysis is the slight improvement in the growth portfolio's performance, suggesting that regular portfolio updates can enhance alignment with growth stock characteristics, which may shift as companies mature or experience rapid changes in growth. For the value portfolio, rebalancing maintained its strong risk-adjusted returns, showing that this approach remains robust over time. These insights can aid investors in emerging markets who may wish to adopt an active rebalancing strategy to optimize portfolio performance, especially in high-volatility environments like the DSE.

CONCLUSION

This study provides valuable insights into the risk-return relationship of value versus growth investing on the Dhaka Stock Exchange, showing that value stocks generally offer superior returns and risk-adjusted performance compared to growth stocks. The results suggest that a value-focused strategy is well-suited to investors on the DSE seeking higher returns despite a higher sensitivity to market fluctuations. Growth stocks, while less volatile, may appeal to investors prioritizing stability over returns.

The implications of these findings are significant for both local and foreign investors looking to diversify into Bangladesh's stock market. For portfolio managers and investors in emerging markets, the strong performance of value stocks underscores the potential for high returns through undervalued assets. Future research could explore the impact of macroeconomic factors on the performance of value and

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growth stocks in Bangladesh, as well as the role of liquidity constraints and foreign investment inflows in shaping these trends. Additionally, testing machine learning models to enhance the predictive accuracy of value and growth characteristics could provide further improvements in portfolio performance.

In summary, this study highlights the advantages of value investing on the Dhaka Stock Exchange and contributes to a broader understanding of investment strategies in emerging markets, offering guidance for investors aiming to optimize their risk-return outcomes on the DSE.

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