

The Future of Equity Investing

John C. Forelli, CFA

Director of Portfolio Research
Boston Partners
Boston, Massachusetts

Bradford Neuman, CFA

Senior Vice President and
Director of Market Strategy
Fred Alger and Company, LLC
New York, New York



The opinions expressed in this presentation are those of the speaker. The International Foundation disclaims responsibility for views expressed and statements made by the program speakers.

International Foundation
OF EMPLOYEE BENEFIT PLANS 

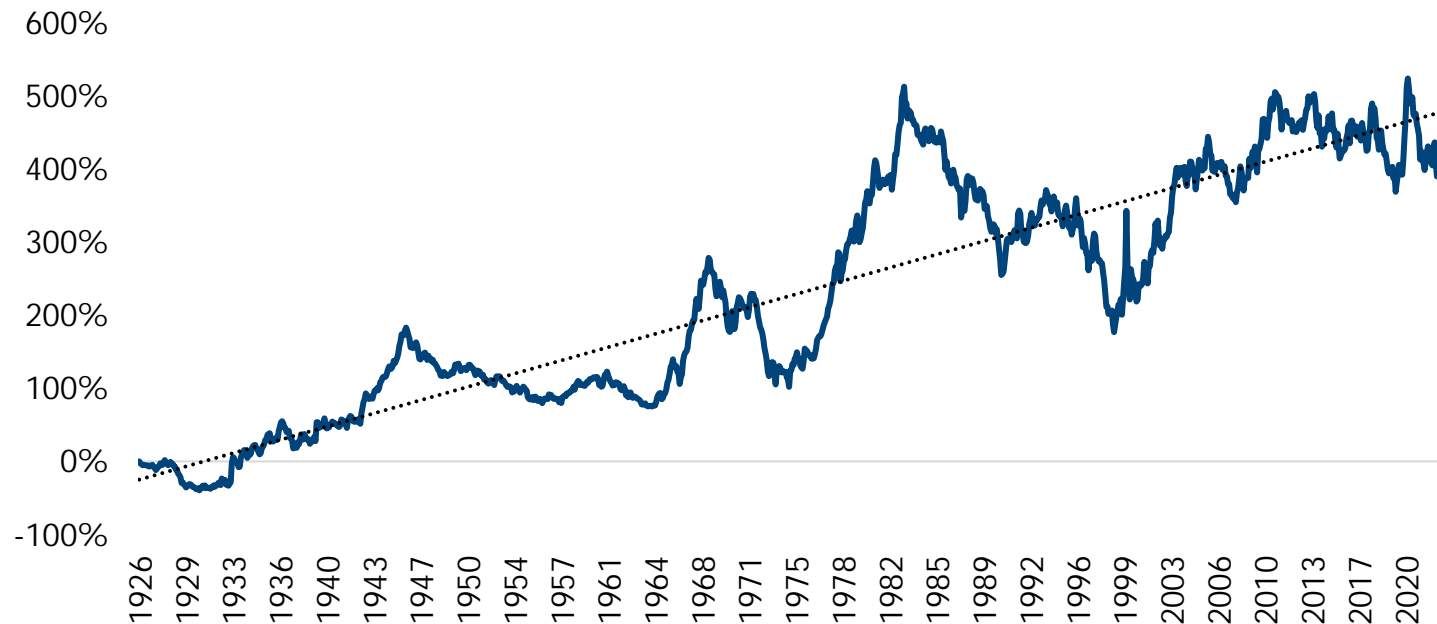


Does Capitalization Size Matter?

Long-Term Returns

- Small cap stocks have historically outperformed relative to large-cap companies

Small Size Factor Cumulative Relative Return

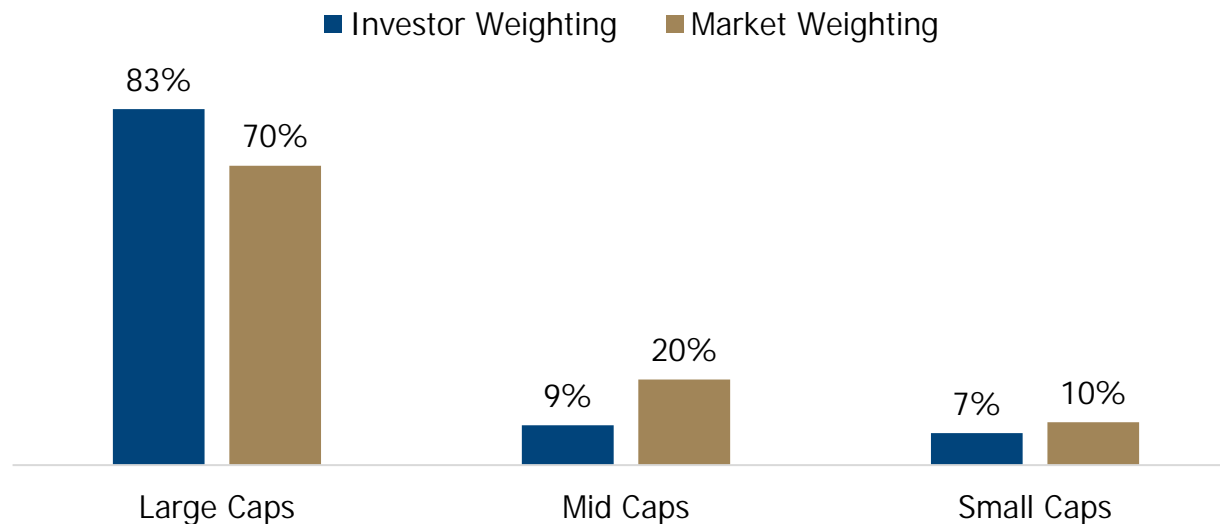


Source: Fama/French 3-factor model from Ken French June 1926 through 2023. **The performance quoted represents past performance which is not an indication or guarantee of future results.**

Under-Allocated?

- Investors tend to under-allocate to small and mid cap stocks compared to the market

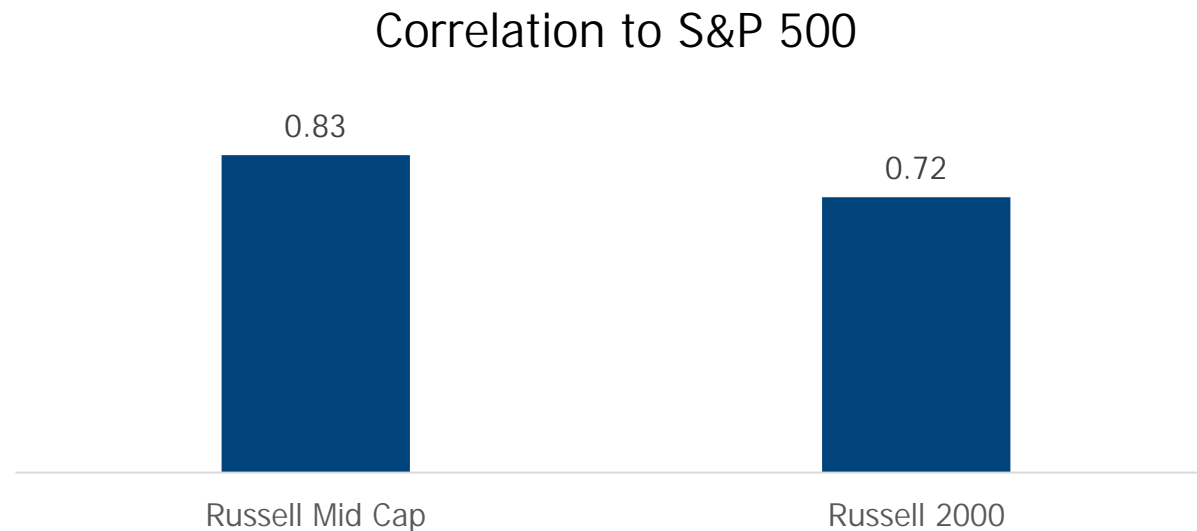
Investor Weighting vs. Market Weighting



Source: Morningstar as of August 2024.

Improving Portfolio Efficiency

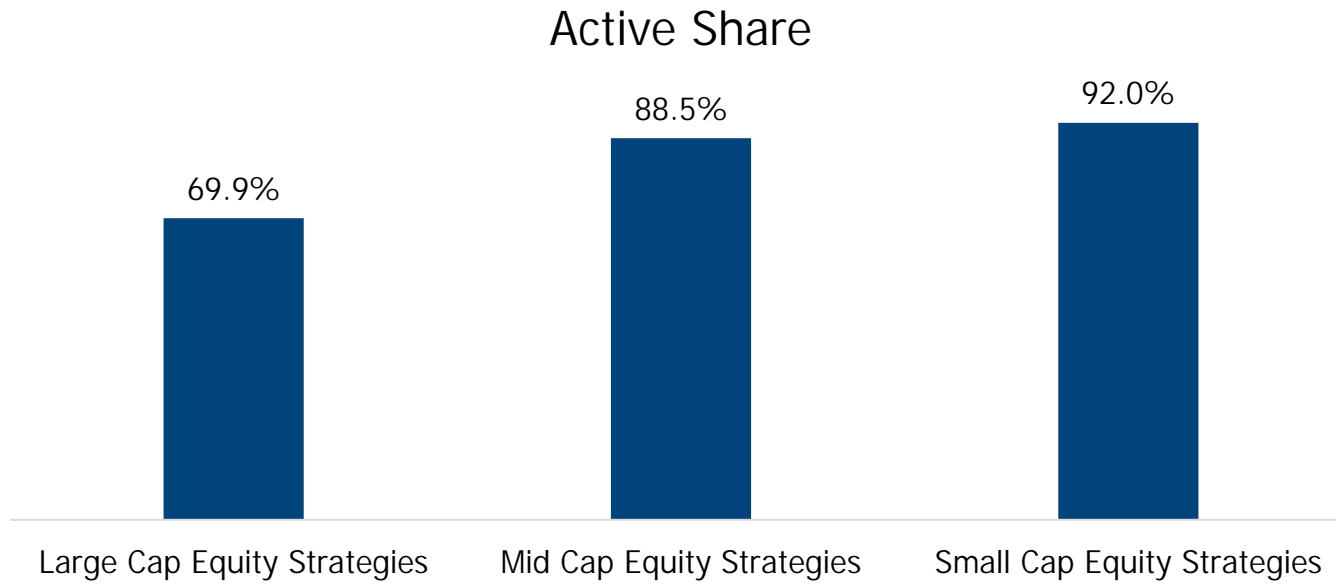
- Adding a security or portfolio with a lower correlation may help enhance diversification and reduce volatility



Source: FactSet. 1 year of daily observations ending 08/30/24.

Beating the Benchmark—Active Share

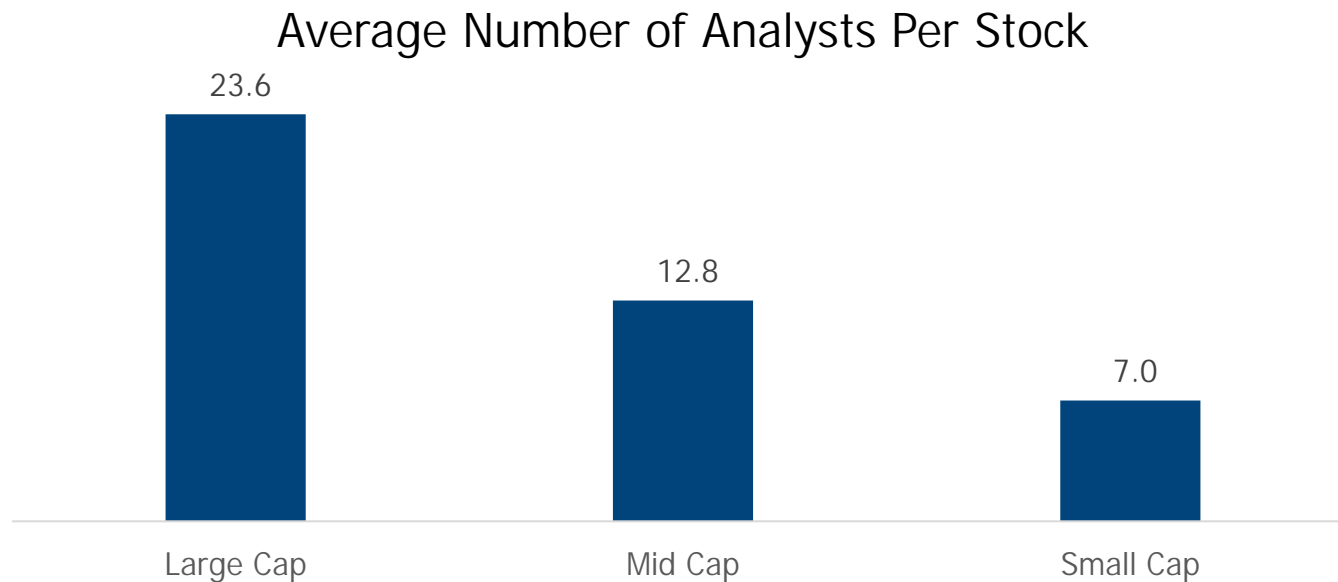
- It has been easier to differentiate relative to the benchmark in small and mid cap stocks



Source: eVestment as of 2Q24.

Beating the Benchmark—Inefficiencies

- Fewer research analysts per stock may make it easier to have a differentiated view on fundamentals and value



Source: FactSet as of September, 2024. Large, mid and small cap indices are S&P 500, S&P 400, and S&P 600, respectively.

Beating the Benchmark—Alpha

- More differentiated portfolios and greater market inefficiencies have historically yielded more outperformance



Source: eVestment. Data is comprised of Growth, Core, and Value styles.

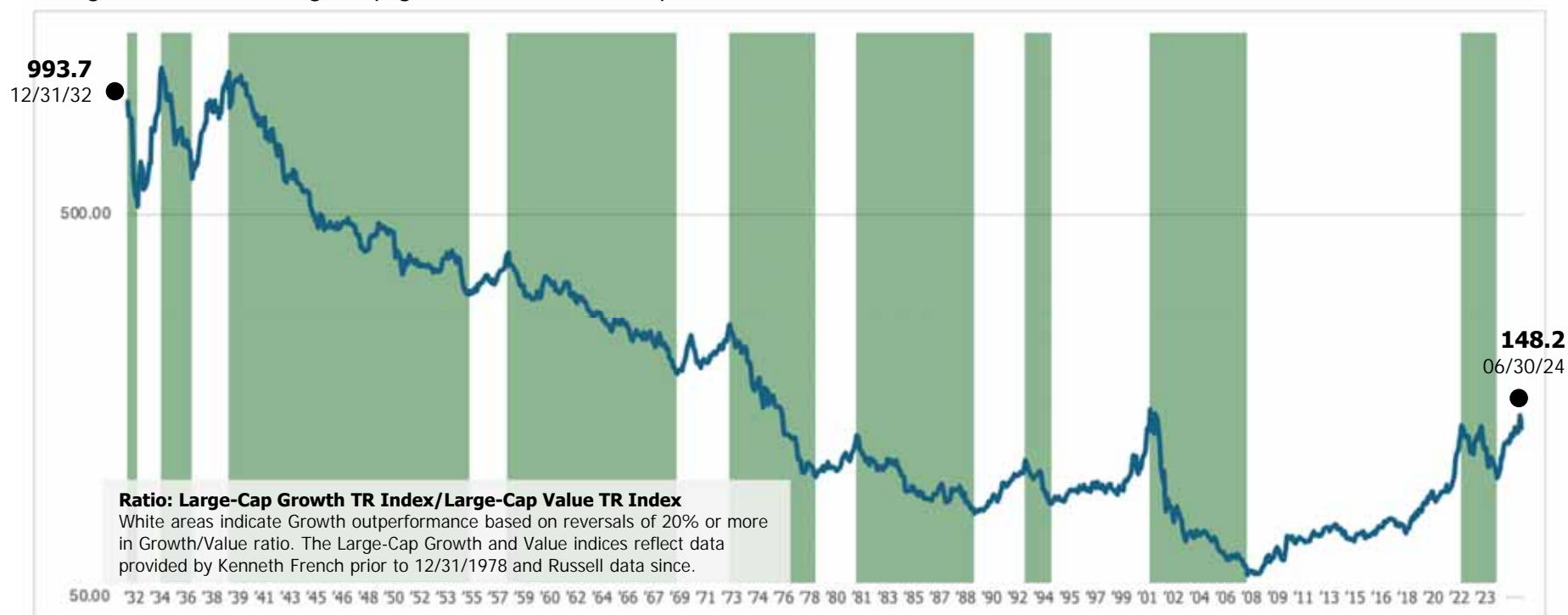
Are Growth Stocks Too Expensive?

Value Has Driven Markets for Much of the Past Century—But Not Lately

Long-term trend in large-cap growth/value relative performance

■ Value Bull Market

□ Growth Bull Market

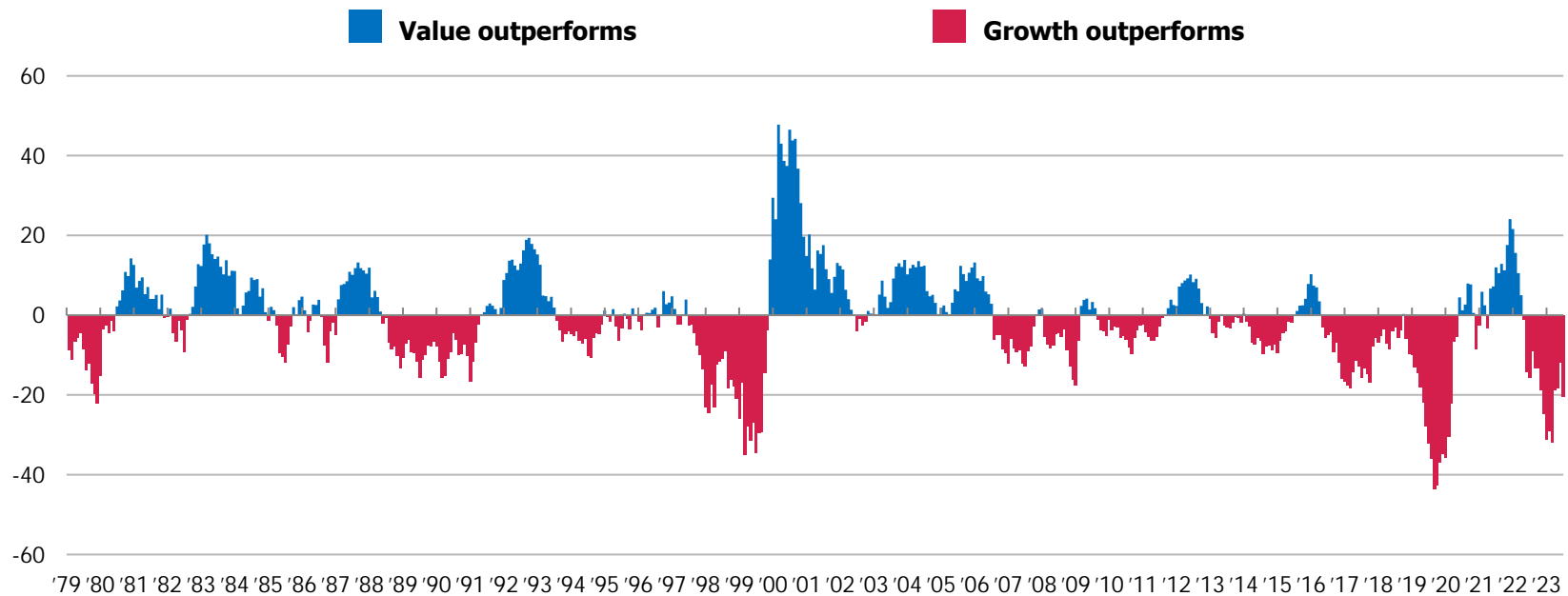


Data as of June 30, 2024.

Source: Ned Davis Research, Inc. (NDR); FTSE Russell. Monthly data December 31, 1932, to June 30, 2024 (Log Scale). Past performance is not an indication of future results.

Shorter Term, Growth and Value Leadership Changes Often

Russell 1000 Value Index—Russell 1000 Growth Index (trailing 12-month % returns)

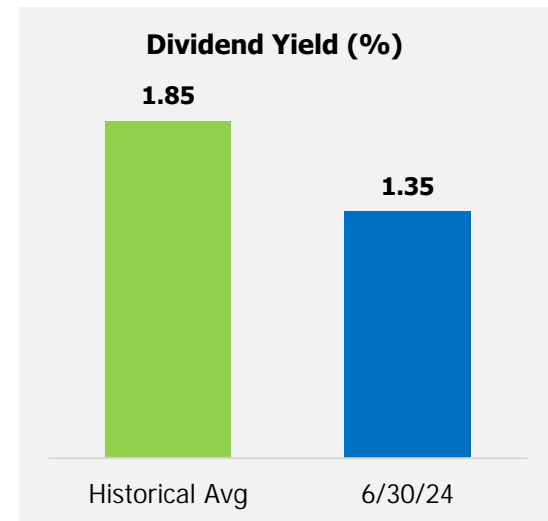
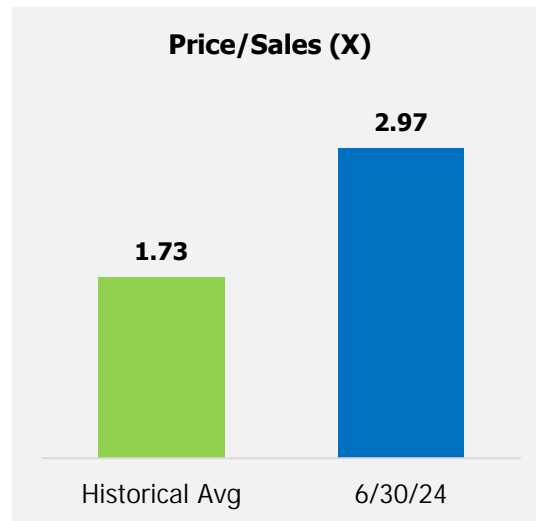
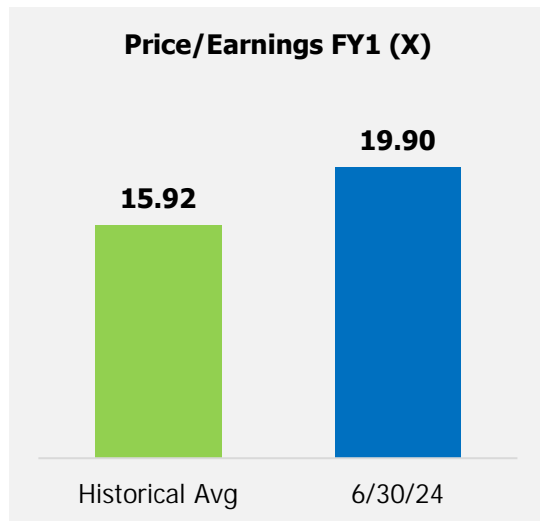


Data as of June 30, 2024.

Source: Boston Partners. Chart reflects trailing-twelve-month relative performance of Russell 1000 Value Index versus Russell 1000 Growth Index. Past performance is not an indication of future results.

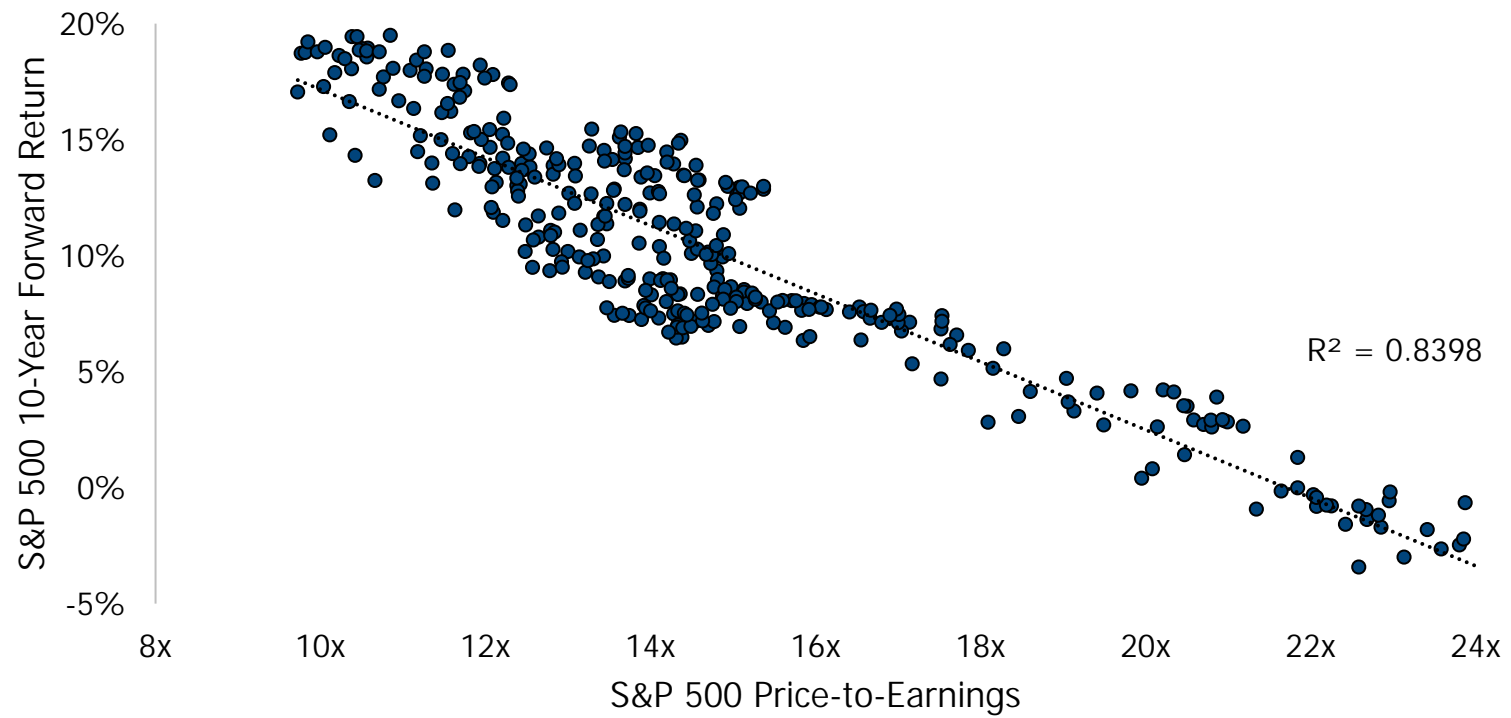
Today's Market Looks Expensive

S&P 500 Index characteristics versus historical averages



Data as of June 30, 2024. Historical data since May 31, 1995.
Source: Reuters.

Valuation

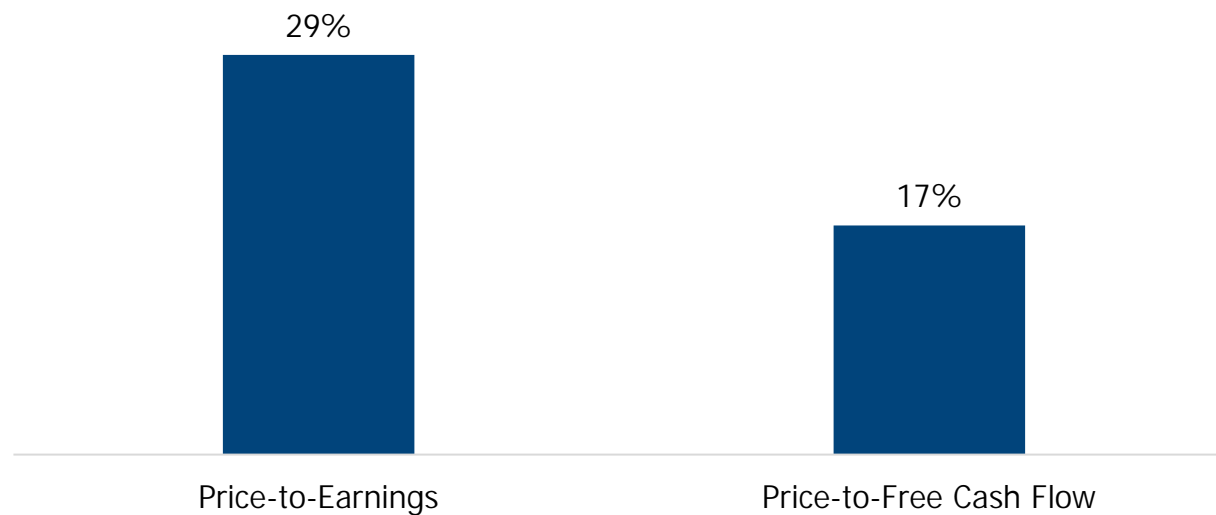


Source: FactSet. Monthly S&P 500 data as of August 30, 2024.

Valuation

- Stocks are cheaper on free cash flow than earnings

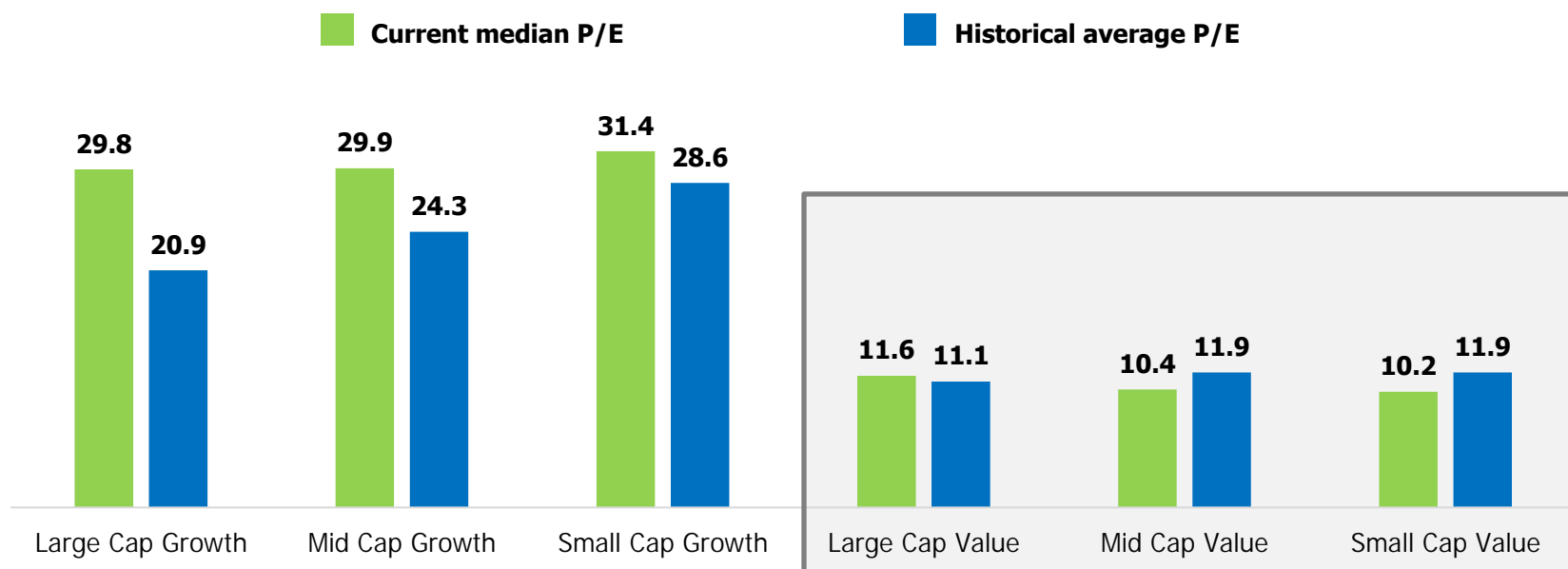
S&P 500 Premium to 30 Year Average



Source: FactSet as of 08/30/24.

Value Looks Attractive Across Market Cap

Current versus historical P/E ratios (X)

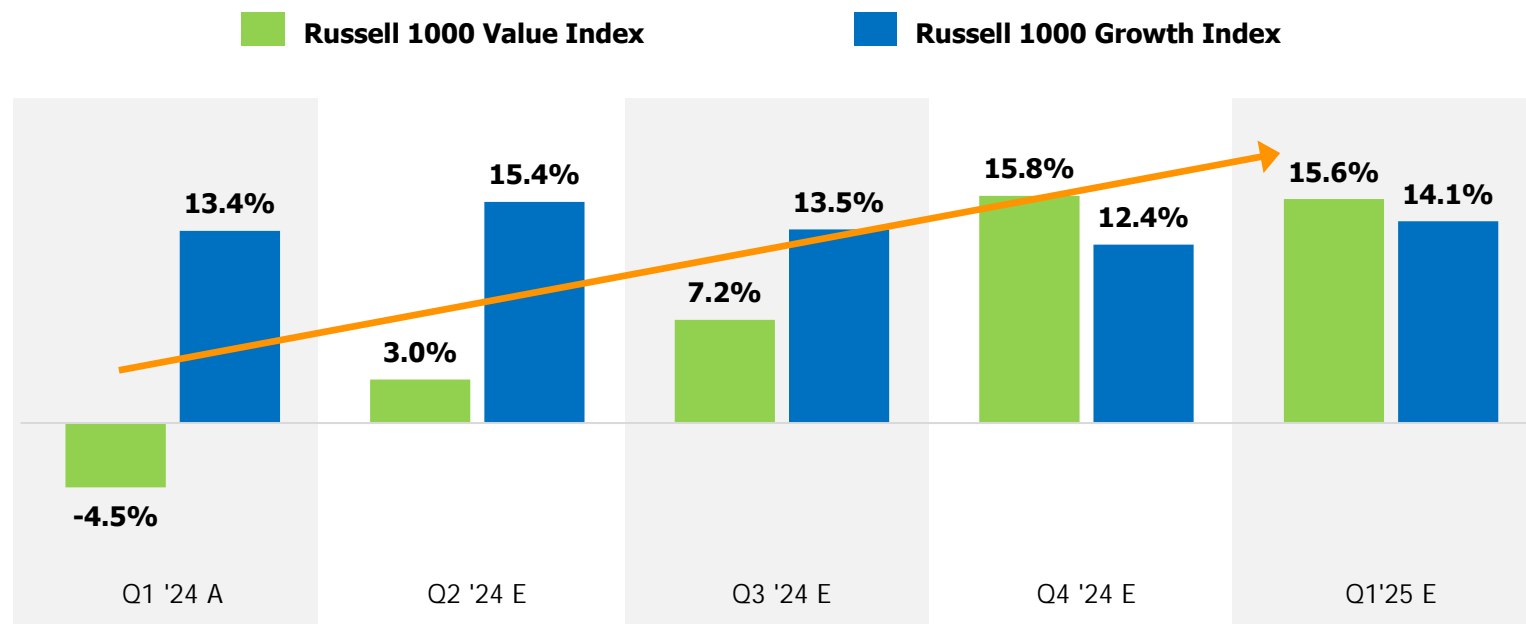


Data as of June 30, 2024.

Source: The Leuthold Group. Market caps and universes are defined by Leuthold. Median Valuations: Largest 3,000 companies Large Cap > \$39.1B; Mid Cap \$5.8B - \$39.1B; Small Cap \$1.4B - \$5.8B. Historical average median 12-month forward P/E period is from January 1, 1982, to June 30, 2024. Past performance is not an indication of future results.

Value Earnings Are Projected to Overtake Growth Earnings This Year

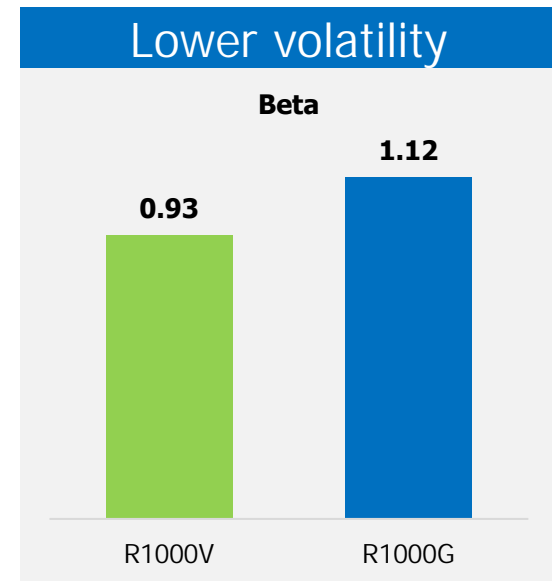
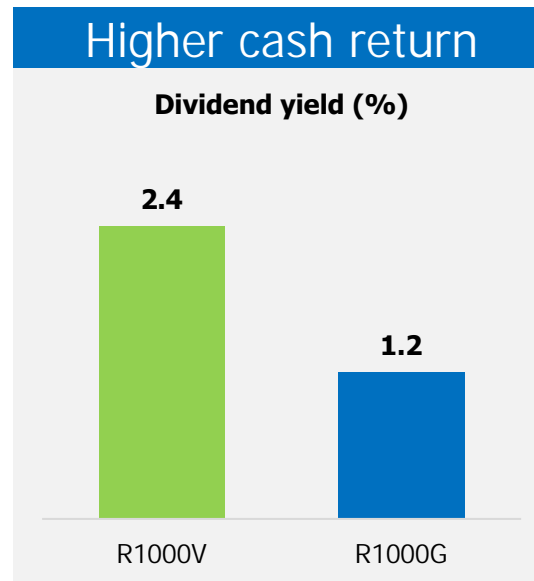
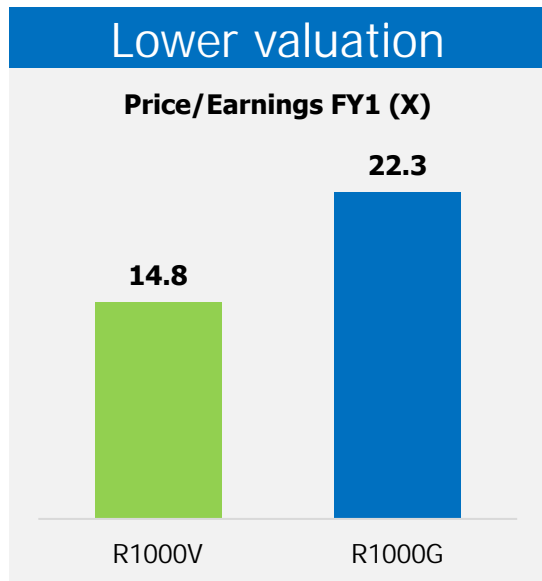
YOY quarterly earnings growth expectations (%)



Data as of June 30, 2024. Source: FactSet. The illustration above is provided for informational purposes only and is not meant as investment advice. Past performance is not an indication of future results.

Risk-Adjusted Returns Are Driven By Valuation, Cash Return and Volatility

- The Russell 1000 Value Index has:



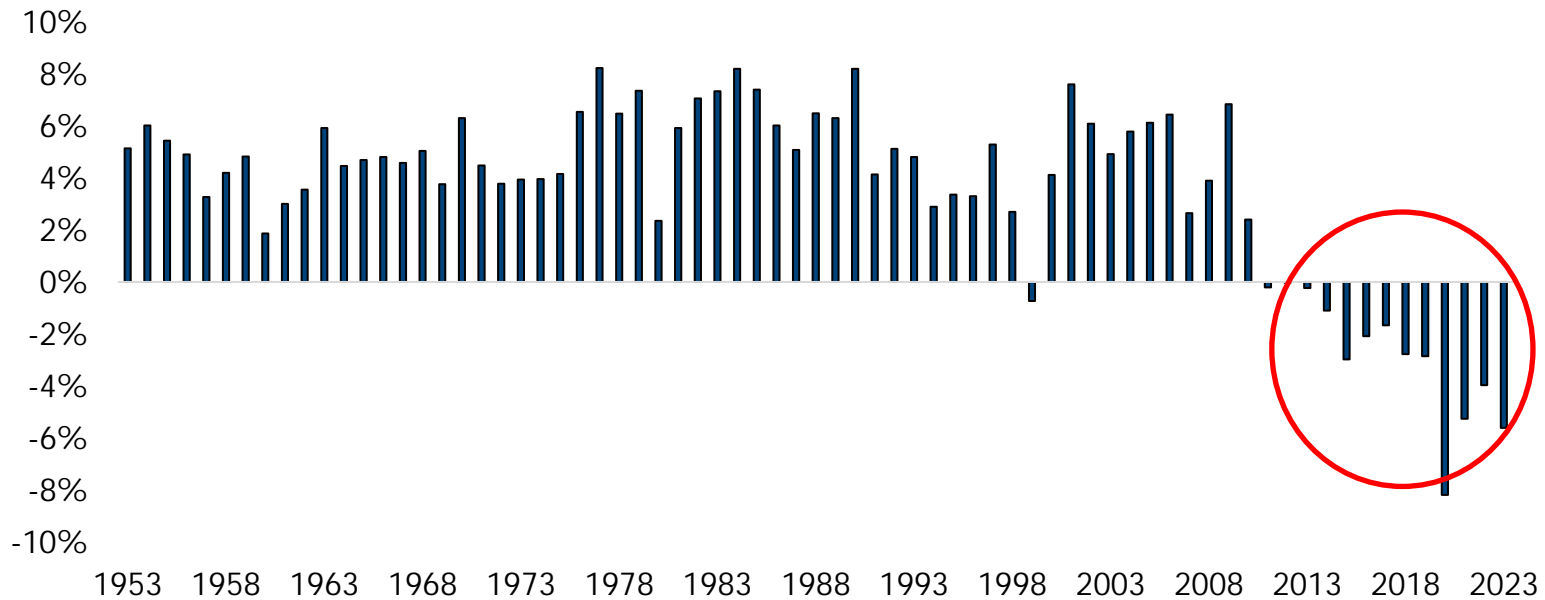
Data for 25-year period ended August 31, 2024. Source: FactSet. The illustration above is provided for informational purposes only and is not meant as investment advice. Past performance is not an indication of future results.



**Has Something Structurally
Changed in the Growth vs. Value
Debate?**

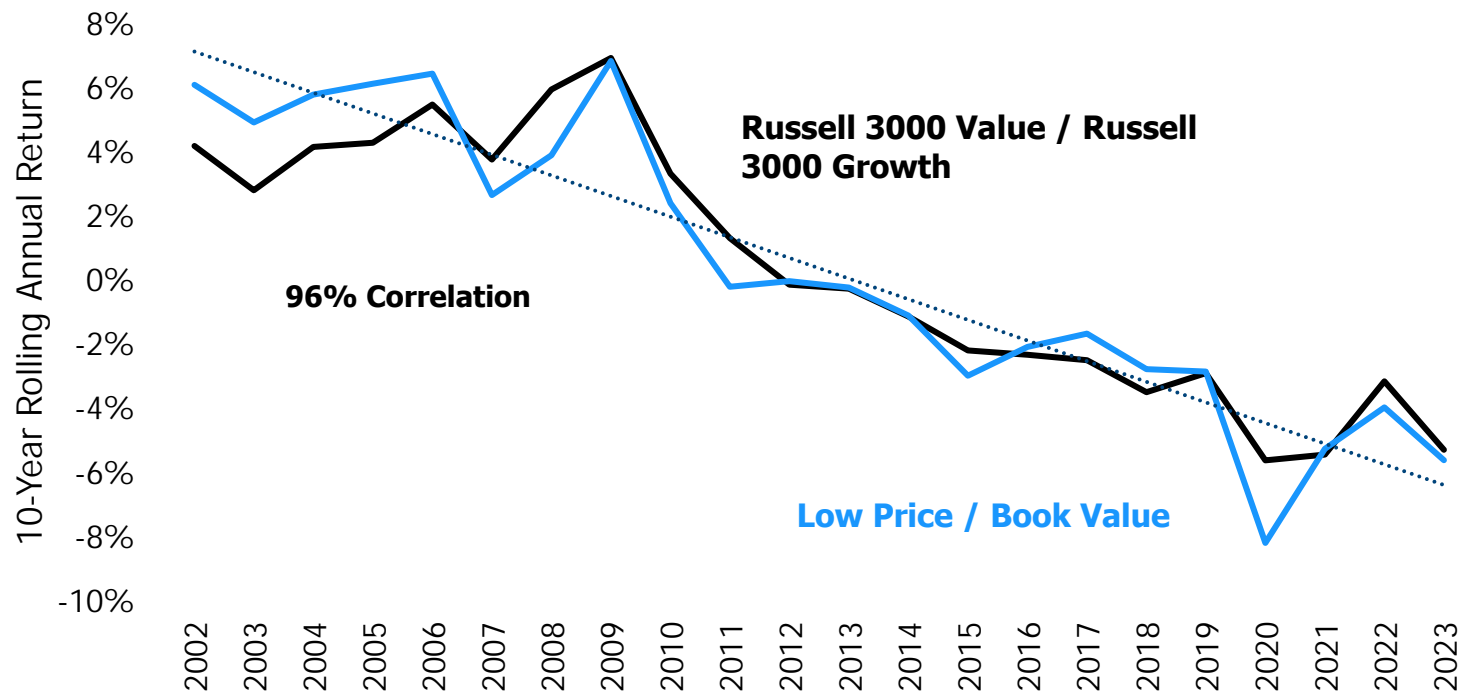
Something Wrong With Value?

Value Factor Performance
10-Year Rolling Returns



Source: Kenneth R. French. https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html. **The performance data quoted represents past performance, which is not an indication or a guarantee of future results.**

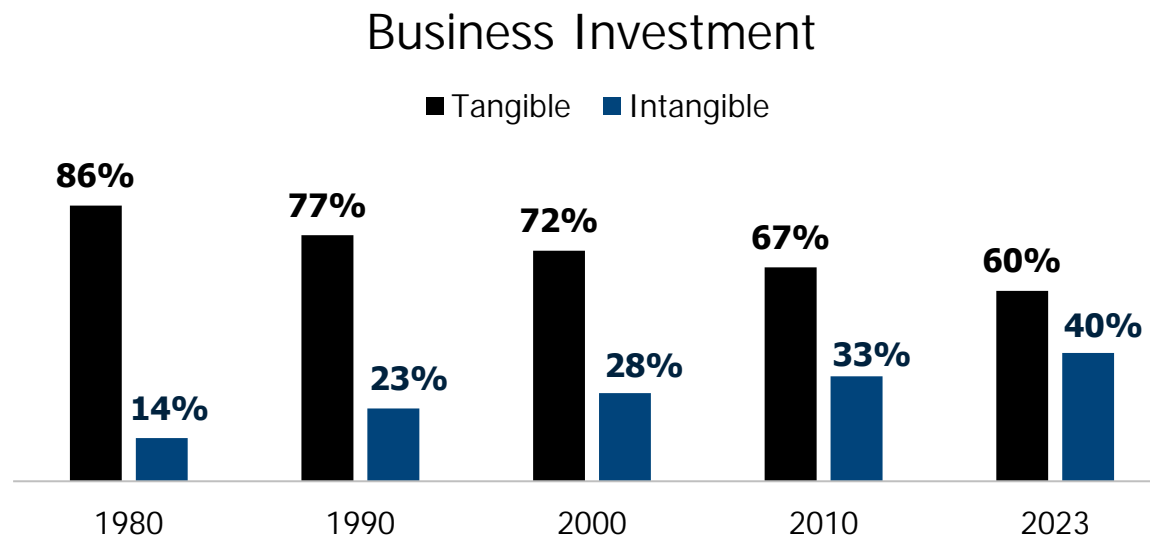
Style Issues



Source: FactSet, Kenneth R. French. https://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html. Low price-to-book returns are based on the B/P Fama/French factor for the CRSP universe which includes U.S. firms listed on the NYSE, AMEX, or NASDAQ. Correlation measures a relationship estimate between two variables. **The performance data quoted represents past performance, which is not an indication or a guarantee of future results.**

Economic Paradigm Shift

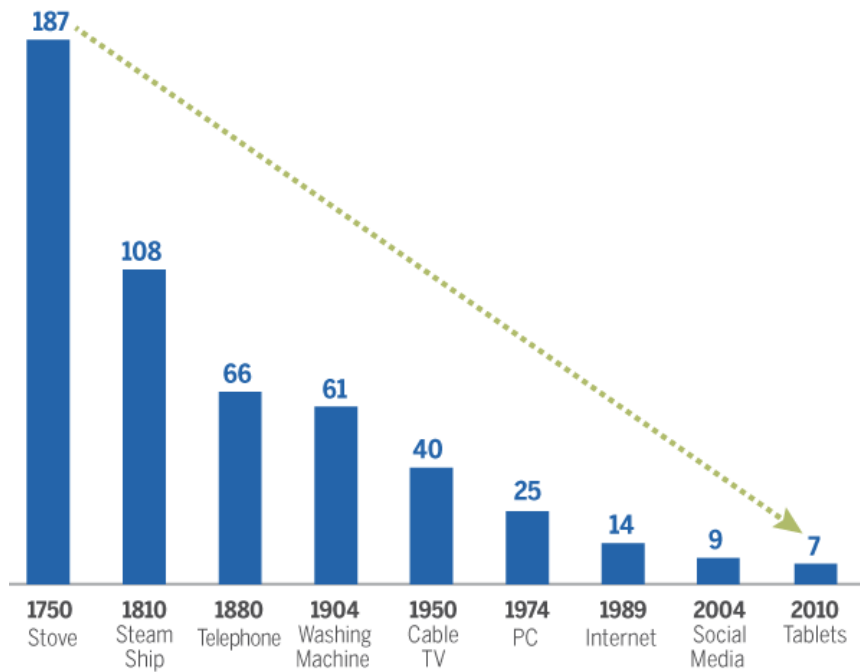
- Increasing use of intangible assets that are expensed rather than capitalized may make book value irrelevant



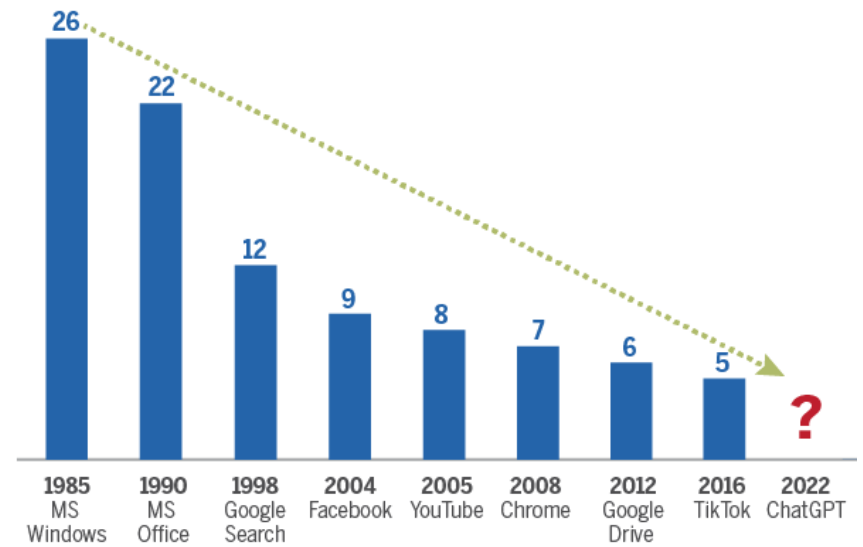
Source: Bureau of Economic Analysis.

Accelerating Change

Years from Market Entry to 50% Penetration



Years to Reach 1 Billion Users



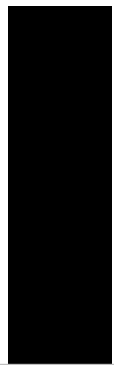
Source: Asymco, Visual Capitalist, company disclosures, Alger estimates.

The Growth Advantage

Stronger Growth

Long-Term EPS Growth

20.1%



11.5%



Russell 1000
Growth

Russell 1000
Value

Higher Returns

Return on Equity

36.4%



12.7%



Russell 1000
Growth

Russell 1000
Value

Lower Risk

Net Debt / EBITDA

0.6x



2.5x



Russell 1000
Growth

Russell 1000
Value

Source: FactSet as of 6/30/24. Growth represents consensus long-term analyst estimates and actual future EPS growth rates might be materially different than the forecasts shown.

Is Active Management Dead?

Shopping at the Grocery Store

- We choose the items we believe are best.
- Buying one of everything on the shelf would be absurd.



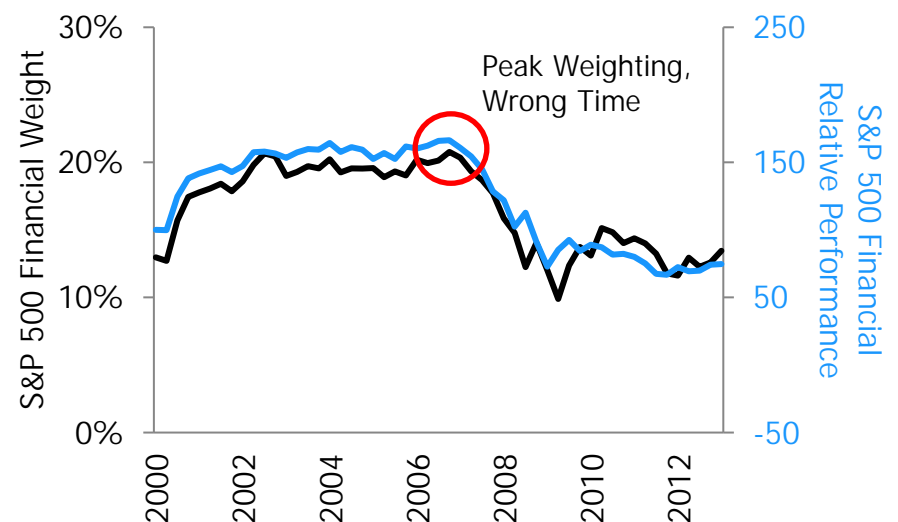
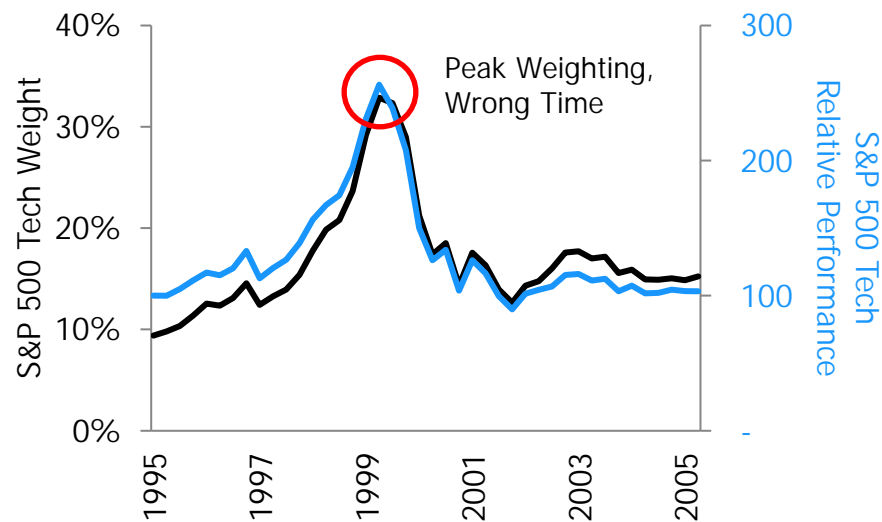
Active Versus Passive Investing

- Active investors choose the securities they believe are best.
- Index funds buy one of everything on the shelf.



Passive Problems?

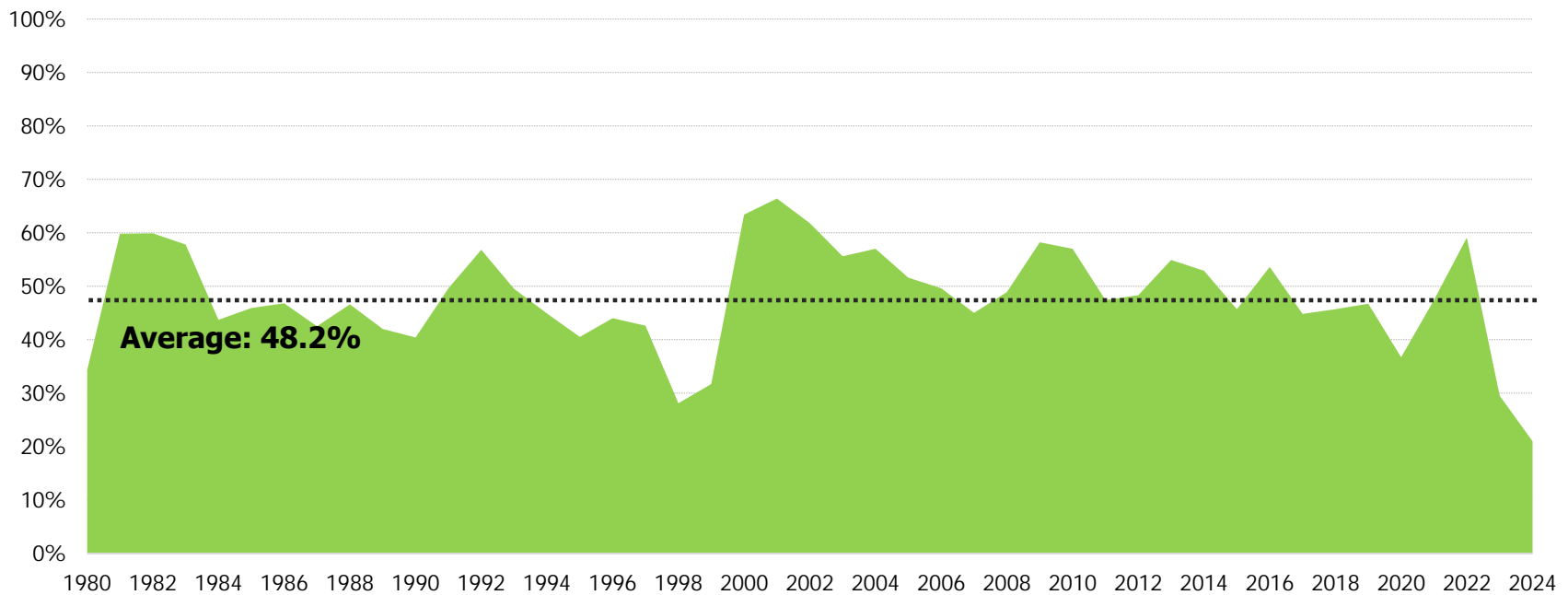
- The vast majority of passive investing allows relative performance to drive relative weighting changes, irrespective of fundamentals



Source: FactSet. The performance data quoted represents past performance, which is not an indication or a guarantee of future results.

Historically, Nearly Half the S&P 500 Index BEATS the Index Each Year

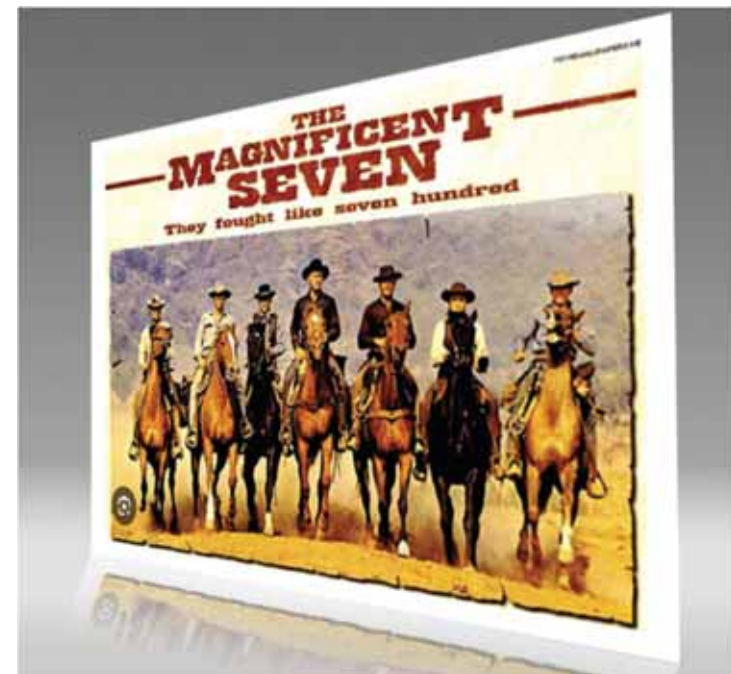
Percentage of S&P 500 Index stocks outperforming the index (%)



Data through June 30, 2024. Source: Ned Davis Research. Price-only returns. Past performance is not an indication of future results.

The Magnificent 7 Companies

The Magnificent 7 companies	Percent of S&P 500 Index
Alphabet (Google)	4.29
Amazon	3.86
Apple	6.62
Meta (Facebook)	2.41
Microsoft	7.25
Nvidia	6.63
Tesla	1.20
Total	32.26



Information is provided for illustrative purposes only. Data as of 6/30/24. It should not be considered a solicitation to buy or an offer to sell a security.

Add Netflix and We Get...

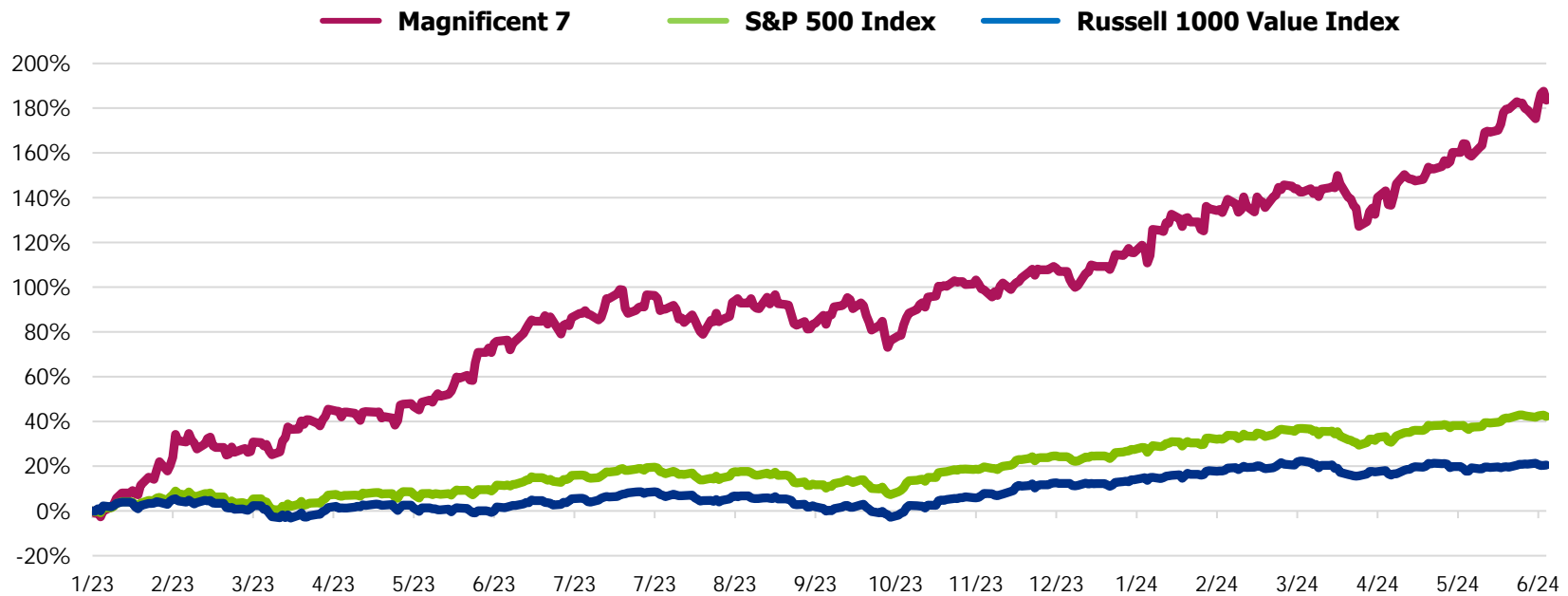
- Perhaps not the company you want to keep



Information is provided for illustrative purposes only. It should not be considered a solicitation to buy or an offer to sell a security.

The Magnificent 7 Have Dominated Performance Since 2023

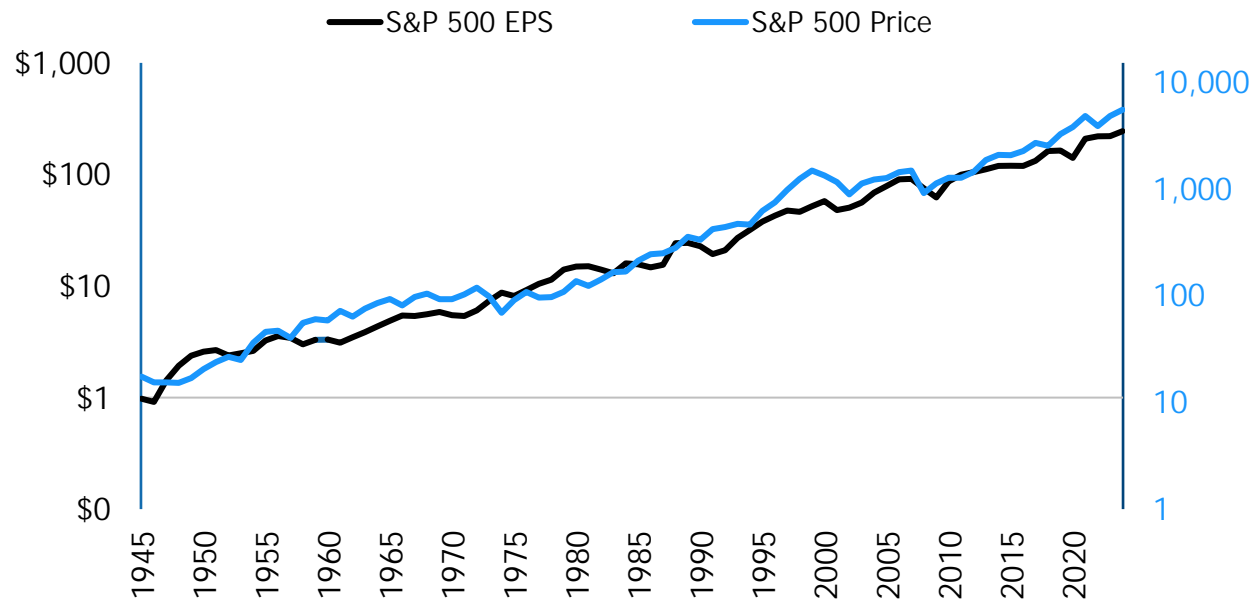
Index performance since January 1, 2023 (%)



Data as of June 30, 2024. Source: Bloomberg; Boston Partners. Magnificent 7 companies include Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia and Tesla. Past performance is not an indication of future results. Information is provided for illustrative purposes only. It should not be considered a solicitation to buy or an offer to sell a security.

Powerful Long-Term Trends

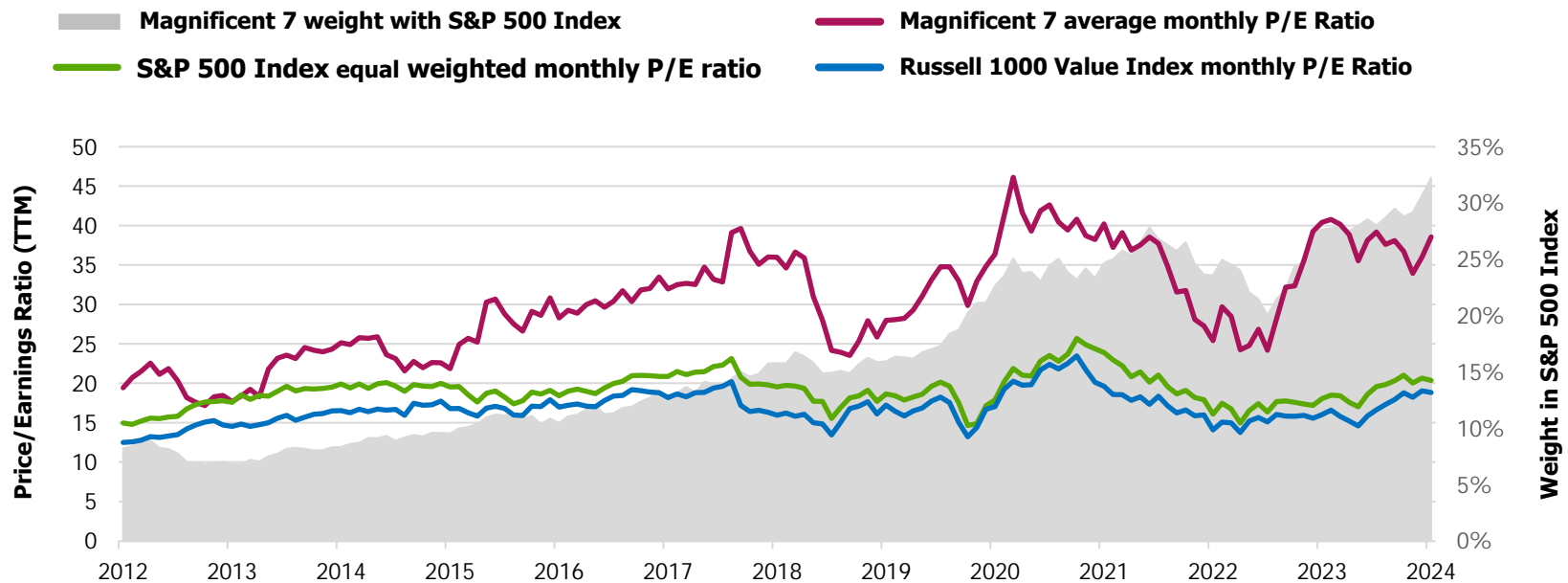
- Earnings drive stock returns



Source: FactSet as of 6/30/24. **The performance data quoted represents past performance, which is not an indication or a guarantee of future results.**

Historically Out of Step With the Market

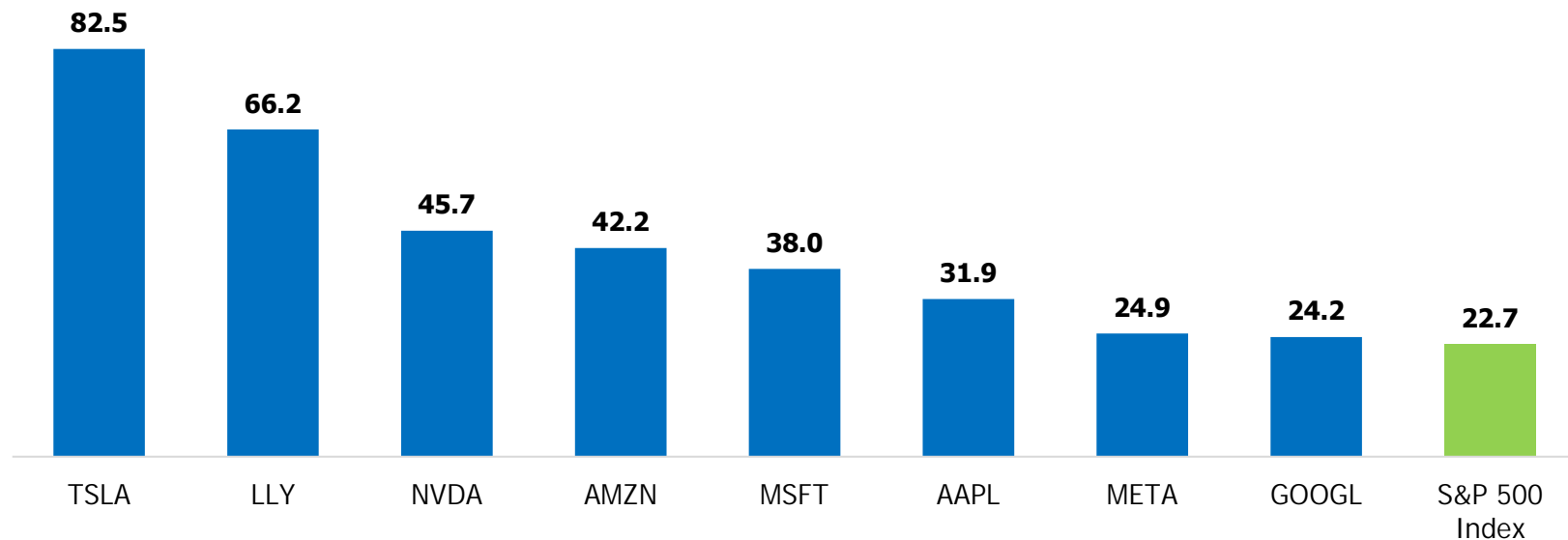
Index weight (%) and valuation (x) of the Magnificent 7 stocks



Data as of June 30, 2024. Source: Morningstar. (RHS): Right hand side. (LHS): Left hand side. Magnificent 7 companies include Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia and Tesla and P/E ratio is equal weighted rebalanced quarterly. P/E ratios are trailing 12-month. Past performance is not an indication of future results. Information is provided for illustrative purposes only. It should not be considered a solicitation to buy or an offer to sell a security.

Top Benchmark Companies Look Very Expensive

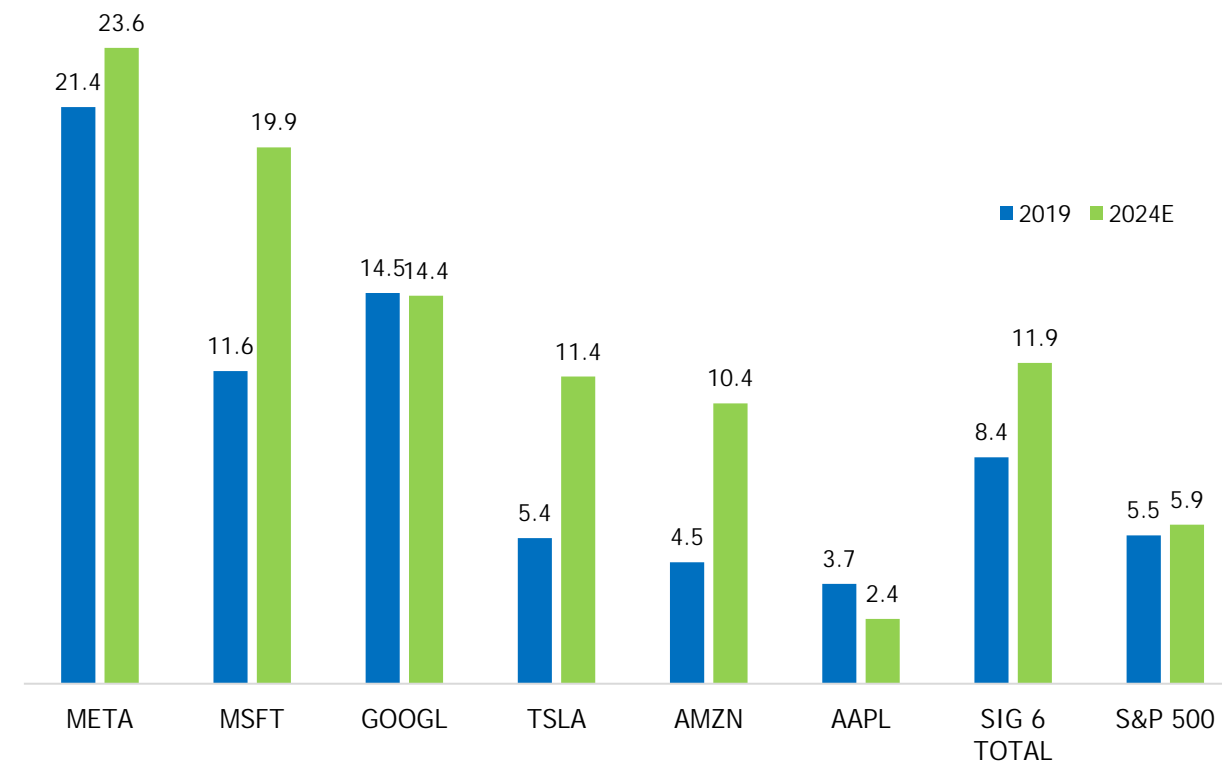
2024 P/E ratios (X)



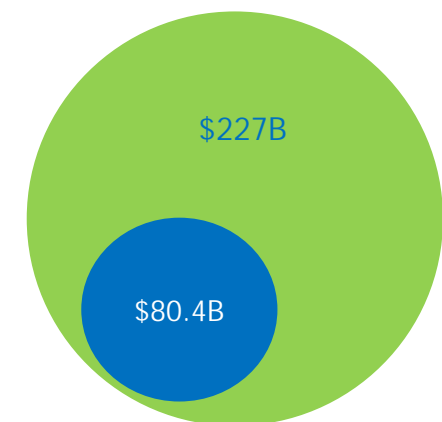
Data as of June 30, 2024. Source: FactSet.
It should not be considered a solicitation to buy or an offer to sell a security.

"Significant 6" Are Becoming More Capital Intensive With AI Investments

Capital expenditures as a percentage of sales (%)



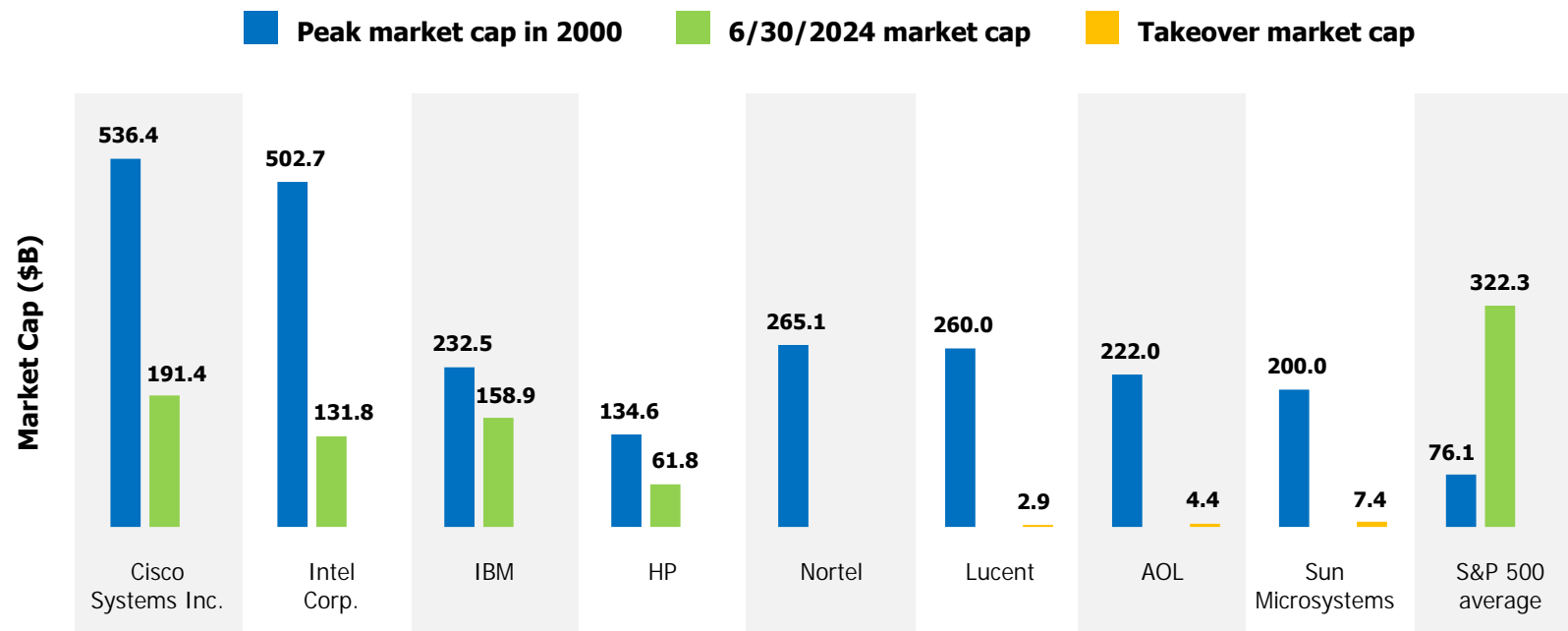
Total capital expenditures of Significant 6 (\$)



Data as of September 30, 2024. Source: FactSet.
It should not be considered a solicitation to buy or an offer to sell a security.

Valuation Matters!

Today's market capitalizations of Tech Bubble favorites are well below year 2000 peak levels



Data as of June 30, 2024. Source: FactSet.
It should not be considered a solicitation to buy or an offer to sell a security.

Largest Index Names Driving Performance

Last year's capitalization-weighted outperformance (%) was the second largest in 53 years

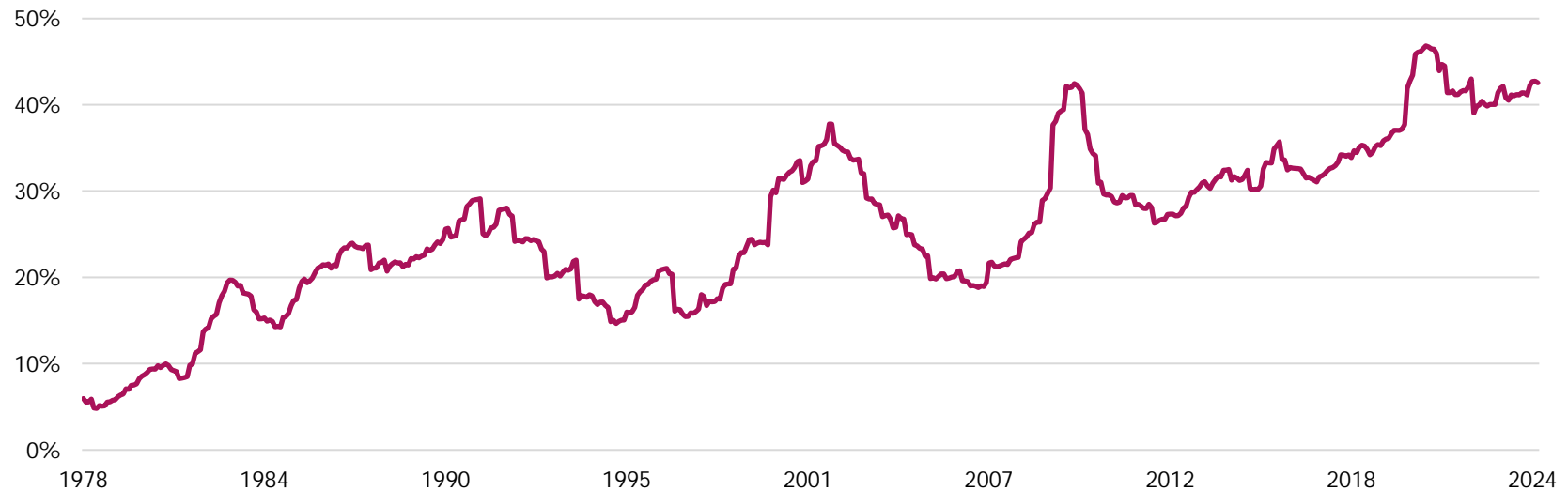
Year	S&P 500 Index Cap Weighted	S&P 500 Index Equal Weighted	Cap Weighted–Equal Weighted Index
TTM 6/30/2024	24.6	11.8	12.8
2023	26.3	13.9	12.4

The last two times this happened (1998-99 and 1972-73) were followed by six years of equal-weighted outperformance.

Data as of June 30, 2024. Source: Morningstar. Magnificent 7 stocks: The group is made up of mega-cap stocks Apple (AAPL), Alphabet (GOOGL), Microsoft (MSFT), Amazon.com (AMZN), Meta Platforms (META), Tesla (TSLA) and Nvidia (NVDA). Past performance is not an indication of future results. Trailing 12 months (TTM).

Is Now the Time to Invest in Unprofitable Companies?

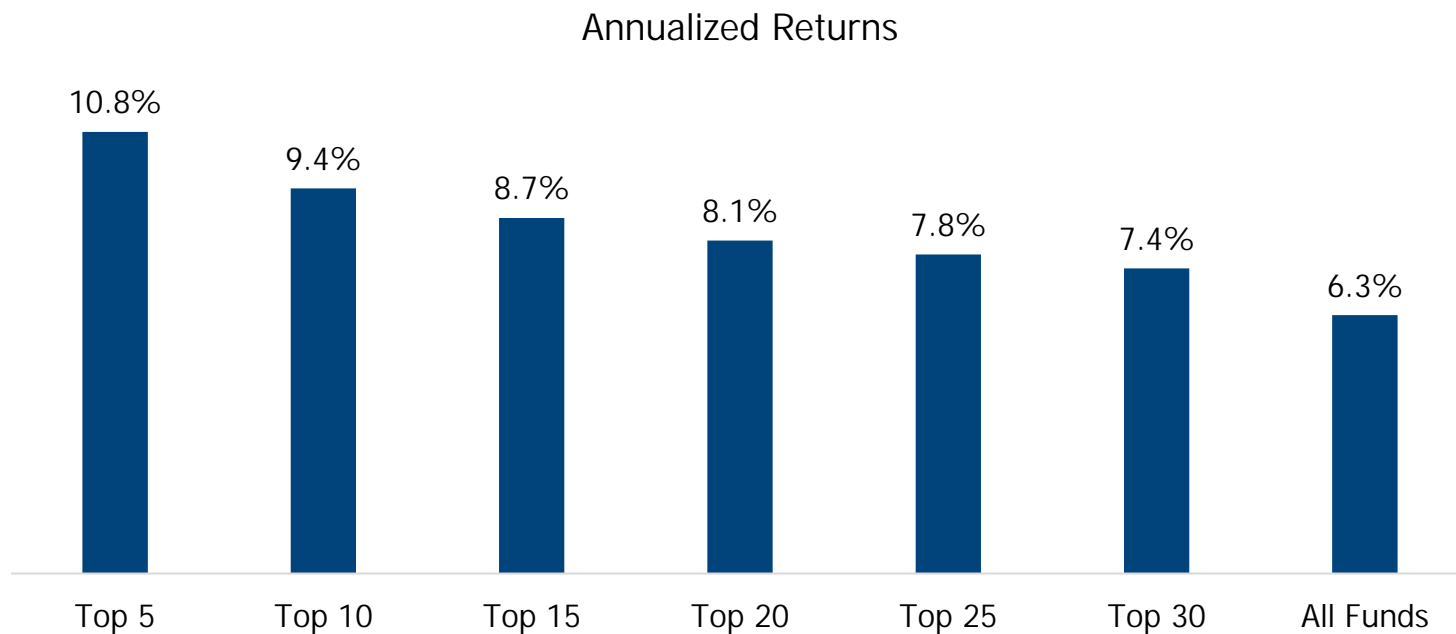
Percent of firms in the Russell 2000 Index with negative earnings



Source: Kailash Capital, LLC; Data from 12/31/1978 - 6/30/2024. Past performance is not an indication of future results.

Concentrated and Diversified Portfolios

- Managers' top positions have historically outperformed



Source: Danny Yeung, et al. "Diversification Versus Concentration...and the Winner is?" University of Technology Sydney, 2012. Based on size of active weight in individual funds.
The performance data quoted represents past performance, which is not an indication or a guarantee of future results.

Active Value- and Small-Cap Managers Historically Have Fared Well Versus Indexes

Managers beating benchmarks:

■ ≥75% of managers

■ 50% to 74% of managers

■ 26% to 49% of managers

■ ≤ 25% of managers

		Value	Growth	Core
Large	Benchmark	Russell 1000 Value	Russell 1000 Growth	Russell 1000
	Universe	US Large Cap Value Equity	US Large Cap Growth Equity	US Large Cap Core Equity
	5 yr Rank	74	9	29
	10 yr Rank	67	6	25
	15 yr Rank	58	5	26
Mid	Benchmark	Russell Midcap Value	Russell Midcap Growth	Russell Midcap
	Universe	US Mid Cap Value Equity	US Mid Cap Growth Equity	US Mid Cap Core Equity
	5 yr Rank	66	33	70
	10 yr Rank	55	38	64
	15 yr Rank	38	29	63
Small	Benchmark	Russell 2000 Value	Russell 2000 Growth	Russell 2000
	Universe	US Small Cap Value Equity	US Small Cap Growth Equity	US Small Cap Core Equity
	5 yr Rank	76	70	85
	10 yr Rank	74	85	79
	15 yr Rank	78	85	79

Source: eVestment. Ranking of the respective index compared to the eVestment universe of active managers. 5 Year, 10 Year and 15 Year time periods are as of June 30, 2024. All data is net of fees. The US Large Cap Value Equity universe contains 355, 315, and 253 strategies during the 5yr, 10yr, and 15yr time periods, respectively. The US Large Cap Growth Equity universe contains 251, 213, and 186 strategies during the 5yr, 10yr, and 15yr time periods, respectively. The US Large Cap Core Equity universe contains 312, 254, and 183 strategies during the 5yr, 10yr, and 15yr time periods, respectively. The US Mid Cap Value Equity universe contains 82, 74, and 61 strategies during the 5yr, 10yr, and 15yr time periods, respectively. The US Mid Cap Growth Equity universe contains 91, 77, and 69 strategies during the 5yr, 10yr, and 15yr time periods, respectively. The US Mid Cap Core Equity universe contains 58, 45, and 37 strategies during the 5yr, 10yr, and 15yr time periods, respectively. The US Small Cap Value Equity universe contains 206, 179, 152 strategies during the 5yr, 10yr, and 15yr time periods, respectively. The US Small Cap Growth Equity universe contains 154, 137, 120 strategies during the 5yr, 10yr, and 15yr time periods, respectively. The US Small Cap Core Equity universe contains 175, 148, and 114 strategies during the 5yr, 10yr, and 15yr time periods, respectively.

Key Takeaways

1. Active management may help avoid passive mistakes by allocating based on fundamentals rather than market cap
2. Active management in value as a style and in small cap has historically provided excess returns over indexing
3. Now may be a good time to rebalance portfolios away from mega-cap favorites and toward the remainder of the U.S. market—including small caps
4. Fundamental research is an important consideration when choosing managers for your equity allocation

**Your Feedback
Is Important.
Please Scan
This QR Code.**

Session Evaluation

