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

70TH ANNUAL **EMPLOYEE BENEFITS** CONFERENCE
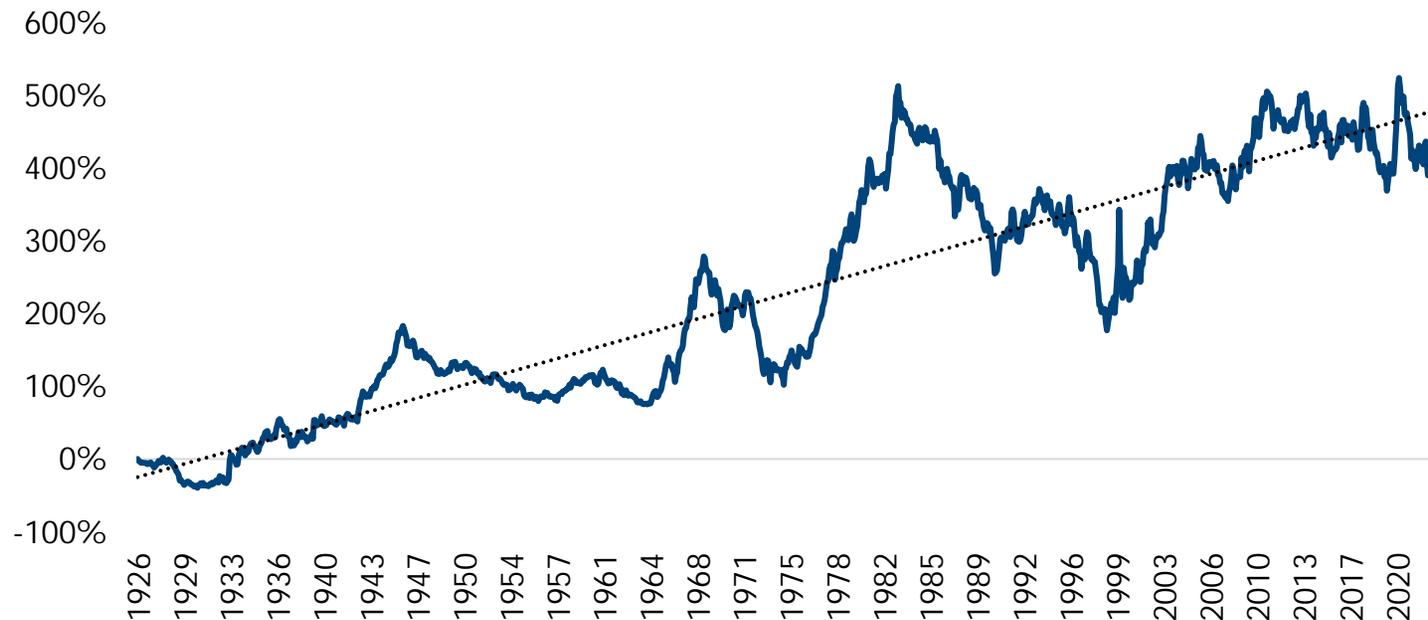
International Foundation OF EMPLOYEE BENEFIT PLANS

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.**

I11.2-3

Under-Allocated?

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

Investor Weighting vs. Market Weighting

■ Investor Weighting   ■ Market Weighting

Category	Investor Weighting	Market Weighting
Large Caps	83%	70%
Mid Caps	9%	20%
Small Caps	7%	10%
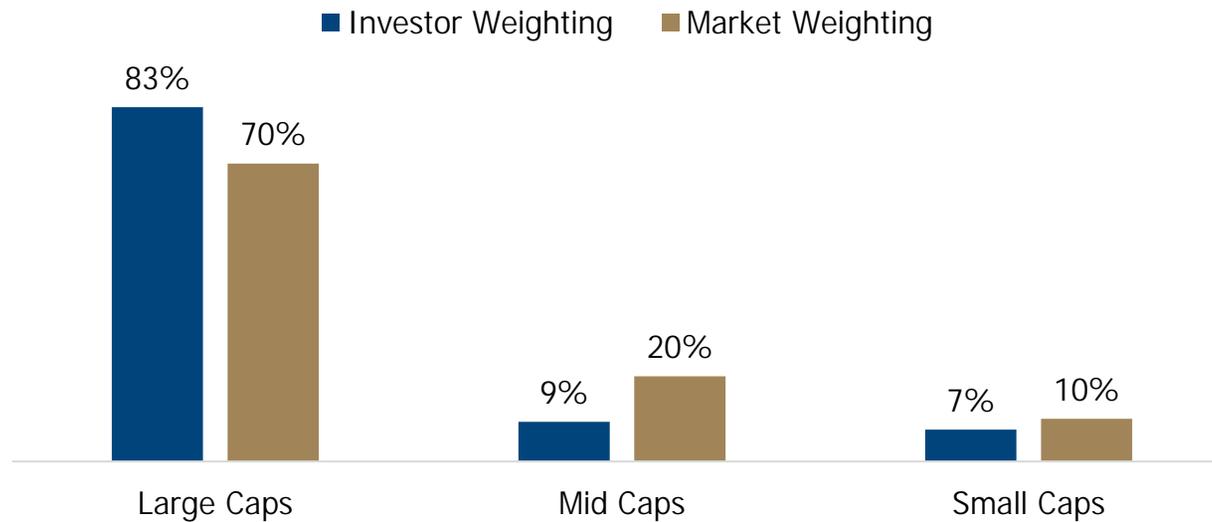
Source: Morningstar as of August 2024.

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Improving Portfolio Efficiency

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

Correlation to S&P 500

Russell Mid Cap	Russell 2000
0.83	0.72
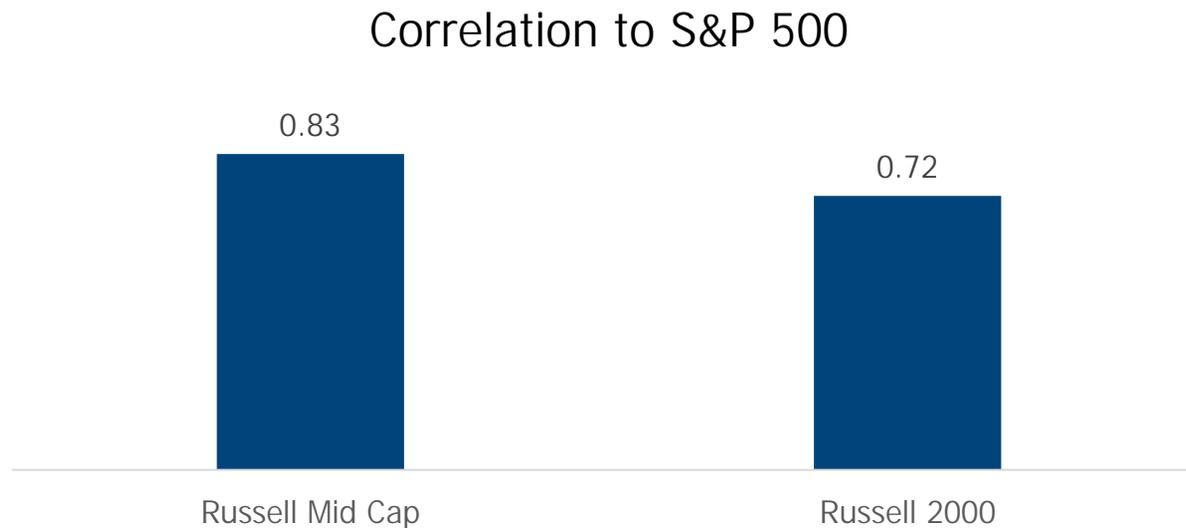
Source: FactSet. 1 year of daily observations ending 08/30/24.
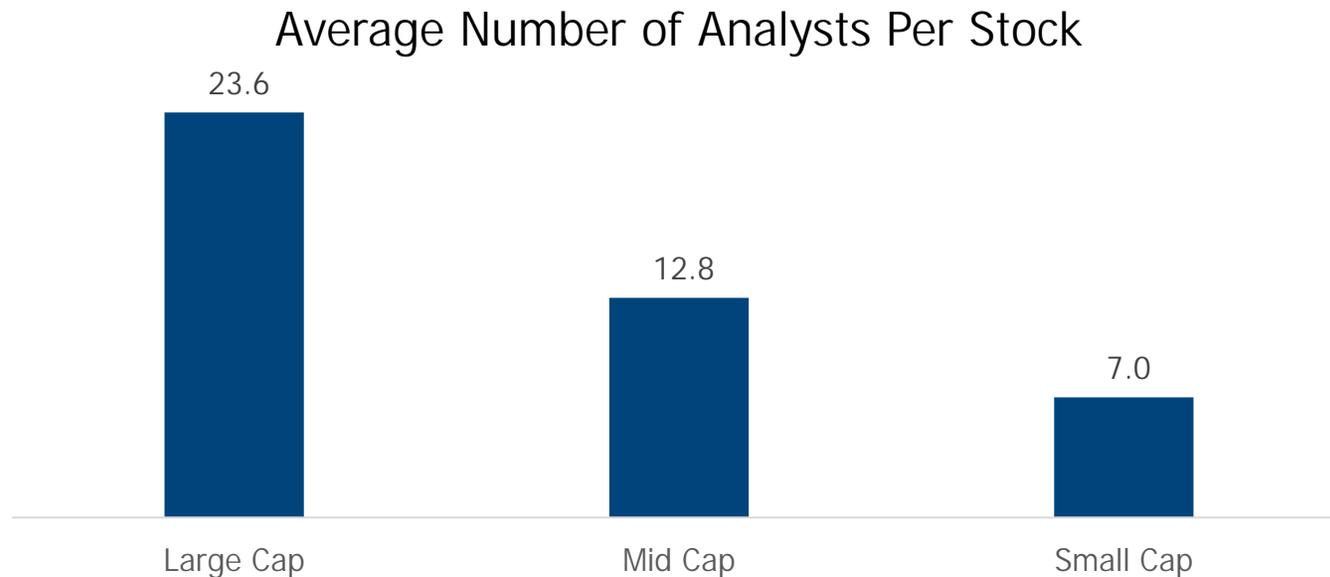
Beating the Benchmark—Active Share

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

Active Share
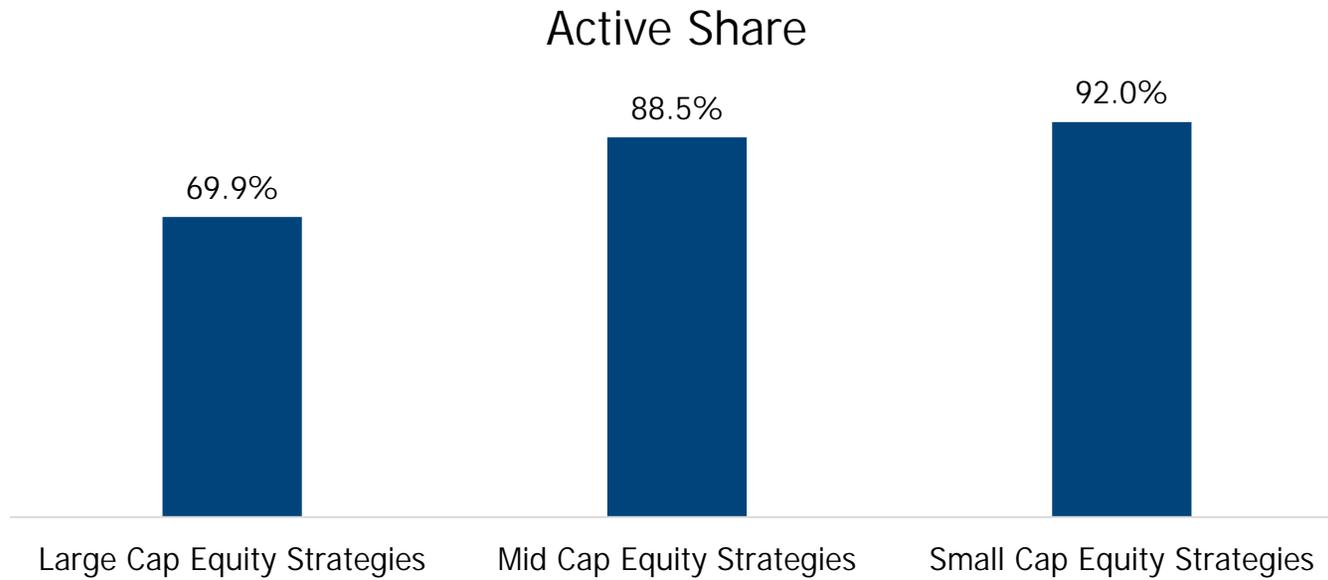
Source: eVestment as of 2Q24.

Beating the Benchmark—Inefficiencies

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

Average Number of Analysts Per Stock

Large Cap	Mid Cap	Small Cap
23.6	12.8	7.0

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
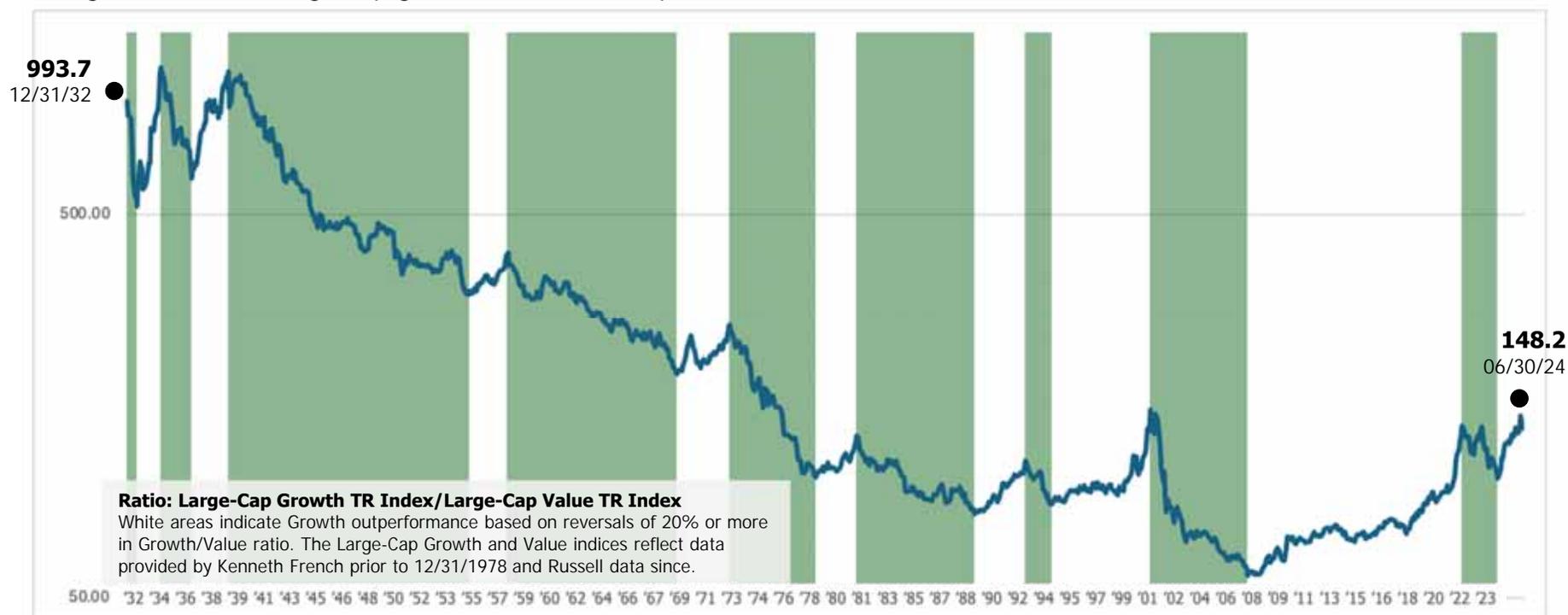
Annualized Alpha
10 Years ending 2023

Large Cap Equity Strategies	Mid Cap Equity Strategies	Small Cap Equity Strategies
0.4%	0.7%	2.3%

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**

993.7
12/31/32

148.2
06/30/24

500.00

Ratio: Large-Cap Growth TR Index/Large-Cap Value TR Index
White areas indicate Growth outperformance based on reversals of 20% or more in Growth/Value ratio. The Large-Cap Growth and Value indices reflect data provided by Kenneth French prior to 12/31/1978 and Russell data since.

50.00   '32 '34 '36 '38 '39 '41 '43 '45 '46 '48 '50 '52 '53 '55 '57 '59 '60 '62 '64 '66 '67 '69 '71 '73 '74 '76 '78 '80 '81 '83 '85 '87 '88 '90 '92 '94 '95 '97 '99 '01 '02 '04 '06 '08 '09 '11 '13 '15 '16 '18 '20 '22 '23
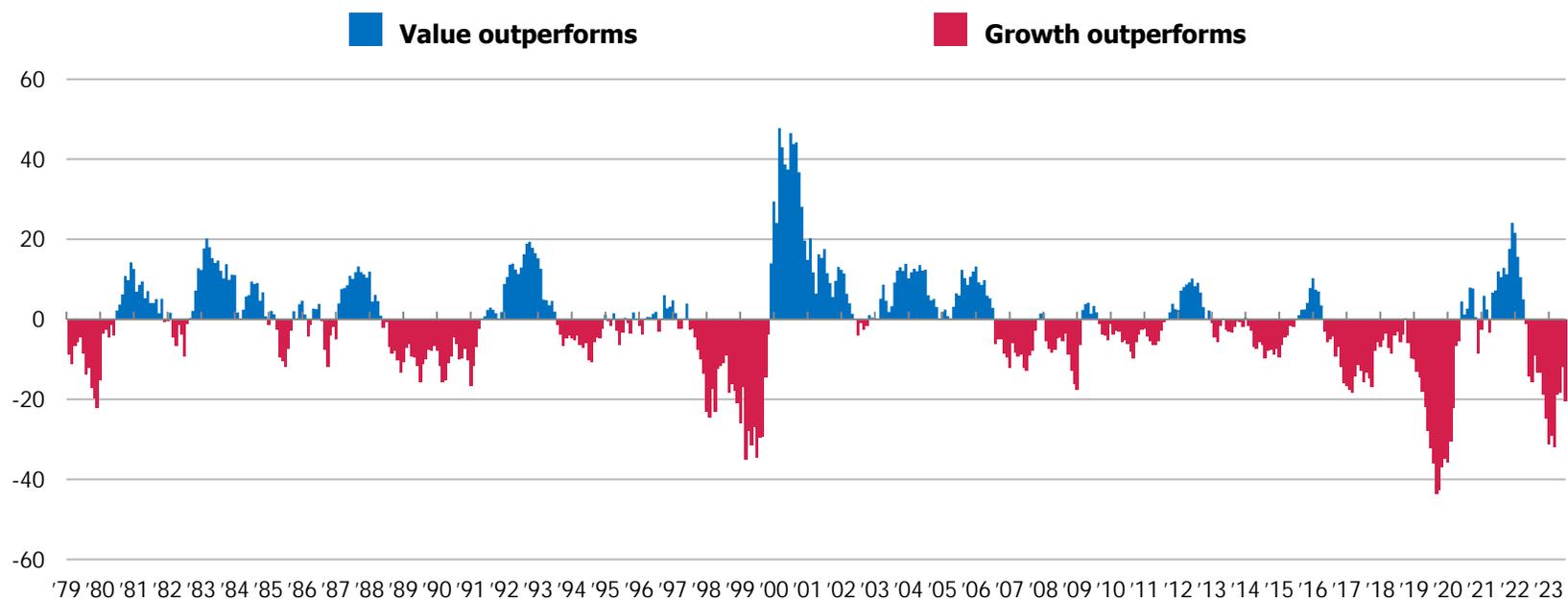
Data as of June 30, 2024.
Source: Ned Davis Research, Inc. (NDR); FTSE Russell. Monthly data December 31, 1932, to June 30, 2024 (Log Scale). Past performance is not an indication of future results.

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Shorter Term, Growth and Value Leadership Changes Often

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

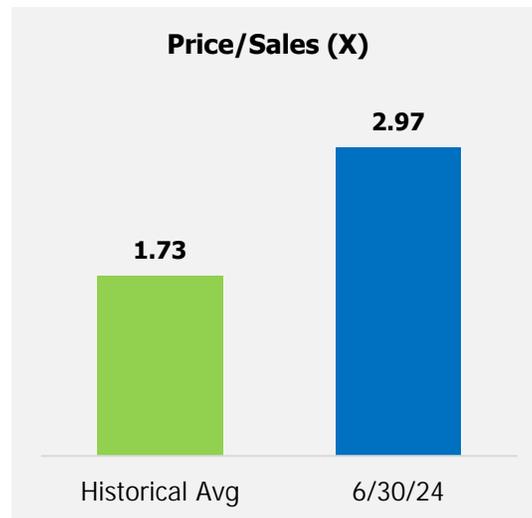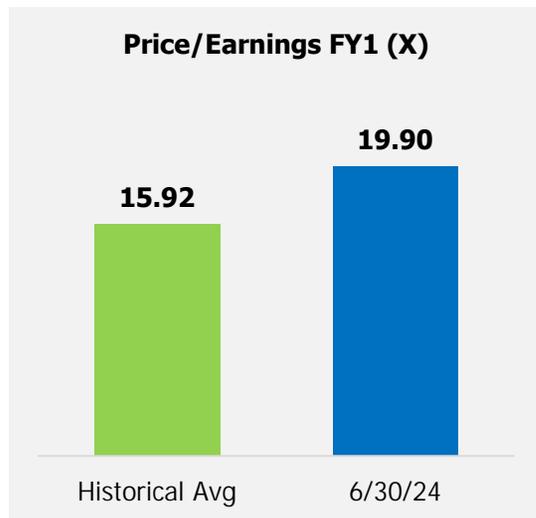Value outperforms ■   Growth outperforms ■

I11.2-11

Today's Market Looks Expensive

S&P 500 Index characteristics versus historical averages

Price/Earnings FY1 (X)	Price/Sales (X)	Dividend Yield (%)

Price/Earnings FY1 (X)
- Historical Avg: 15.92
- 6/30/24: 19.90

Price/Sales (X)
- Historical Avg: 1.73
- 6/30/24: 2.97

Dividend Yield (%)
- Historical Avg: 1.85
- 6/30/24: 1.35

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

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Valuation

R² = 0.8398

y-axis: S&P 500 10-Year Forward Return
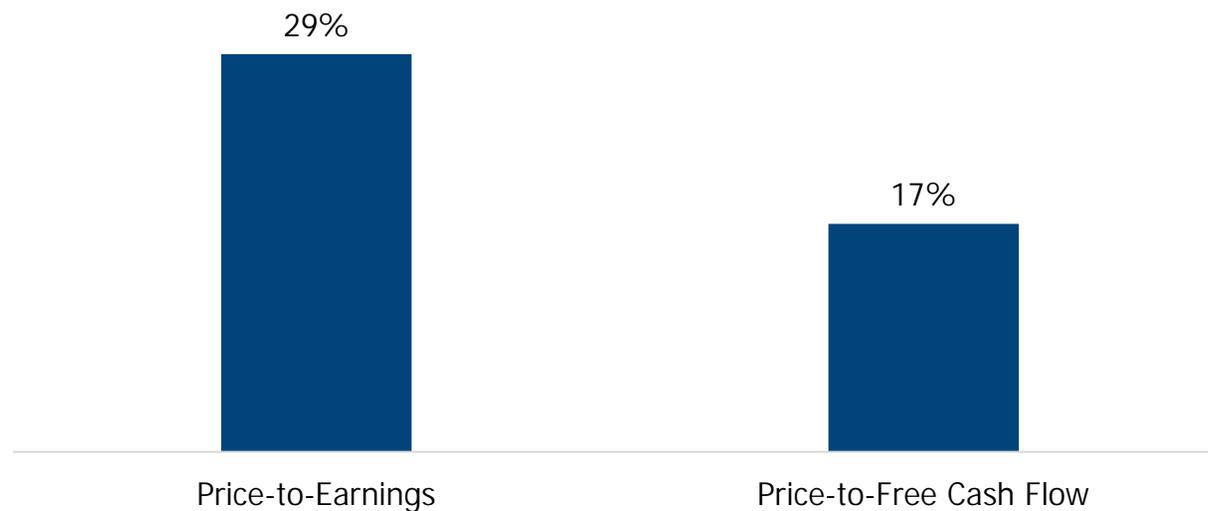x-axis: S&P 500 Price-to-Earnings
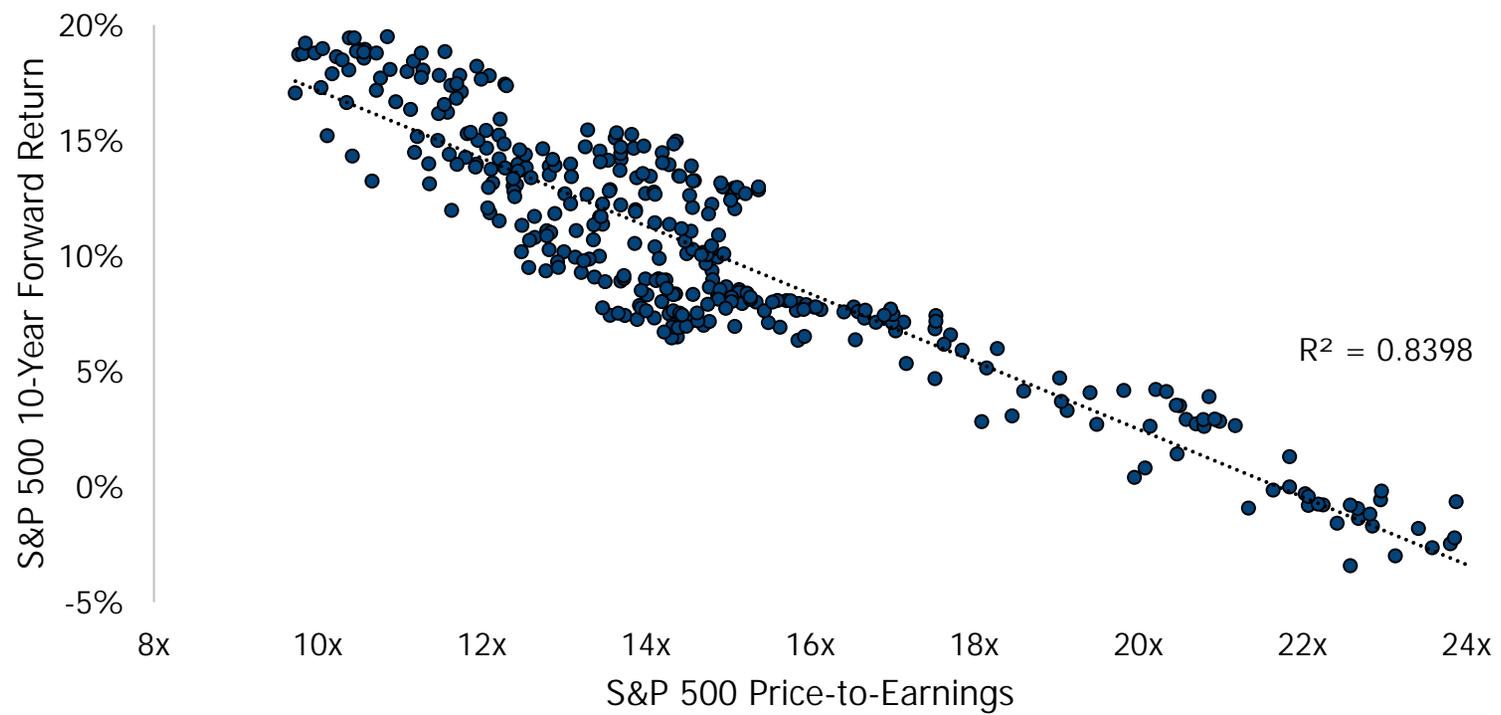
Source: FactSet. Monthly S&P 500 data as of August 30, 2024.

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Valuation

- Stocks are cheaper on free cash flow than earnings
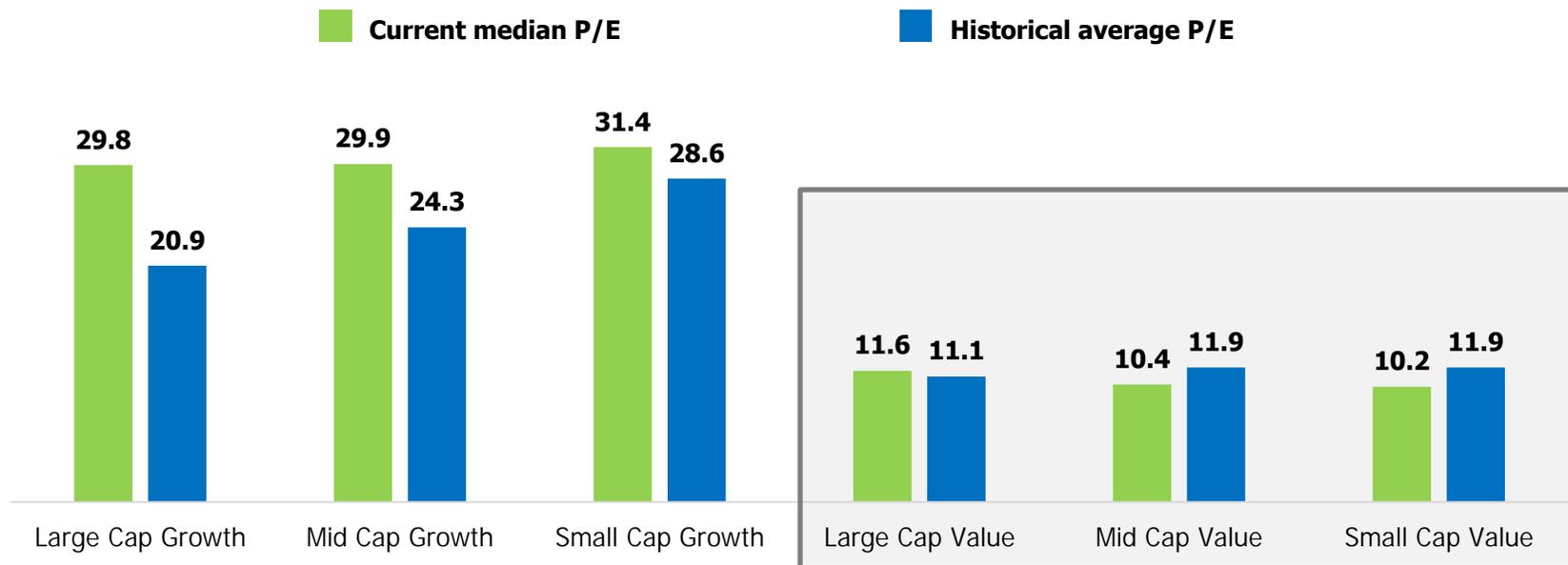
S&P 500 Premium to 30 Year Average

Source: FactSet as of 08/30/24.

Value Looks Attractive Across Market Cap
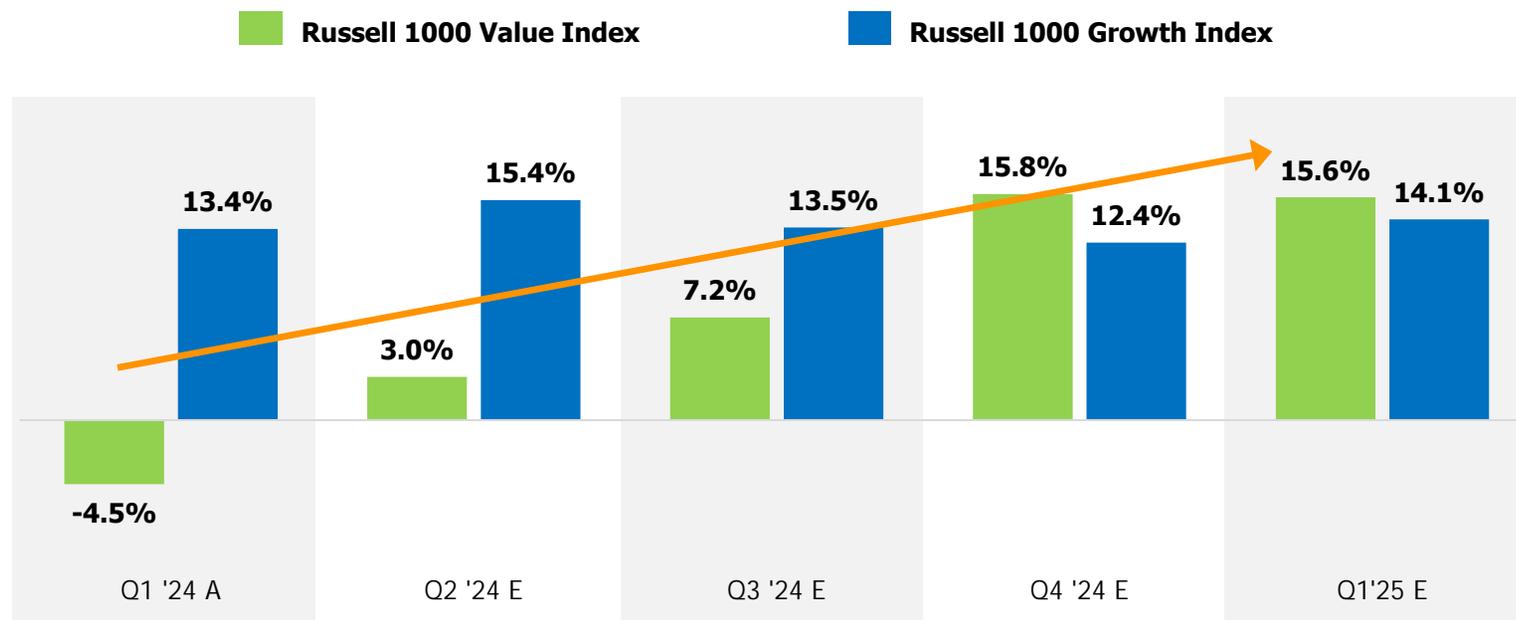
Current versus historical P/E ratios (X)

■ **Current median P/E**   ■ **Historical average P/E**

Category	Current median P/E	Historical average P/E
Large Cap Growth	29.8	20.9
Mid Cap Growth	29.9	24.3
Small Cap Growth	31.4	28.6
Large Cap Value	11.6	11.1
Mid Cap Value	10.4	11.9
Small Cap Value	10.2	11.9

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
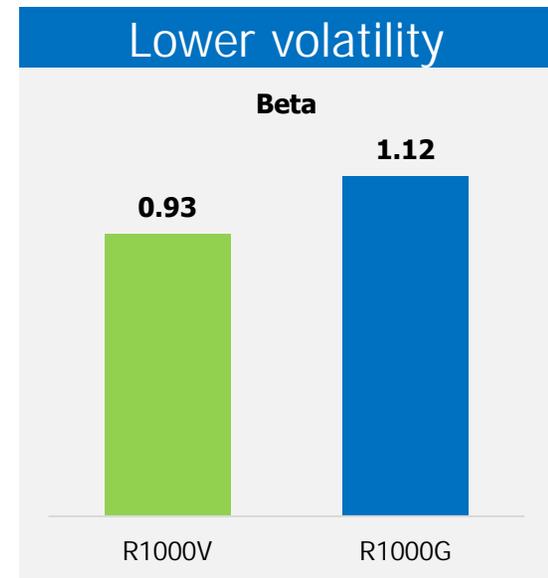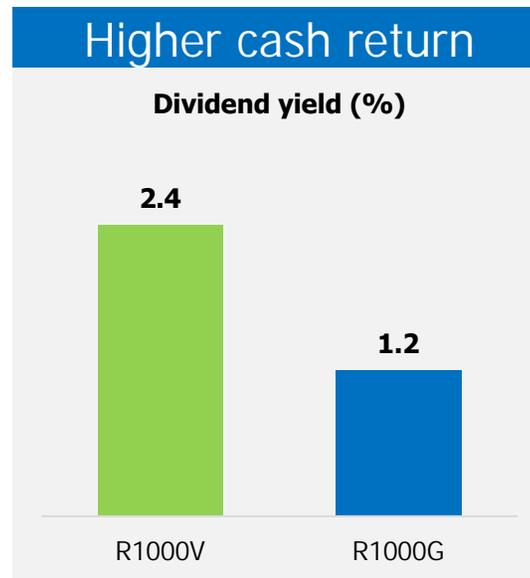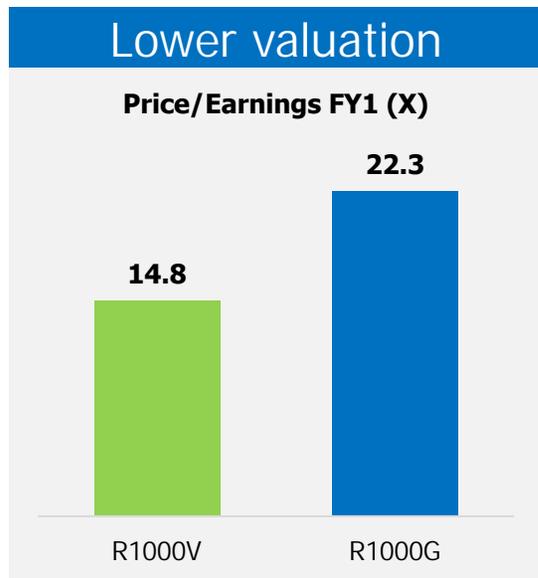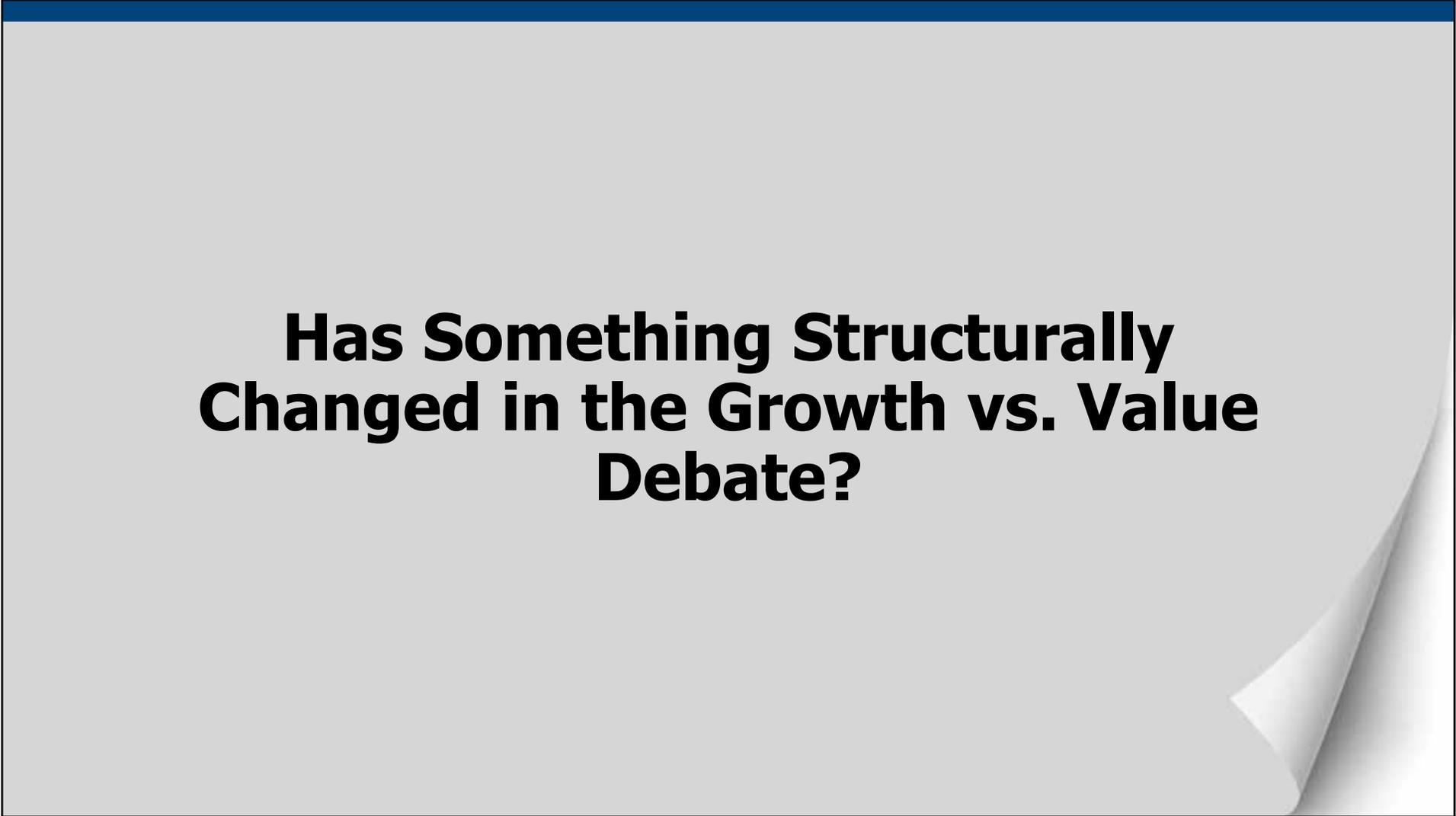
YOY quarterly earnings growth expectations (%)

■ Russell 1000 Value Index   ■ Russell 1000 Growth Index

	Q1 '24 A	Q2 '24 E	Q3 '24 E	Q4 '24 E	Q1'25 E
Russell 1000 Value Index	-4.5%	3.0%	7.2%	15.8%	15.6%
Russell 1000 Growth Index	13.4%	15.4%	13.5%	12.4%	14.1%

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

- The Russell 1000 Value Index has:

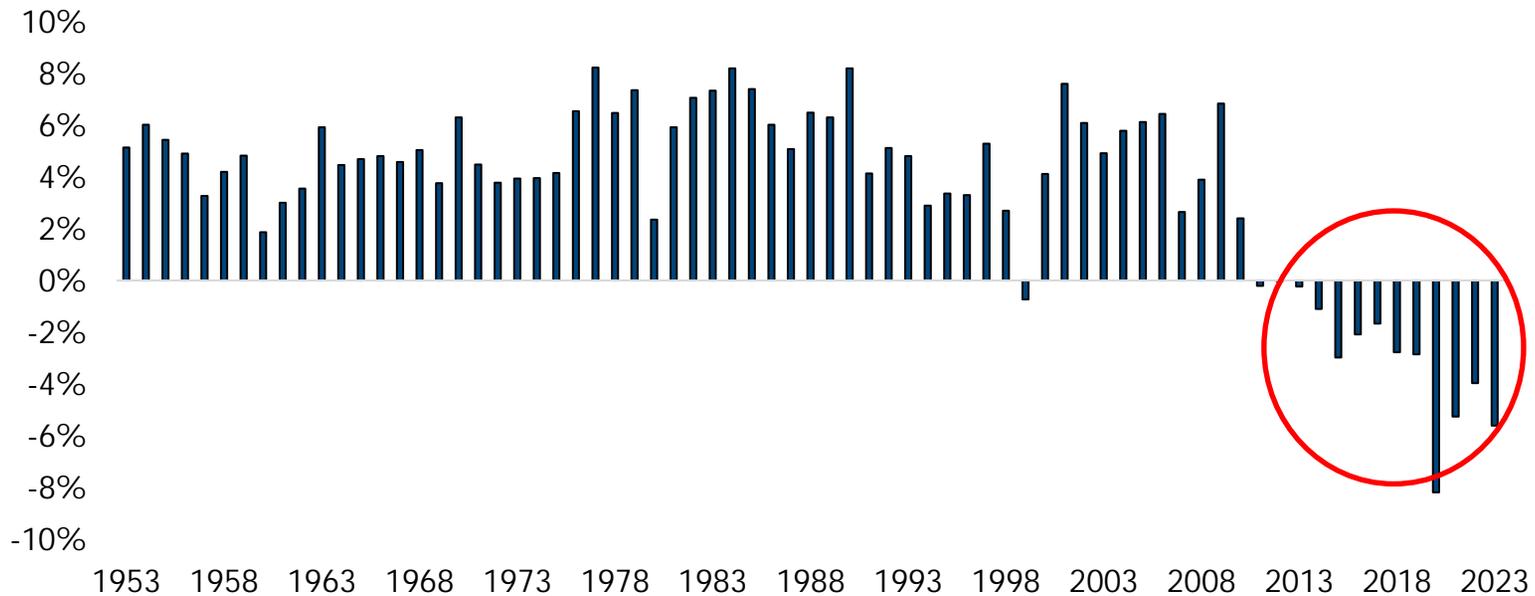| Lower valuation	Higher cash return	Lower volatility
Price/Earnings FY1 (X)	**Dividend yield (%)**	**Beta**

Lower valuation — Price/Earnings FY1 (X)
- R1000V: 14.8
- R1000G: 22.3

Higher cash return — Dividend yield (%)
- R1000V: 2.4
- R1000G: 1.2

Lower volatility — Beta
- R1000V: 0.93
- R1000G: 1.12

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

Something Wrong With Value?

Value Factor Performance
10-Year Rolling Returns

Style Issues

10-Year Rolling Annual Return

Russell 3000 Value / Russell 3000 Growth

96% Correlation

Low Price / Book Value

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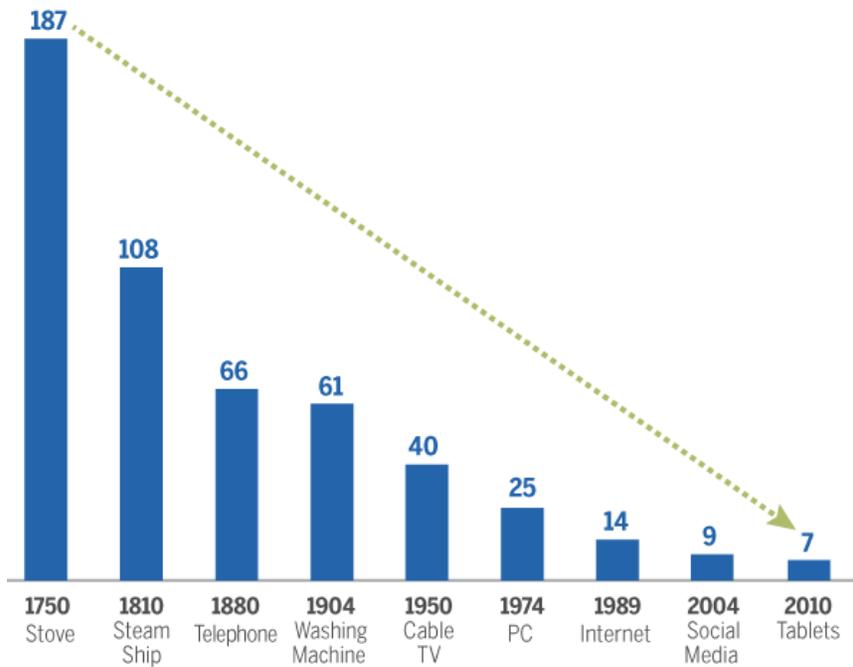
- Increasing use of intangible assets that are expensed rather than capitalized may make book value irrelevant

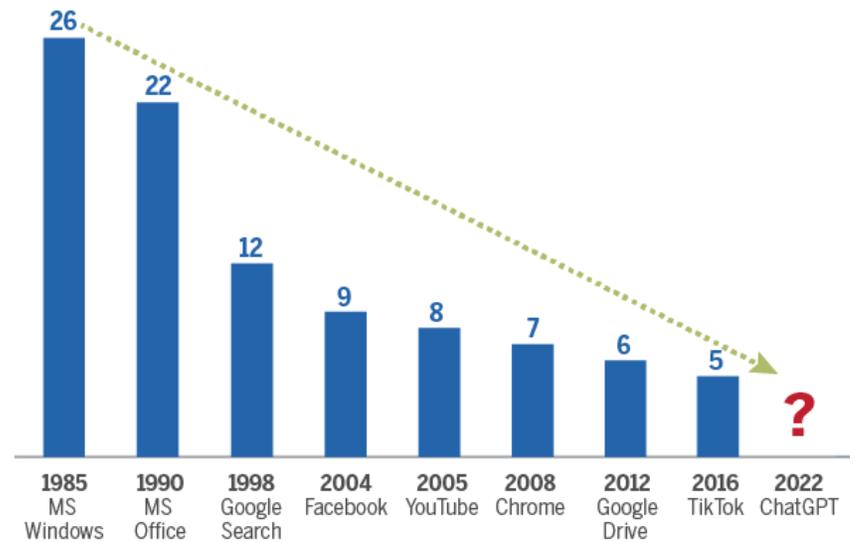## Business Investment

■ Tangible ■ Intangible

Year	Tangible	Intangible
1980	86%	14%
1990	77%	23%
2000	72%	28%
2010	67%	33%
2023	60%	40%
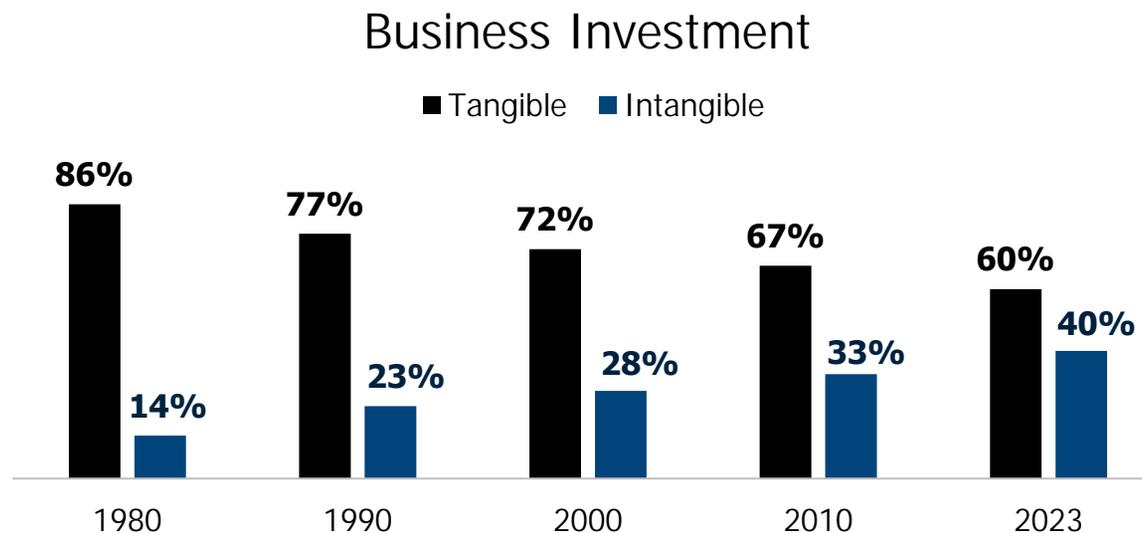
Source: Bureau of Economic Analysis.

Accelerating Change

Years from Market Entry to 50% Penetration

1750 Stove	1810 Steam Ship	1880 Telephone	1904 Washing Machine	1950 Cable TV	1974 PC	1989 Internet	2004 Social Media	2010 Tablets
187	108	66	61	40	25	14	9	7

Years to Reach 1 Billion Users

1985 MS Windows	1990 MS Office	1998 Google Search	2004 Facebook	2005 YouTube	2008 Chrome	2012 Google Drive	2016 TikTok	2022 ChatGPT
26	22	12	9	8	7	6	5	?

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

I11.2-22

The Growth Advantage

| Stronger Growth | Higher Returns | Lower Risk |

Long-Term EPS Growth

20.1%

11.5%

Russell 1000 Growth | Russell 1000 Value

Return on Equity

36.4%

12.7%

Russell 1000 Growth | Russell 1000 Value

Net Debt / EBITDA

2.5x

0.6x

Russell 1000 Growth | Russell 1000 Value
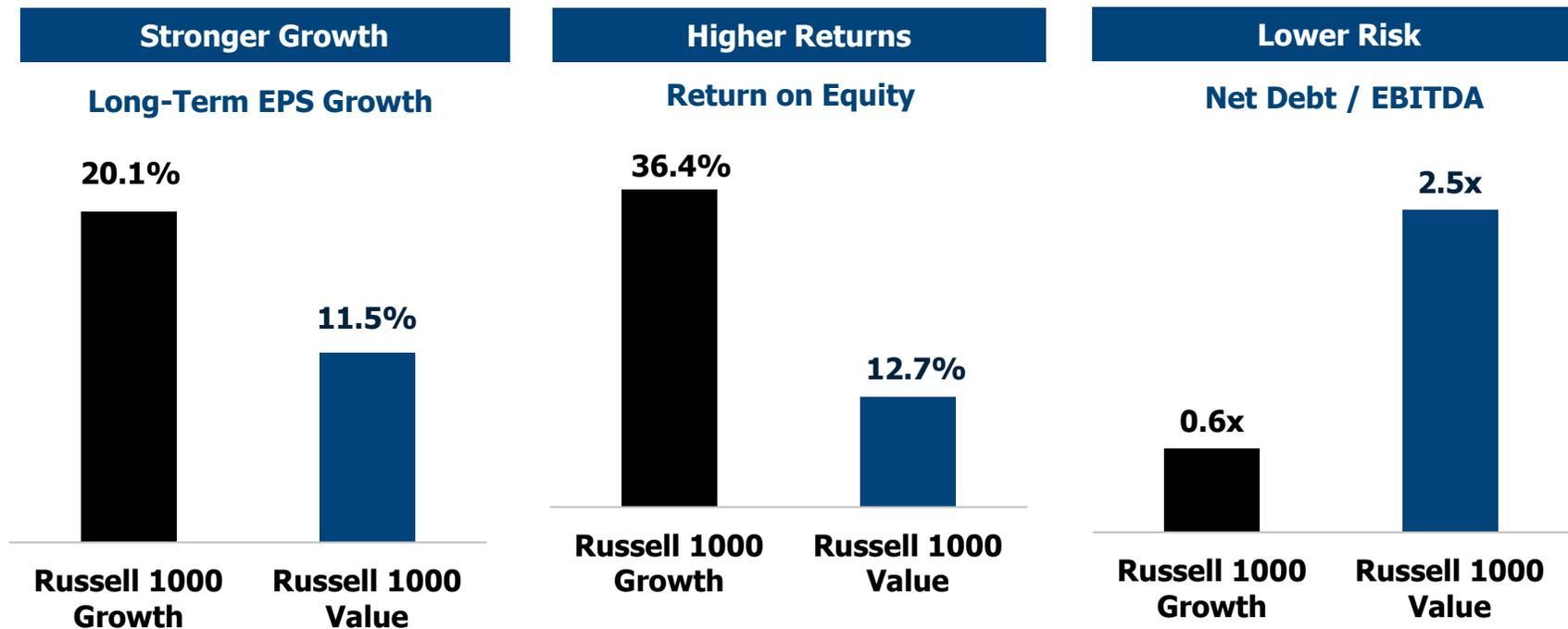
Source: FactSet as of 6/30/24. Growth represents consensus long-term analyst estimates and actual future EPS growth rates might be materially different than the forecasts shown.

Is Active Management Dead?

Shopping at the Grocery Store

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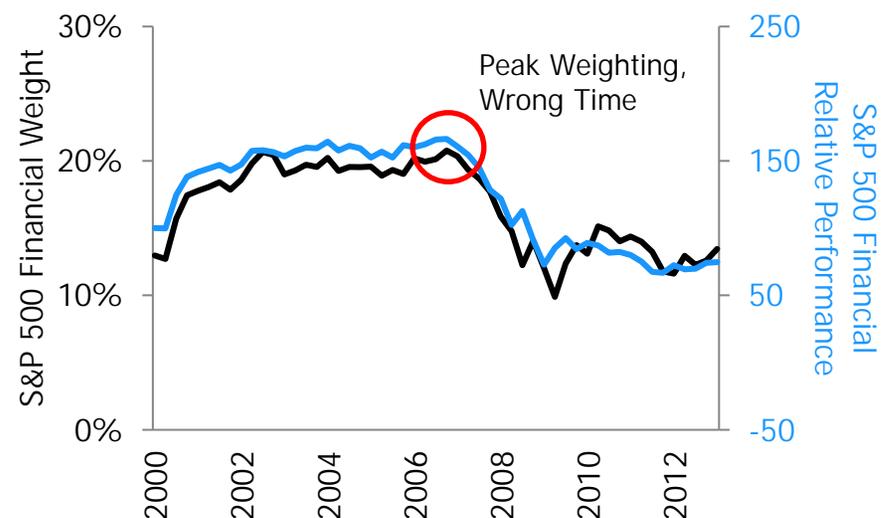- Buying one of everything on the shelf would be absurd.

Active Versus Passive Investing

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

If we don't shop that way, why would we invest that way?

Passive Problems?

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

Peak Weighting, Wrong Time

Peak Weighting, Wrong Time

S&P 500 Tech Weight — S&P 500 Tech Relative Performance

S&P 500 Financial Weight — S&P 500 Financial Relative Performance

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 (%)

Average: 48.2%
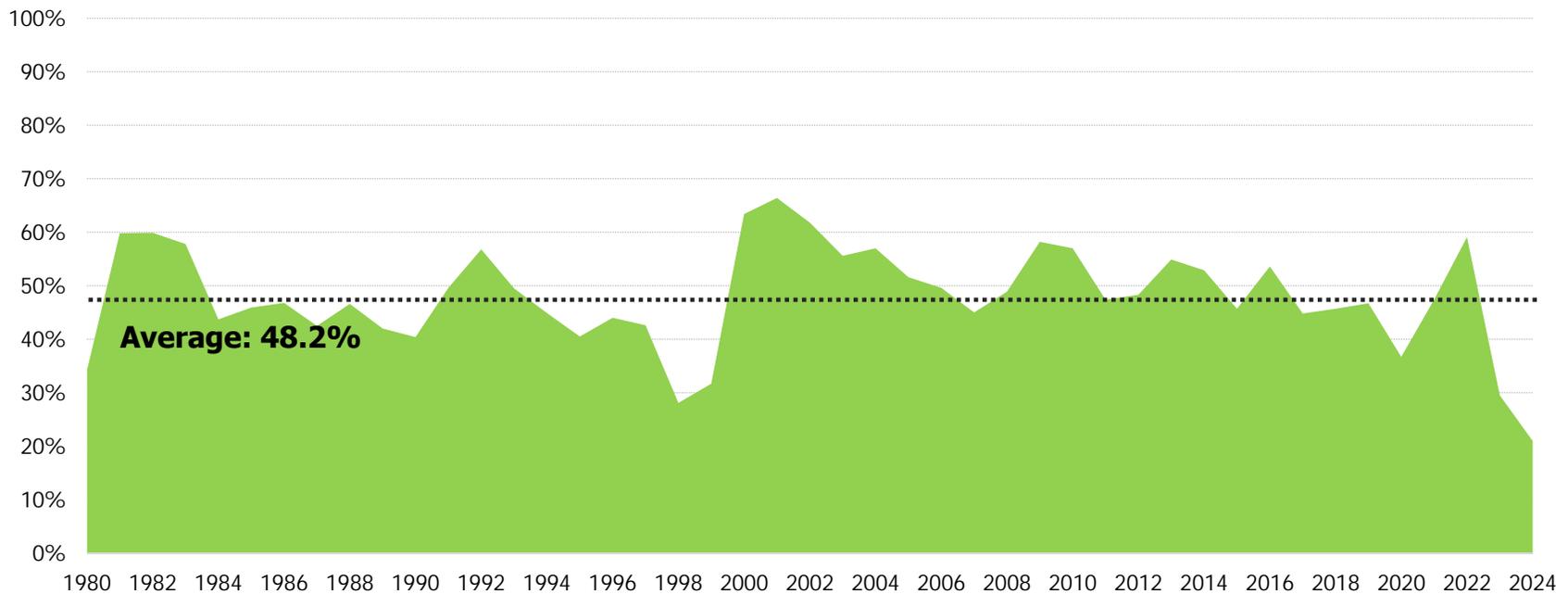
Data through June 30, 2024. Source: Ned Davis Research. Price-only returns. Past performance is not an indication of future results.

I11.2-28

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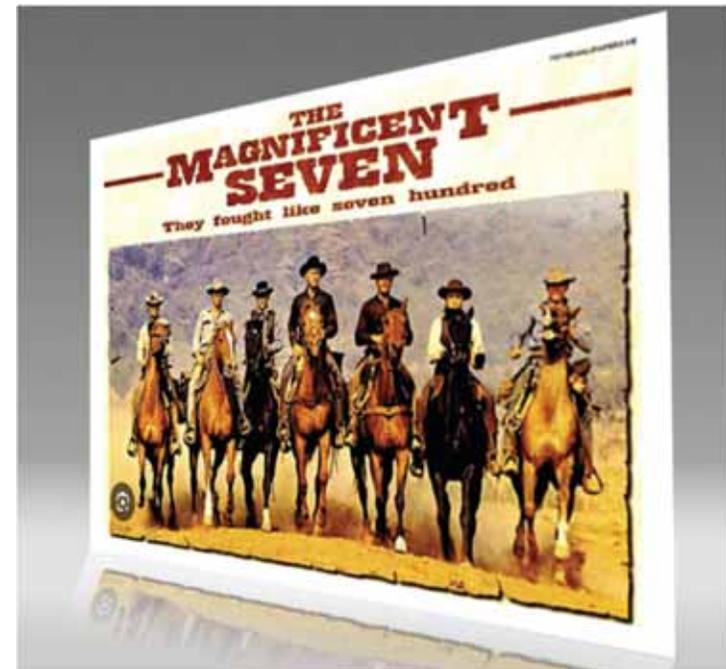
Information is provided for illustrative purposes only. Data as of 6/30/24. It should not be considered a solicitation to buy or an offer to sell a security.
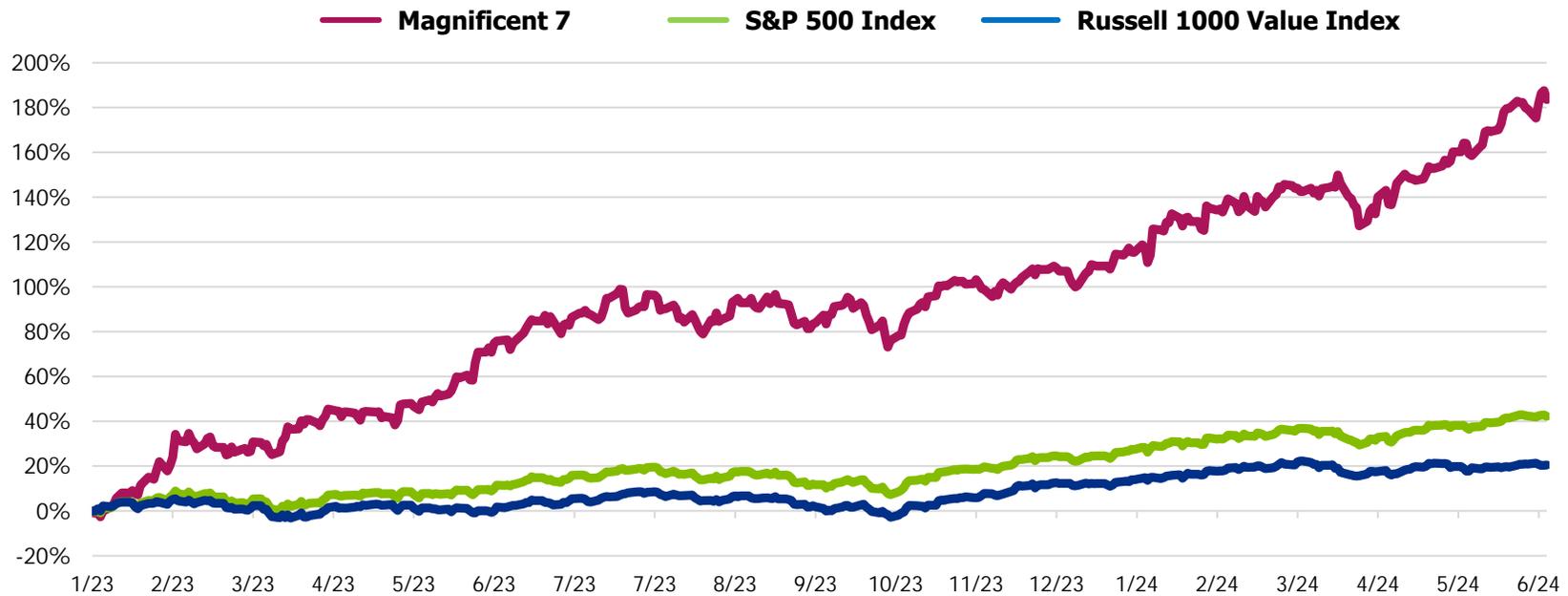
Add Netflix and We Get...

- Perhaps not the company you want to keep

The Magnificent 7 Have Dominated Performance Since 2023

Index performance since January 1, 2023 (%)

Legend: **Magnificent 7** — **S&P 500 Index** — **Russell 1000 Value Index**

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.
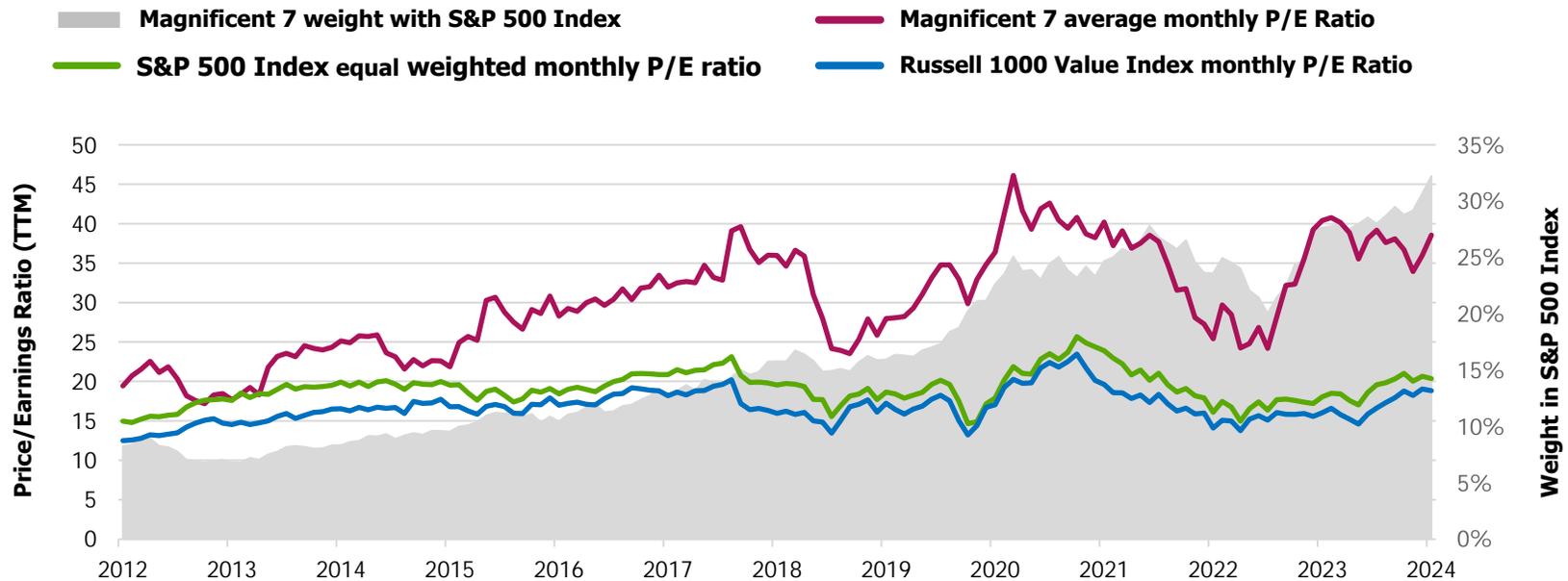
Powerful Long-Term Trends

- Earnings drive stock returns

S&P 500 EPS   S&P 500 Price
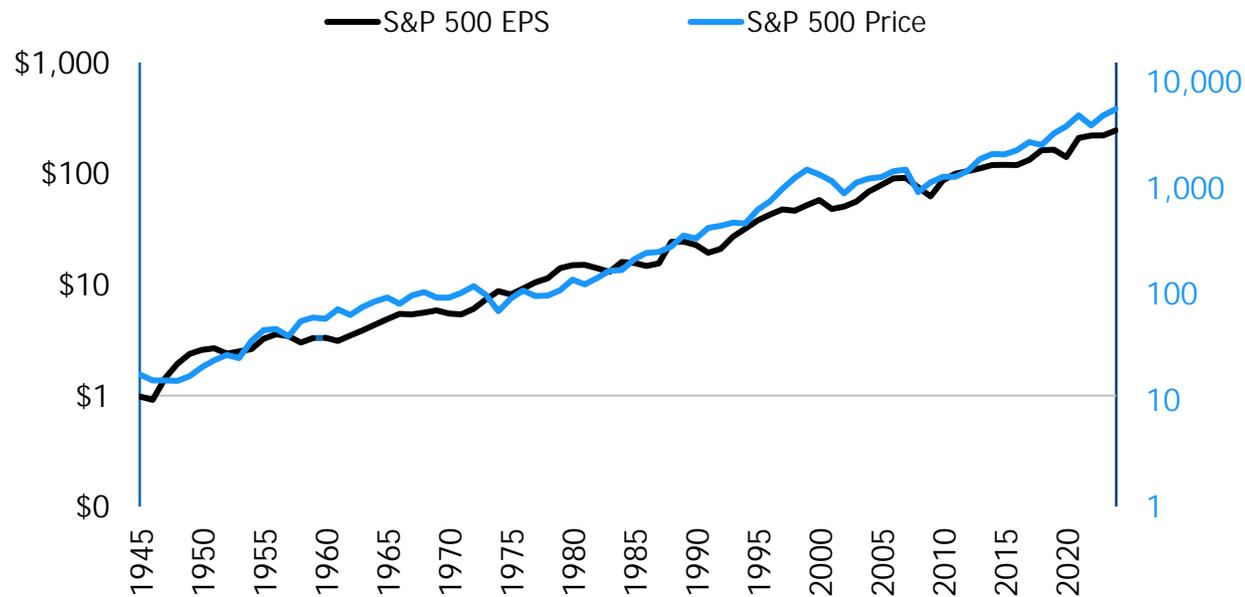
Source: FactSet as of 6/30/24. **The performance data quoted represents past performance, which is not an indication or a guarantee of future results.**
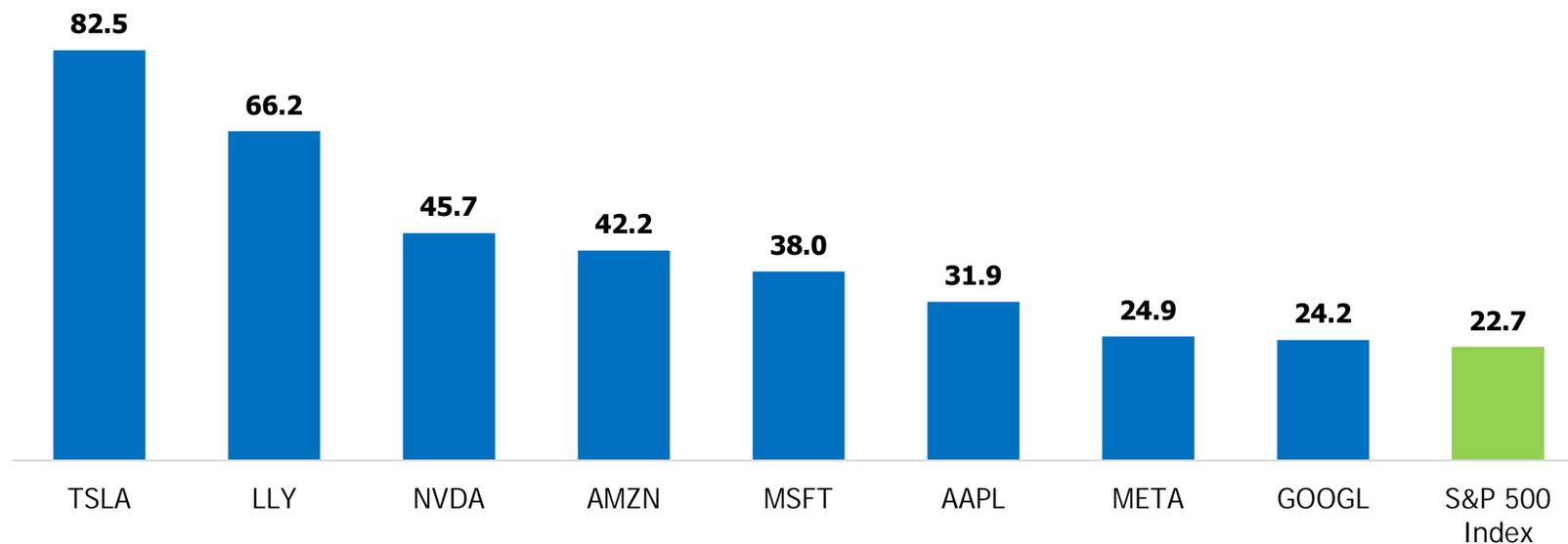
Historically Out of Step With the Market

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

Legend:
- ▬ Magnificent 7 weight with S&P 500 Index
- ▬ Magnificent 7 average monthly P/E Ratio
- ▬ S&P 500 Index equal weighted monthly P/E ratio
- ▬ Russell 1000 Value Index monthly P/E Ratio

I11.2-33

Top Benchmark Companies Look Very Expensive

2024 P/E ratios (X)

TSLA	LLY	NVDA	AMZN	MSFT	AAPL	META	GOOGL	S&P 500 Index
82.5	66.2	45.7	42.2	38.0	31.9	24.9	24.2	22.7

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

Capital expenditures as a percentage of sales (%)

Legend: ■ 2019 ■ 2024E

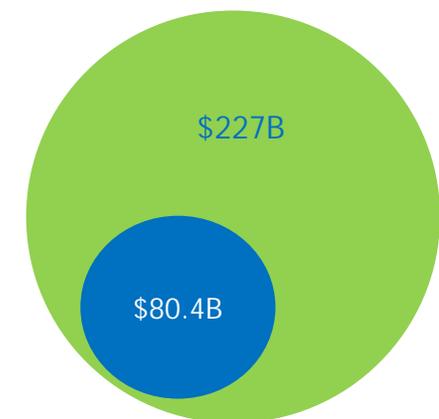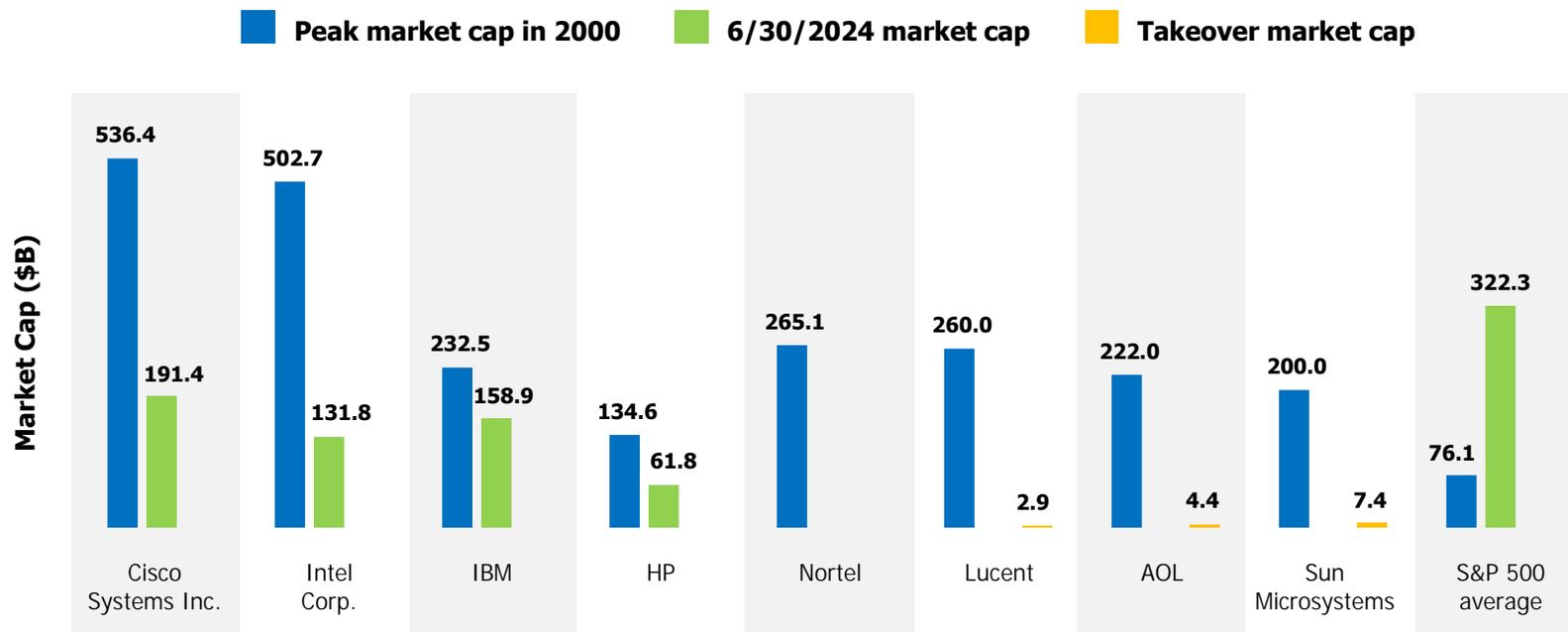|	META	MSFT	GOOGL	TSLA	AMZN	AAPL	SIG 6 TOTAL	S&P 500
2019	21.4	11.6	14.5	5.4	4.5	3.7	8.4	5.5
2024E	23.6	19.9	14.4	11.4	10.4	2.4	11.9	5.9
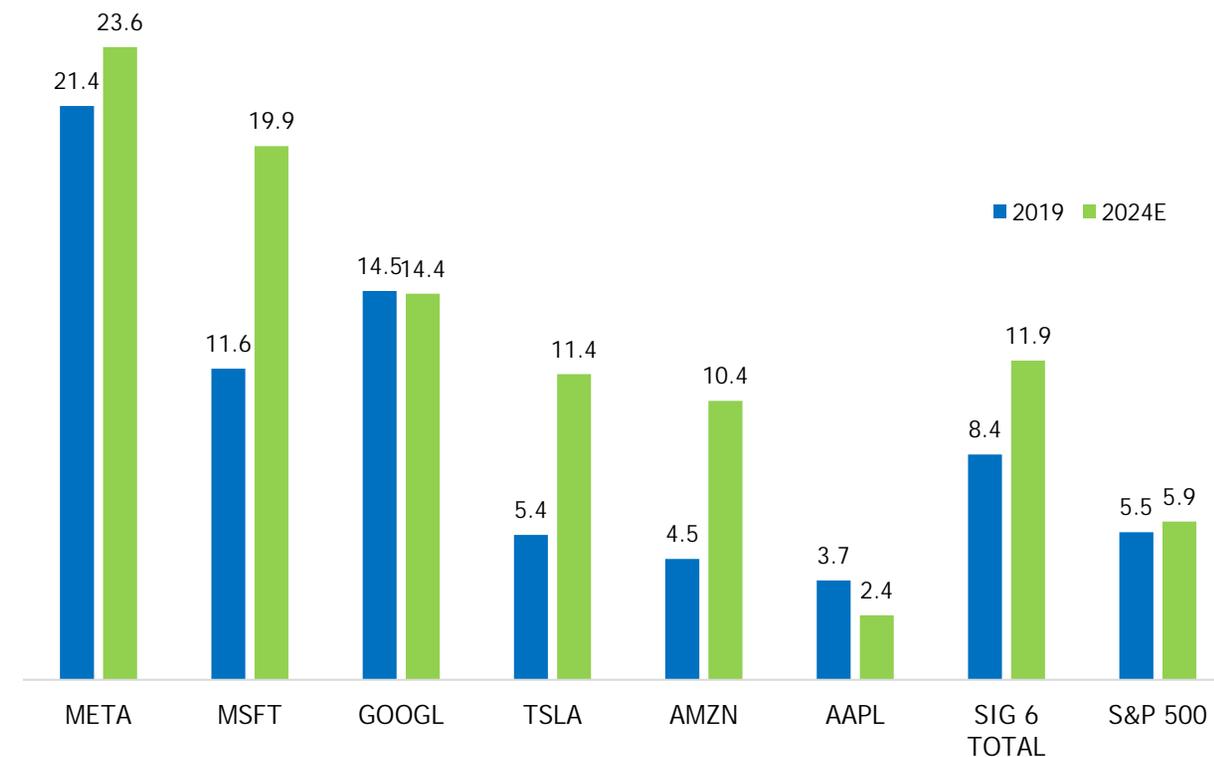
Total capital expenditures of Significant 6 ($)

$227B

$80.4B

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

I11.2-35

Valuation Matters!

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

Legend: ■ Peak market cap in 2000 ■ 6/30/2024 market cap ■ Takeover market cap

Y-axis: Market Cap ($B)

Company	Peak market cap in 2000	6/30/2024 market cap	Takeover market cap
Cisco Systems Inc.	536.4	191.4	
Intel Corp.	502.7	131.8	
IBM	232.5	158.9	
HP	134.6	61.8	
Nortel	265.1		
Lucent	260.0		2.9
AOL	222.0		4.4
Sun Microsystems	200.0		7.4
S&P 500 average	76.1	322.3	

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).

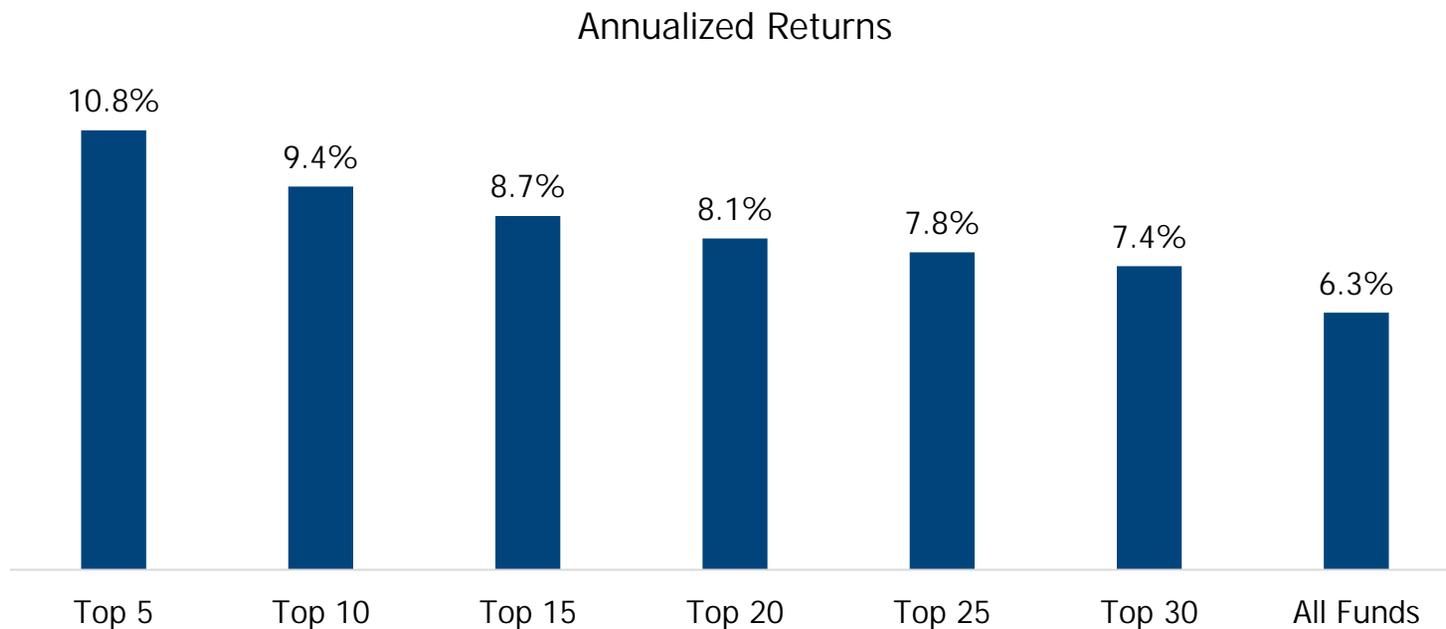# Is Now the Time to Invest in Unprofitable Companies?

Percent of firms in the Russell 2000 Index with negative earnings

I11.2-38

Concentrated and Diversified Portfolios

- Managers' top positions have historically outperformed

Annualized Returns

Top 5	Top 10	Top 15	Top 20	Top 25	Top 30	All Funds
10.8%	9.4%	8.7%	8.1%	7.8%	7.4%	6.3%

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

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

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Session Evaluation