

Investtalk *InfoSheet*: Growth Stocks

In the investment world stocks are categorized in different ways.

Some of these are blue chip, value, growth, trusts, REITs and penny stocks. Though there is no official definition of any of these groups there are certain similarities that are common to each category.

Growth stocks are the most common and sought after type of stock. The thinking is that since the company is growing its sales and earnings the stock price will go up. Essentially that thinking has been proven correct over the decades.

A growth stock is one in which sales and earnings are increasing quickly. Generally the minimum would be 10% but more commonly these stocks should be growing 20% or more quarter over quarter. Because of this growth the stock usually carries a higher P/E ratio than the overall market or even for its sector. They usually do not pay a dividend as they usually invest their profits back into their company to keep growing. They always have higher growth prospects in the future.

The danger is that growth eventually slows. The stock could still keep growing but as soon as the 'rate' of growth begins to wane there is an immediate reaction in the stock price. That is because these stocks are trading on future expectations of growth and the investors and traders usually push the price of the stock to excessive levels. For those who invest in these stocks early enough profits are very high but for those late to the cycle it could be very painful.

Growth stocks are not usually associated with long term (meaning multi-year) ownership. It's a nice ride but usually for months to a year or two before growth starts to slow. This is not always the case of course but it generally is the norm.

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