The S&P 500 Growth index significantly lagged peers, while the S&P 500 Value index outperformed peers. (UBS)

Traditional style ETFs: Results may vary

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In 2023, there was a significant divergence between the S&P 500 Growth and Value indexes versus other traditional US large-cap style indexes, such as the Russell 1000 Growth and Value and the CRSP US Large Cap Growth and Value indexes. The S&P 500 Growth index significantly lagged peers, while the S&P 500 Value index outperformed peers.

We wanted to use this divergence to highlight some considerations with traditional style indexes and thus the ETFs designed to track them.

- First, many traditional style indexes include stocks in the respective style bucket along with stocks that are more "core," meaning they do not exhibit strong growth or value characteristics. A 50/50 combination of these indexes essentially recreates the parent index. So an equal combination of the S&P 500 Growth and S&P 500 Value closely approximates the S&P 500. Therefore, investors who own a 50/50 blend from the same index issuer are not hurt versus the parent index by the relative performance of growth and value.

- Investors who do not want to implement style tilts can certainly simply own the large-cap core exposure through ETFs tracking indexes such as the S&P 500, Russell 1000, CRSP US Large Cap, and others. This will be lower-cost than the equal-weight blend, as there is less turnover associated with traditional core indexes than style indexes. The potential benefits of an equal-weight blend would be: 1) using two funds instead of one may lead to additional tax-loss harvesting opportunities; and 2) owning the blend may create opportunities to add value through rebalancing after periods of meaningful style outperformance.

- Mixing style indexes from different index issuers will lead to active risk versus the traditional parent index. For instance, an equal-weight blend of the S&P 500 Value and the CRSP US Large Cap Growth did very well versus the S&P 500 in 2023. However, an equal-weight blend of the CRSP Value and S&P 500 Growth suffered.

- When tilting toward growth or value, it's important to understand the composition of the index. There are differences in how index issuers classify stocks as growth and value. This received a lot of attention in late 2022 when the S&P 500 Growth index rebalancing resulted in notable sector changes that made the growth index not as "growthy." The growth index's allocation to energy increased, while its allocation to consumer discretionary and technology decreased. For value, it was the opposite, with energy virtually disappearing from the index and with increases in consumer discretionary and technology. These composition changes contributed to the performance divergence for the S&P indexes versus peers. Notably, the composition of the S&P 500 style indexes is back to "normal" following the last rebalancing.

We generally don't expect significant performance differences over the long term between the various traditional style indexes focused on US large-caps. However, investors with more tactical horizons should take the time to evaluate the portfolio exposures of traditional style indexes to find the best fit for implementing their view.

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Original report - Traditional style ETFs: Results may vary, 23 January 2024.

Appendix

Exchange Traded Funds (ETFs) Disclosure

For purposes of this report, ETFs include index-linked funds regulated under the Investment Company Act of 1940 that trade on US securities exchanges under exemptive relief from the Securities and Exchange Commission. The shares of all of the ETF issuers discussed in this Report are listed on U.S. securities exchanges. The ETFs are either open-end, registered investment companies (including UITs) operating under an exemptive order from the SEC, or collective investment vehicles, formed as grantor trusts, limited partnerships or similar structures that offer pass-through tax treatment to investors. The different structures provide different rights for investors. For example, ETFs registered under the Investment Company Act of 1940 must stand ready at all times to redeem shares (albeit only in creation unit size) whereas those ETFs that are not subject to registration under the Investment Company Act of 1940 may suspend redemptions at any time. We refer to ETFs registered with the SEC under the Investment Company Act of 1940 as "'40 Act ETFs" and to non-registered ETFs as "33 Act ETFs." All of the ETFs discussed in this Report track an index of financial instruments or provide exposure to a single commodity type.

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