

ABOVE THE FRAY

Encouraging Data from Value's Past and Present

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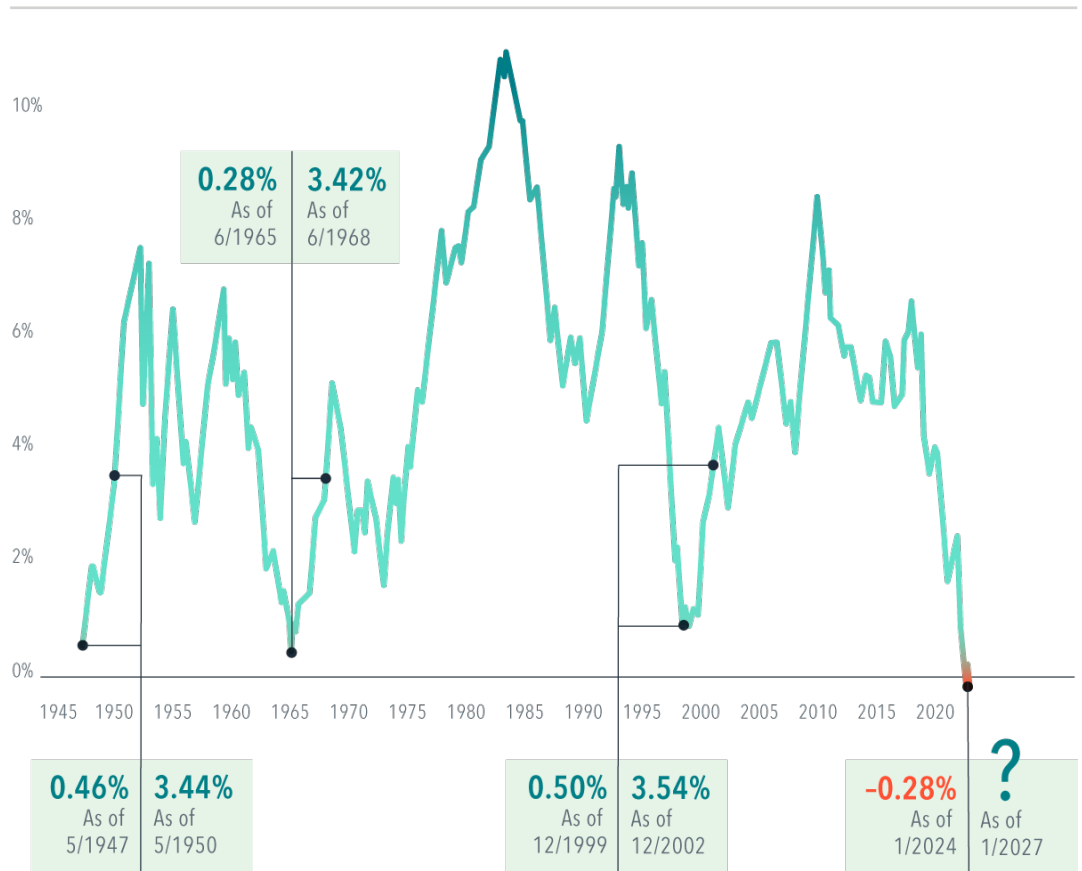
The 20-year relative return of US small cap value stocks versus the S&P 500 Index dipped negative recently for the first time in US stock market history. Two decades is a long time for an expected premium not to show up. Outliers on the negative side are never pleasant, but we can look to other previous outliers for some positive encouragement.

Many in the industry will recall the disappointing stretch at the end of the 1990s when US small cap value's trailing 20-year return was statistically indistinguishable from the S&P 500's. Less familiar might be the periods in 1947 and 1965 when the trailing 20-year premium was similarly flat. In all three cases, small value staged a rapid turnaround. We can see this by measuring each of the trailing 20-year return spreads again three years later. For example, we compare the observation on December 31, 1999, with the trailing 20-year return difference as of December 31, 2002. In all three previous cases, small cap value's advantage jumped to more than three percentage points annualized.

No one can say if we'll get a similar turnaround this time. But history suggests giving up on small cap value after its worst stretches would have been a mistake. Past performance doesn't upend the logic of expecting a higher return for stocks with low prices relative to their book equity. And, for any remaining skeptics, it's worth noting that small value's struggles in the US have not been shared by developed ex US or emerging markets, where small cap value stocks have outperformed their large cap counterparts by 2.7%¹ and 4.0%², respectively, over the past 20 years.

Exhibit 1
Better Days Ahead?

20-year rolling return difference between the Dimensional US Small Cap Value Index and the S&P 500 Index, May 1947–January 2024



Past performance is no guarantee of future results.

The Dimensional indices represent academic concepts that may be used in portfolio construction and are not available for direct investment or for use as a benchmark. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. See "Index Descriptions" for descriptions of the Dimensional index data.

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INDEX DESCRIPTIONS

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Dimensional US Small Cap Value Index was created by Dimensional in March 2007 and is compiled by Dimensional. It represents a market-capitalization-weighted index of securities of the smallest US companies whose market capitalization falls in the lowest 8% of the total market capitalization and whose relative price is in the bottom 35% of the eligible market, or 25% prior to January 1975, after the exclusion of utilities, companies lacking financial data, and companies with negative relative price. The eligible market is composed of securities of US companies traded on the NYSE, NYSE MKT (formerly AMEX), and Nasdaq Global Market. Exclusions: non-US companies, REITs, UITs, and investment companies. From January 1975 to the present, the index excludes companies with the lowest profitability and highest relative price within the small cap universe. The index also excludes those companies with the highest asset growth within the small cap universe. Profitability is measured as operating income before depreciation and amortization minus interest expense scaled by book. Asset growth is defined as change in total assets from the prior fiscal year to the current fiscal year. Source: CRSP and Compustat. The index monthly returns are computed as the simple average of the monthly returns of 12 subindices, each one reconstituted once a year at the end of a different month of the year. The calculation methodology was amended in January 2014 to include profitability as a factor in selecting securities for inclusion in the index. The calculation methodology was amended in December 2019 to include asset growth as a factor in selecting securities for inclusion in the index.

Dimensional International Small Cap Value Index was created by Dimensional in April 2008 and is compiled by Dimensional. January 1990–present: Consists of small cap companies in eligible markets whose relative price is in the bottom 35% of their country's respective constituents, after the exclusion of utilities and companies with either negative or missing relative price data. The index excludes securities with the lowest profitability within their country's small cap universe. The index also excludes those companies with the highest asset growth within their country's small cap universe. Profitability is defined as operating income before depreciation and amortization minus interest expense divided by book equity. Asset growth is defined as change in total assets from the prior fiscal year to the current fiscal year. The index monthly returns are computed as the simple average of the monthly returns of four sub-indices, each one reconstituted once a year at the end of each quarter of the year. Exclusions: REITs and

investment companies. July 1981–December 1989: Includes securities of MSCI EAFE countries in the top 30% of book-to-market by market capitalization conditional on the securities being in the bottom 10% of market capitalization, excluding the bottom 1%. All securities are market capitalization weighted. Each country is capped at 50%. Rebalanced semiannually. Source: Bloomberg. The calculation methodology was amended in January 2014 to include profitability as a factor in selecting securities for inclusion in the index. The calculation methodology was amended in November 2019 to include asset growth as a factor in selecting securities for inclusion in the index.

Dimensional Emerging Markets Small Value Index was created by Dimensional in April 2008 and is compiled by Dimensional. Consists of small cap companies in eligible markets whose relative price is in the bottom 35% of their country's respective constituents, after the exclusion of utilities and companies with either negative or missing relative price data. The index excludes securities with the lowest profitability within their country's small cap universe. The index also excludes those companies with the highest asset growth within their country's small cap universe. Profitability is defined as operating income before depreciation and amortization minus interest expense divided by book equity. Asset growth is defined as change in total assets from the prior fiscal year to the current fiscal year. The index monthly returns are computed as the simple average of the monthly returns of four sub-indices, each one reconstituted once a year at the end of each quarter of the year. Maximum index weight of any one company is capped at 5%. Exclusions: REITs and investment companies. Source: Bloomberg. The calculation methodology was amended in January 2014 to include profitability as a factor in selecting securities for inclusion in the index. The calculation methodology was amended in November 2019 to include asset growth as a factor in selecting securities for inclusion in the index.

Expected premium: Represents the expected return difference between two investments. An expected return is the percentage increase in value a person may anticipate from an investment based on the level of risk associated with the investment, calculated as the mean value of the probability distribution of possible returns.

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1. 1. Based on the Dimensional International Small Cap Value Index (net div., USD) vs. the MSCI World ex USA Index (net div., USD) over the 20 years ending 1/31/2024. MSCI data © MSCI 2024, all rights reserved.
 2. 2. Based on the Dimensional Emerging Markets Small Value Index (net div., USD) vs. the MSCI Emerging Markets Index (net div., USD) over the 20 years ending 1/31/2024. MSCI data © MSCI 2024, all rights reserved.

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