

THE 2020S LONG GAME: LARGE-CAP GROWTH VS. SMALL-CAP VALUE

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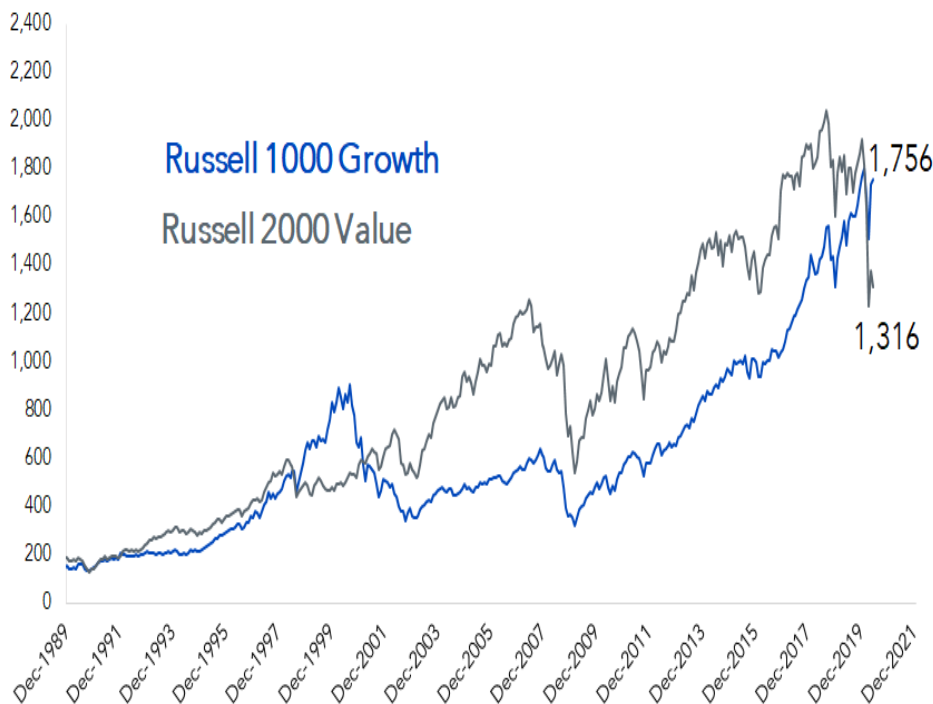
“Unchanged over a generation.” This [bull market](#) was so legendary that even after the crash, not many U.S. stock market indexes could make that claim.

Yet that was exactly the case at the depths of Covid-19 fear, when the [Russell 2000 Value Index](#) of U.S. [small caps](#) briefly traded at levels last seen in 2007.

Granted, 2007 isn’t the most encouraging of years for a bull case—the stock market peaked that year, and then the financial system fell apart.

But if you think that’s discouraging, wait until I tell you about another part of the U.S. stock market. The [Russell 1000 Growth Index](#) ran so much higher last year that the Covid-19 crash could only bring it back to 2018 levels. Now that the market is rallying, the Index is on the precipice of being unchanged so far in 2020 (figure 1).

Figure 1: Russell 1000 Growth Index vs. Russell 2000 Value Index



Sources: Bloomberg, WisdomTree, 12/31/1989–5/7/2020. Past performance is not indicative of future results. You cannot invest directly in an index.

What we have is a [bubble](#)—at least a relative one—between the do-no-wrong [large-cap growth](#) portion of the U.S. stock market and the can’t-do-right small-cap [value](#) leper.

I’m not saying this is the dot-com bust reincarnated, but let’s acknowledge the facts: There hasn’t been a 10-year clobbering of small-cap value by large-cap growth like this since the absolute final stages of the 1990s tech bubble (figure 2).

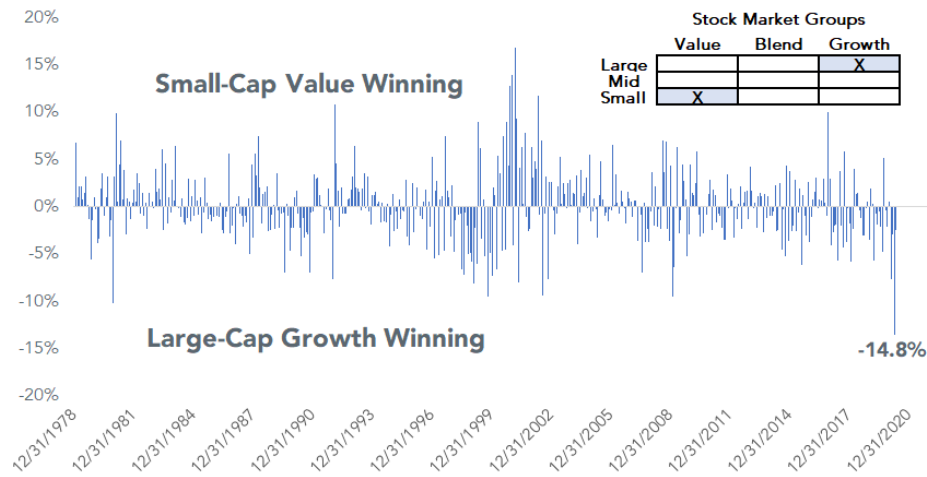
Figure 2: 10-Year Annual Outperformance, Russell 1000 Growth vs. Russell 2000 Value



Sources: WisdomTree, Bloomberg. Rolling 10-year returns for the Russell 1000 Growth and Russell 2000 Value Indexes. Data from 1/1/1984–4/30/2020. Past performance is not indicative of future results. You cannot invest directly in an index.

For those looking for an indication of end-of-days exhaustion between these two, consider the 14.8% performance gap in March, which was followed by another 2.5% in April. The only thing like this was the opposite side of the coin: various months in the 2000–2002 crash that witnessed small-cap value holding up while large-cap growth bled (figure 3).

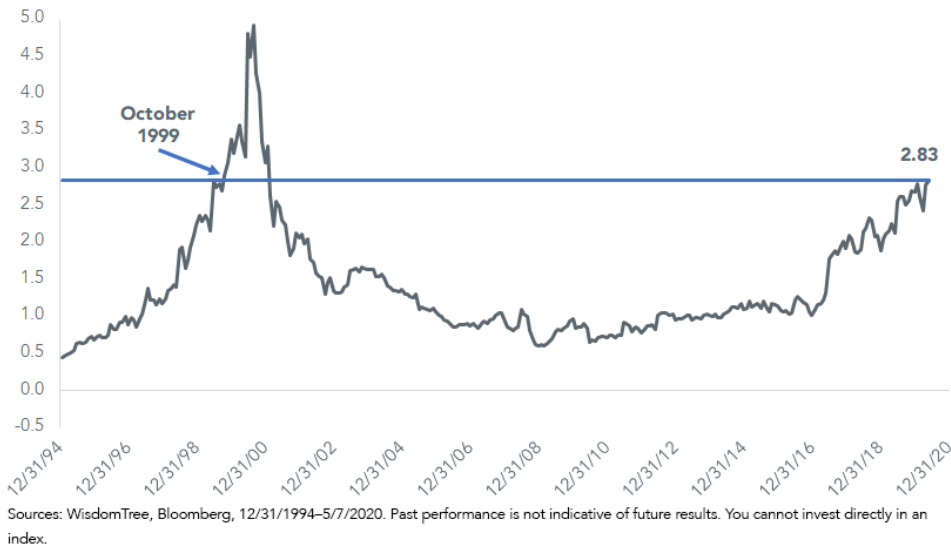
Figure 3: Monthly Performance Differential, Small-Cap Value vs. Large-Cap Growth



Sources: Bloomberg, WisdomTree, 1/1/1984–4/30/2020. Small-Cap Value = Russell 2000 Value. Large-Cap Growth = Russell 1000 Growth. Past performance is not indicative of future results. You cannot invest directly in an index.

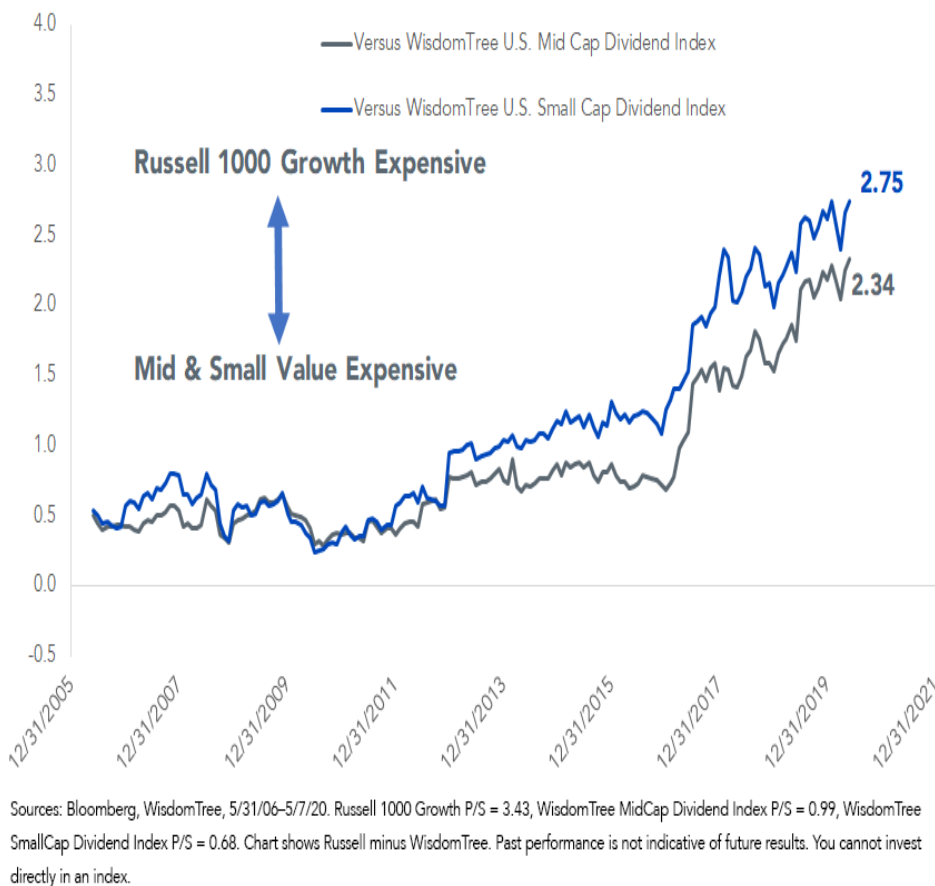
The [valuation](#) divergence is stark. With 2020 earnings uncertain because of the Covid-19 shutdowns, look at [price-to-sales ratios \(P/S\)](#). The gap between small-cap value’s 0.60 P/S ratio and large-cap growth’s 3.43 P/S ratio is 2.83. Though that is not as yawning as it was at the absolute apex of the dot-com bubble, it may not be wise to wait around to see if the differential can keep growing (figure 4).

Figure 4: Russell 1000 Growth Index Price-to-Sales Ratio Minus Russell 2000 Value



Now do it versus the [wisdomTree U.S. SmallCap Dividend](#) and [wisdomTree U.S. MidCap Dividend Indexes](#), which go back to 2006. I wonder what our business will look like in the next 14 years if figure 5 reverts.

Figure 5: Russell 1000 Growth Price-to-Sales Premium to wisdomTree Indexes



With investors questioning the viability of [dividends](#) amid political pushes for payout cuts, think about some math. Our mid-cap dividend index has a dividend yield of 4.5%. Many companies will cut or eliminate payments—that is the sober truth. But how much? Even if you slice payments by half, the resulting 2.3% yield is still higher than what could be obtained in the no-cuts 2.1%-yielding [S&P 500 Index](#) of large caps.

One more thing: Investors need to make sure they know what they own, because something is amiss inside the [Russell 2000](#). Consider something “normal.” Figure 6 shows how Morningstar’s quant work places the Russell Midcap Index and the collection of mid-cap “blend” funds roughly in the center of the left-right spectrum, where you would expect them.

Now look at the Russell 2000 and the rest of the so-called small-cap “blend” funds in figure 7. Shouldn’t they be in the center of the bottom row, not over on the right side? So much for “blend” indexes and funds.

Figure 6: Russell Midcap (Blue) vs. Mid-Cap Blend Universe (Yellow)

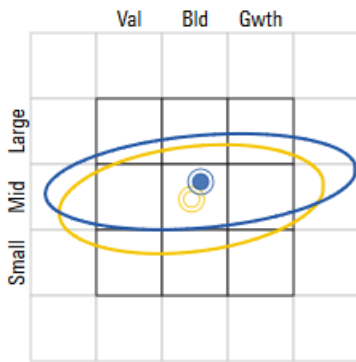
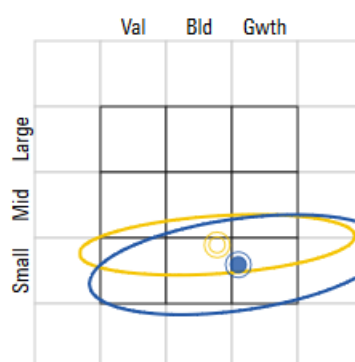


Figure 7: Russell 2000 (Blue) Small-Cap Blend Universe (Yellow)



Source: Morningstar, as of 3/31/20. You cannot invest directly in an index. Subject to change. The data in the Morningstar Style Box™ may vary due to availability on the Morningstar site. The Morningstar Style Box reveals a fund’s investment strategy. For equity funds, the vertical axis shows the market capitalization of the stocks owned, and the horizontal axis shows investment style (value, blend or growth). For fixed income funds, the vertical axis shows the average credit quality of the bonds owned, and the horizontal axis shows the interest rate sensitivity as measured by a bond’s duration (short, intermediate or long). The Morningstar Ownership Zone™ provides details about a portfolio’s equity investment style by showing the range of stock sizes and styles. A portfolio’s Ownership Zone is derived by plotting each stock in the fund’s portfolio within the proprietary Morningstar Style Box. The shaded area represents the center 75% of the fund’s assets, and it provides an intuitive visual representation of the area of the market in which the fund invests. A “centroid” plot in the middle of the Ownership Zone represents the weighted average of all the fund’s holdings. A fund that is concentrated will have a small Ownership Zone relative to the area of the Style Box, and a broadly diversified fund will have an Ownership Zone that stretches across many sizes and styles. Over a period of time, the shape and location of a fund’s Ownership Zone may vary.

It boils down to this: It may be time to consider a generational move out of the “upper right” to the “lower left” of the classic Morningstar Style Box. In the meantime, make sure that in doing so you actually end up in the style box that you are seeking. I suspect there are a lot of investors who are holding “small-cap value” and “small-cap blend” funds that are actually engaging in quasi-growth strategies.

The WisdomTree ETFs that seek to track price and yield performance, before fees and expenses, of the WisdomTree Indexes mentioned in this blog are:

[The WisdomTree U.S. SmallCap Dividend Fund \(DES\)](#)

[The WisdomTree U.S. MidCap Dividend Fund \(DON\)](#)

Unless otherwise stated, all data as of May 11, 2020.

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For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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view the online version of this article [here](#).

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DEFINITIONS

Bullish: a position that benefits when asset prices rise.

Russell 2000 Value Index: measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.

Small caps: new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Russell 1000 Growth Index: A measure of the large-cap growth segment of the U.S. equity universe, selecting from the Russell 1000 Index.

Bubble: when market participants drive stock prices above their “fair value” in relation to some system of stock valuation.

Large-Capitalization (Large-Cap): A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term “large market capitalization”. Market capitalization is calculated by multiplying the number of a company’s shares outstanding by its stock price per share.

Value: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Valuation: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Price-to-sales (P/S) ratio: share price divided by per share revenue.

Dividend: A portion of corporate profits paid out to shareholders.

S&P 500 Index: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor’s Index Committee designed to represent the performance of the leading industries in the United States economy.

Russell 2000 Index: Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.