

# 1H23 SAW NARROW EQUITY MARKET LEADERSHIP...SO WHAT?

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A small subset of [mega-cap](#) companies—many of them associated with generative artificial intelligence—have driven most of the U.S. equity market's positive returns in 2023.

So what?

Investors now are trying to decide if the [growth](#) setback in 2022 is indicative of a longer-term shift toward [value](#) investing over the coming years—or even decade—or if this was just a temporary speed bump for the large tech giants.

This year is also showing there is a wide dispersion of returns across the standard index providers' definitions of growth and value—and we think this serves as a good case study for the choices made in portfolio construction.

What is growth? What is value? And how concerned should you be about [valuations](#) in each of these approaches? These are questions we explore below.

Notably, the [S&P 500 Value Index's](#) compositional change in December 2022 highlights these nuanced strategies.

## In 2023, Has 'Growth' Really Meant Growth?

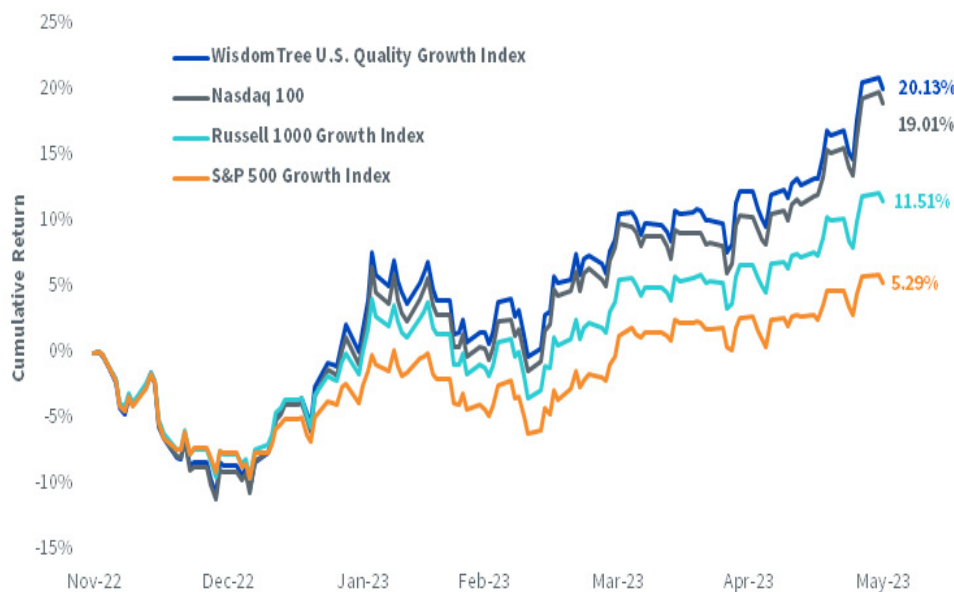
While growth stocks beat value stocks this year, different constructs of "growth" have wide variation—selection rules and composition under the hood mattered.

We see in figure 1 over a relatively short six-month time frame:

- The [WisdomTree U.S. Quality Growth Index](#) delivered a similar return to that of the [Nasdaq 100 Index](#). While not a dedicated growth style per se, since the [global financial crisis of 2008–2009](#), the Nasdaq 100 has been one of the most widely followed equity benchmarks for growth or tech investors.
- The Russell 1000 Growth Index was unable to match the returns of either the WisdomTree U.S. Quality Growth Index or the Nasdaq 100 Index, but it delivered more than twice the cumulative return of the [S&P 500 Growth Index](#).

**Bottom line:** What is the appropriate measure of growth equity returns? It appears these four indexes, at a minimum, have very different overall constructions.

## Figure 1: The Battle of the Growth Indexes



Sources: WisdomTree, FactSet, S&P. 11/30/22 represents the base date for the WisdomTree U.S. Quality Growth Index, with data going through 5/31/23. Past performance is not indicative of future results.

### What about Value?

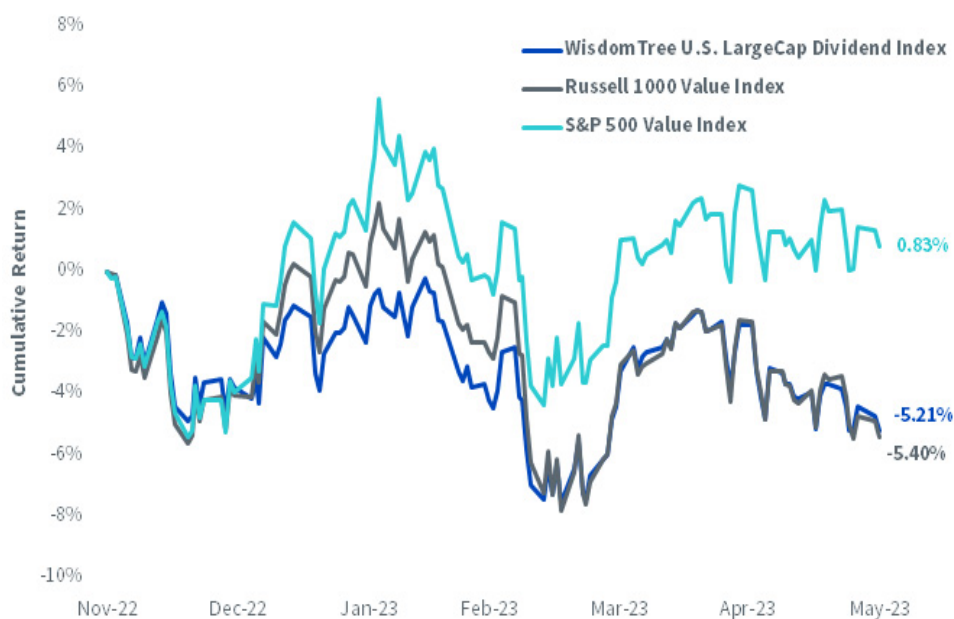
The value factor generated a lot of attention during 2022, as the long-duration tech stocks with the highest [multiples](#) sold off the most.

Market leadership in 2023 has been anything but value. However, we see a similar issue as with the growth style: different indexes built to capture value are exhibiting quite different outcomes.

- The [WisdomTree U.S. LargeCap Dividend Index](#) focuses on [dividend](#)-paying stocks, weighted on the basis of their cash dividends, and this methodology has a longstanding association with the value factor. We see here that the return of this WisdomTree Index was very similar to that of the [Russell 1000 Value Index](#) over this period.
- The S&P 500 Value Index starts off the time period with similar performance to the other two indexes in figure 2, but then it begins to diverge, ultimately showing a separation of more than 6% in cumulative return terms.

**Bottom line:** Again, we ask, what is the appropriate encapsulation of value? Are the WisdomTree U.S. LargeCap Dividend and Russell 1000 Value indexes dramatically underperforming, or is something unique happening within the S&P 500 Value Index?

**Figure 2: The Battle of the Value Indexes**



Sources: WisdomTree, FactSet, S&P. 11/30/22 represents the base date for the WisdomTree U.S. Quality Growth Index, with data through 5/31/23. We wanted the time period of figure 2 to line up with figure 1. Past performance is not indicative of future results.

### Do You Know How to Separate Value and Growth Stocks?

One detailed point in index methodologies that surprises some: the same stock can be in BOTH the value and the growth index.

A second detail that can surprise investors is that the S&P 500 Value and Growth indexes incorporate a [momentum](#) measure within the list of three growth factors. The list of value and growth factors used to denote value and growth is shown in figure 3.

We note the following:

- [Fundamental](#) data can certainly change, but the volatility of these changes in a single year tends to be more muted—especially when ranked against the changes of other, similarly large firms.
- Price data, particularly based on a 12-month percentage price change (12-Month % Price Change), has much higher volatility. Stocks with higher long-run earnings and sales growth may see a period (like 2022) with a terrible 12-Month % Price Change, even if their other two growth metrics, measured as three-year figures, don't change much.

**Figure 3: Factors that S&P Uses to Denote Value and Growth Equities**

Growth Factors	Value Factors
Three-Year Net Change in Earnings per Share (Excluding Extra Items) over Current Price	Book Value-to-Price-Ratio
Three-Year Sales per Share Growth Rate	Earnings-to-Price-Ratio
Momentum (12-Month % Price Change)	Sales-to-Price-Ratio

Source: Standard & Poor's, "S&P U.S. Style Indices Methodology," June 2022.

The Russell indexes, surprise, surprise, look at different variables, noted below:

- Russell 1000 Growth Fundamentals: 1) [I/B/E/S](#) forecast medium-term growth (2 year) and, 2) sales-per-share historical growth (5 year).
- Russell 1000 Value Fundamentals: Solely the book [value-to-price ratio](#).

So the fact that S&P is using momentum, specifically 12-Month % Price Change, as a growth factor stands out in that it is based on a direct measure of price change.

We see the result of all of this clearly in figure 4<sup>1</sup>, where something different has been going on for about six months within the S&P 500 Value and Growth indexes.

- **Microsoft** was the **second**-largest holding in the S&P 500 **Growth** Index and the **top** holding in the S&P 500 **Value** Index. The company was weighted similarly in each index as of this date.
- Amazon.com was the **sixth**-largest holding in the S&P 500 **Growth** Index and the **third**-largest holding in the S&P 500 **Value** Index.
  - Amazon was actually weighted more highly in the value index.
- Amazon and Microsoft had been in some of the pre-eminent growth indexes for the last decade yet showed up in value due to their underperformance—**not because they were cheap stocks on an absolute basis**. Nothing even remotely like this had happened within the top 10 of the Russell 1000 Value and Growth indexes.

**Figure 4: A Comparison of Top 10 Lists Provides Clarity on S&P vs. Russell**

S&P 500 Growth		S&P 500 Value	
Name	Weight	Name	Weight
Apple, Inc.	13.91%	Microsoft Corp.	6.42%
Microsoft Corp.	7.48%	Meta Platforms, Inc.	3.68%
Alphabet, Inc.	7.24%	Amazon.com, Inc.	3.63%
NVIDIA Corp.	4.91%	Berkshire Hathaway, Inc.	3.62%
Tesla, Inc.	2.89%	JPMorgan Chase & Co.	2.49%
Amazon.com, Inc.	2.61%	Salesforce, Inc.	1.40%
UnitedHealth Group, Inc.	2.40%	Walmart, Inc.	1.29%
Exxon Mobil Corp.	2.22%	Cisco Systems, Inc.	1.28%
Visa, Inc.	1.89%	Bank of America Corp.	1.21%
Eli Lilly & Co.	1.79%	Netflix, Inc.	1.10%

Russell 1000 Growth		Russell 1000 Value	
Name	Weight	Name	Weight
Apple, Inc.	12.97%	Berkshire Hathaway, Inc.	3.24%
Microsoft Corp.	11.97%	Meta Platforms, Inc.	2.60%
Alphabet, Inc.	5.87%	Exxon Mobil Corp.	2.36%
Amazon.com, Inc.	5.22%	Johnson & Johnson	2.29%
NVIDIA Corp.	4.36%	JPMorgan Chase & Co.	2.22%
Tesla, Inc.	2.57%	Chevron Corp.	1.63%
UnitedHealth Group, Inc.	2.02%	Pfizer Inc.	1.20%
Visa, Inc.	1.75%	Walmart, Inc.	1.17%
Broadcom Inc.	1.55%	Cisco Systems, Inc.	1.14%
Mastercard, Inc.	1.51%	Bank of America Corp.	1.09%

Sources: WisdomTree, FactSet, as of 5/31/23. Subject to change.

### Conclusion: Narrow Market Leadership Maximizes the Effect

Another element that we might not have expected in 2023 was that a narrow subset of stocks in the S&P 500, largely associated with tech or even more specifically artificial intelligence, would drive the entire benchmark index return. We see the list in figure 5:

- These 10 stocks contributed 10.28% of return to the overall S&P 500.

- Since the full index return for this period was 9.65%, that means the other stocks (roughly 490 or so) actually detracted from the index's total return.

**Figure 5: 10 Stocks Driving the S&P 500 Index for the First Five Months of 2023**

S&P 500 Index - 12/30/22-5/31/23			
Name	Average Weight	Total Return	Contribution to Return
Apple Inc.	6.68%	36.78%	2.18%
Microsoft Corporation	5.88%	37.35%	2.01%
NVIDIA Corporation	1.65%	158.50%	1.72%
Amazon.com, Inc.	2.58%	43.56%	0.99%
Meta Platforms Inc. Class A	1.18%	119.92%	0.97%
Tesla, Inc.	1.39%	65.72%	0.66%
Alphabet Inc. Class A	1.73%	39.07%	0.62%
Alphabet Inc. Class C	1.53%	38.86%	0.55%
Broadcom Inc.	0.73%	45.10%	0.31%
Salesforce, Inc.	0.51%	68.41%	0.28%

Sources: WisdomTree, FactSet, 12/30/22-5/31/23. You cannot invest in an index. Past performance is not indicative of future results.

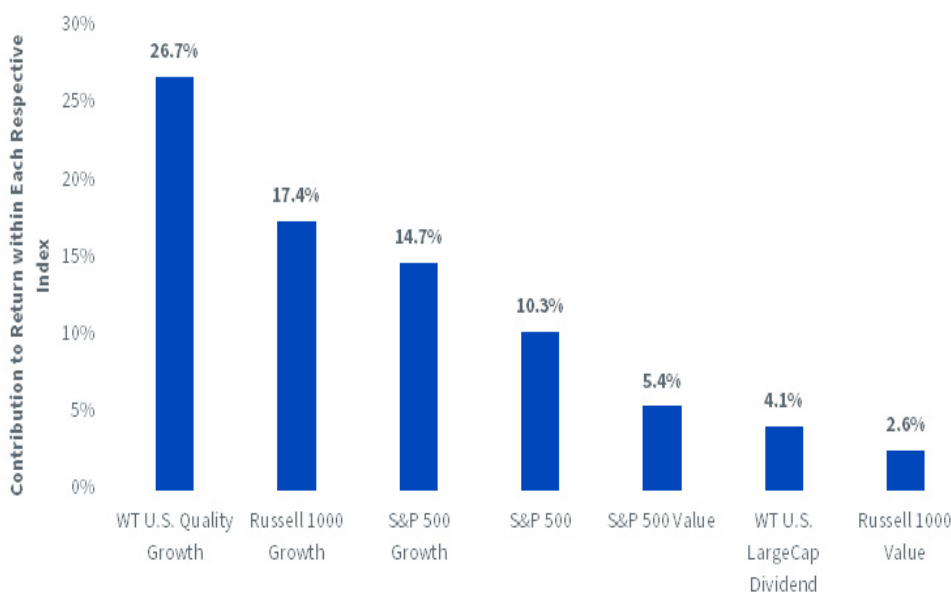
The final figure brings it all together to indicate the contribution to returns coming from these 10 mega-cap stocks in each of the indexes we have studied in this piece.<sup>2</sup>

The WisdomTree U.S. Quality Growth Index was IDEALLY positioned for the first half of 2023, at least as of this writing. It found and positioned significant weight in the stocks most responsible for driving the S&P 500 forward. Those who are thinking the second half of 2023 will be more of the same should study this Index further. It selects companies with high returns on capital and profitability with strong forward-looking earnings growth expectations.

- The WisdomTree U.S. LargeCap Dividend and Russell 1000 Value indexes had the lowest exposures to these stocks, and therefore saw the lowest contribution to total returns from them. However, this is useful, in that investors who believe the growth rally is getting over-extended may want to study exposures that are genuinely different.

**Bottom line:** When positioning a portfolio, a greater difference is your friend in that it allows you to both have a view and use a tool that is really taking that particular stand. The S&P 500, in the middle, represents the 'no-view' type of positioning, and many people who sit there tend to want a passive approach at the lowest possible cost.

**Figure 6: Contribution to Returns, by Index, from the Stocks Driving the S&P 500 in the First Five Months of 2023**



Sources: WisdomTree, FactSet, 12/30/22-5/31/23. You cannot invest in an Index. Past performance is not indicative of future results.

We believe that this is an important topic and in our next analysis, we are going to look at what all the above means from a valuation perspective, in that if investors are looking for an index to have a valuation discount against a core option (i.e., S&P 500 Value vs. S&P 500), it is tougher to do this IF the value index is including growth stocks.

<sup>1</sup> Index constituents weight discussed as of 5/31/23.

<sup>2</sup> We do not have access to index constituents of the Nasdaq 100 to create this analysis.

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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You cannot invest directly in an index.

## DEFINITIONS

**Mega Cap** : Market Capitalization over \$100 Billion.

**Growth** : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

**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.

**S&P 500 Value Index** : A market capitalization-weighted benchmark designed to measure the value segment of the S&P 500 Index.

**Nasdaq 100 Index** : Includes 100 of the largest domestic and international non-financial companies listed on The Nasdaq Stock Market based on market capitalization. The Index reflects companies across major industry groups including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology. It does not contain securities of financial companies, including investment companies.

**The Global Financial Crisis** : Refers to the period of extreme stress in global financial markets and banking systems between mid 2007 and early 2009.

**S&P 500 Growth Index** : A market capitalization-weighted benchmark designed to measure the growth segment of the S&P 500 Index.

**Multiple** : A multiple measures some aspect of a company's financial well-being, determined by dividing one metric by another metric.

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

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

**Momentum** : Characterized by assets with recent price increase trends over time. This term is also associated with the Momentum Factor which associates these stock characteristics with excess return vs the market over time.

**Fundamentals** : Attributes related to a company's actual operations and production as opposed to changes in share price.

**The Institutional Brokers' Estimate System (IBES)** : A database used by brokers and active investors to access the estimates made by stock analysts regarding the future earnings of publicly traded American companies.

**Price-to-book ratio** : Share price divided by book value per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.