

## **The Blurred Lines Between Growth and Value Create an Investment Opportunity**

- Jim talks with equity strategist Chris Morahan about the annual reconstitution of the FTSE Russell equity indexes, designed to reflect changes in the U.S. equity market.
- For example, with this year's reconstitution, Amazon, Apple and Microsoft will now be the three largest stocks in the Russell 1000 **Value** Index.
- The reconstitution means that Growth and Value managers are now overlapping more than they have in the past ... and investors must be aware that their portfolios might not providing them with sufficient diversification.

**Jim Caron:** Hello, this is Jim Caron, CIO of the Portfolio Solutions Group. Welcome to another edition of Caron's Corner powered by The BEAT, our asset allocation framework across Bonds, Equities, Alternatives, Taxes and short-term Transitional (cash) investing.

Today I am super excited today to be joined by equity strategist Chris Morahan on a subject that I always find very interesting, the blurred lines between Growth and Value. Look, for a long time we've thought about asset allocation and balancing portfolios, and we use classic studies like Fama and French, and we realized that you need to have some growth, you need to have some value, some dividends, some quality and all of these other different styles that come into investing in order to balance a portfolio.

But what's interesting today is that there are some blurry lines between growth and value. So what do we do with that and what market implications might that have? So Chris Morahan, welcome and I'd like to start with a question. It's that time of year again when we get the annual Russell reconstitution. What is the reconstitution and how does it impact clients?

**Chris Morahan:** Thanks, Jim, for having me on today. It's exciting to be a part of Caron's Corner. So the Russell reconstitution is essentially an annual process where FTSE Russell, one of the major index providers, updates its indexes in order to reflect changes in the U.S. equity market, making sure it's keeping up with trends that are taking place. What you have is companies get re-ranked based on their market caps and other characteristics, like growth and value, and then those companies get assigned to the various indexes. So think of the Russell 1000, Russell 2000, the 1000 Growth, 1000 Value, etc.

This process is essentially put in place to acknowledge that a lot can happen over the course of the year. There are large price movements that impact companies that can end up skewing the indexes, so you have this annual process to make sure that everything gets sort of reset back to alignment with their index methodologies. It sounds a bit like a routine technical exercise, but it's very important for us to remember that there are trillions of dollars being managed to either mirror these indexes for passive strategies or approximate the characteristics for active managers. Russell is extremely prominent, has very large market share in the industry for indexes and their process for many investors will define what is microcap and small cap for the coming year, and their growth and value style indexes are highly influential given the market share for the Russell 1000 Growth and the Russell 1000 Value.

You'll see companies move between indexes, for example a company will go from small cap to midcap or midcap to large cap or value to growth, and that means that many managers will adjust their holdings, which can create significant trading activity, capital gains, etc. It happens every year, draws a lot of attention from the professional investors, the traders, the risk managers but it's not necessarily

visible to clients. But I think this year it is quite significant, and we will see some pretty noticeable impacts on client portfolios.

**Jim:** So it sounds like a pretty large technical in the markets. But I think as you're pointing out it is actually very impactful because it's going to likely put a lot of money in motion because some of the sizes of these companies are just enormous. So what do you think is the most notable change that clients should be aware of?

**Chris:** If you break it down by sectors, market caps, etc. there are a lot of significant changes. But I think the biggest change connects to how Russell is categorizing the Magnificent 7 stocks and semiconductors. So as far as the Magnificent 7 goes, just a reminder that they are Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla, some of the largest companies in the world that have all handily outperformed the market over the last 10 years. As a result, they've grown significantly as a percentage of the U.S. equity market and specifically the Russell 1000 Growth index where all of these companies have been primarily situated. These are companies that have demonstrated higher than average growth and have had higher than average valuation, so that has really made sense.

If we look back to last year before the last reconstitution, these stocks accounted for 52% of the Russell 1000 Growth index, but 0% in the Value index. So after this year's reconstitution, now 15% of the Russell 1000 Value index will be in these stocks. In fact Amazon, Apple and Microsoft will be the three largest stocks in the Russell 1000 Value index and as a result, that index will now be significantly more concentrated in top 10 holdings than it has been.

**Jim:** That does sound significant. So with those three stocks being so prominent in the Value index now, what are the impacts on the Growth index?

**Chris:** This is really interesting because you would think that if all that moved from Growth to Value, Growth now gets less concentrated and a little bit more manageable for those growth managers who've struggled with evaluating an index that's so heavily weighted to a few stocks. But that's not exactly the case because the concentration in the Growth index has come down. The top 10, instead of being 62% at the end of last month, will now be 57%. So it's come down, but not meaningfully and still very heavily concentrated.

There is a bunch of movement. Amazon has moved from growth to almost exclusively value. Alphabet had been primarily value last year, now it's in growth. The big one from value to growth is semiconductors. Micron, the top contributing stock to the S&P 500 this year, up about 300%, is leaving value and going into growth at a 4% position. That's why you see some of those Mag 7 stocks coming out of growth, but Micron and other semiconductors are coming in. Semiconductors will now be 32.5% of the Russell 1000 Growth index, almost a third in a single industry, and that's up from 23.6% at the end of May. So not only do growth managers look at a 9% increase in semiconductors coming into their benchmark, but many managers can only hold 25% in one industry. That industry will now have almost 33%. This will be a real challenge for managers and something that's going to change the way portfolios look because of that shift of semiconductors from value to growth, and those names like Amazon, Microsoft and Apple shifting into value.

**Jim:** Given the performance of the market, especially with some of the big names that you mentioned, it's really putting that money in motion and so what can our clients make of these major index changes resulting from this Russell reconstitution?

**Chris:** Great question. I think that obviously there's a lot of arbitraging which goes on with quantitative managers around the reconstitution date of June 26. I don't think that's something that clients really need to worry about. It's been shown that there's very little benefit to be made by trying to sort of time the changes in the index.

But what they should really think about is the diversification in their portfolios. For many years if you invest in a manager that manages relative to the 1000 Growth and you get diversification managing with a manager managing to the Russell 1000 Value, putting those together has provided good diversification. You've seen over the last few years growth has generally dominated with the Magnificent Seven performing well, but value strategies really deliver when the market broadens out like what we're seeing so far in 2026. So you've got a good, uh, you know, benefit by pairing the two.

But with these changes clients may find that the portfolios of their growth and their value managers are overlapping more now than they have in the past. Microsoft and Apple are split with about 4% in each benchmark. So you could have your Value manager owning Apple and your Growth manager owning Apple. Under the surface, clients may not be getting the diversification that they've come to expect. What we would emphasize is just to dig deeper, look through the strategy's name and the strategy's category, and get an understanding for the underlying holdings because it's gotten a bit more complicated. Passive funds will change immediately, but for active managers we're going to see over the course of the next month it'll take 30 days for holdings to be published and I would encourage advisors and clients to take a look at the underlying holdings and make sure that you're getting the diversification that that you've come to expect.

**Jim:** That's a fantastic point that should not be overlooked. I want to go back and emphasize that in my mind the key point is that clients may find that the portfolios of their Growth and Value managers are overlapping more now than they have in the past and not providing the desired diversification. That's a really critical element. Now when we think about asset allocation and portfolio construction, these are very important factors to take into account because you do want to get the diversification so that you can get stable and steady compounded returns. This is something that we think about with asset selection, investment selection, portfolio construction all of these technicals that go into constructing a portfolio and actively managing a portfolio.

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