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A Case Study in Profitability vs. Growth

We are at a unique point in time that clearly demonstrates a universal investment fallacy where growth in Gross Domestic Product (GDP) will somehow translate to positive stock market returns. The performance of the Chinese stock market clearly exposes how simplistic this assumption is in reality.

Common folk lore, constantly regurgitated by the media, would have us believe that GDP growth is almost essential to stock market returns. We might never have a clearer example to clarify that the stock market does not measure growth in the economy by growth in profits.

The Chinese economy has grown 240% in the last 5 years, from $3.5 trillion dollars to $8.5 trillion dollars. There are few examples in human history to compare to this phenomenon of advancement. However, the stock market (here we use the Shanghai Composite Index) is down 68%.

We have to go back 14 years to 1999 before we can calculate a positive investment return. In that time frame the Chinese economy has increased in size 670%.

An explanation for this unique phenomenon is that the Chinese economy grew but profitability did not emerge as fast as anticipated by investors.

The core of our investment strategy at Avenue is focusing on the profitability of our investments. The reason we care so much about profits is because that is what drives stock prices. All our investments have to be profitable businesses or assets. We have to make sure we don't pay too much for them. But if the profits grow, that is even better.

Avenue Investment Management
Getting there together

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