Russell US Indexes Spotlight

QUARTERLY REPORT: **JULY 2023** FOR PROFESSIONAL INVESTORS ONLY

Large-caps and Growth retain leadership in Tech-driven Q2 rally

Large-caps and Growth continued to dominate US stock gains in Q2, with most of their outperformance coming amid a late-quarter rush into Tech and other sectors perceived as more recession-resilient and best positioned to benefit from advances in artificial intelligence (AI). Growth valuations also got a lift from relatively well-anchored longer-term rate expectations.

Highlights

Growth gets AI fever

Growth trounced Value in Q2, benefiting in large part from its bigger exposure to the recent surge into potential beneficiaries of the AI revolution. (page 2 & 5)

Large-caps win favor as economic outlook dims

Preference for larger players within Tech, Discretionary and Financials drove Russell 1000 outperformance vs the Russell 2000 in Q2. (pages 2-4)

EPS growth outlook brightens

Forward EPS growth forecasts continued to improve in Q2, with the Russell 1000 and its Growth offshoot enjoying the biggest gains from the prior quarter. (page 7-8)

Dividend yields in recovery

Amid a broad rebound, dividend yields have returned to pre-pandemic levels for the Value indexes, which are more tilted to high dividend-paying firms. (page 9)

Valuation re-ratings continue

Forward P/Es continued to rise in Q2, particularly those of large-cap Growth, which are now well above 10-year norms in absolute terms and vs its Value peer. (page 10)

Russell IPO activity still in the doldrums

IPO activity remained sluggish in Q2, with only the Russell 2000 adding newcomers. (page 11)

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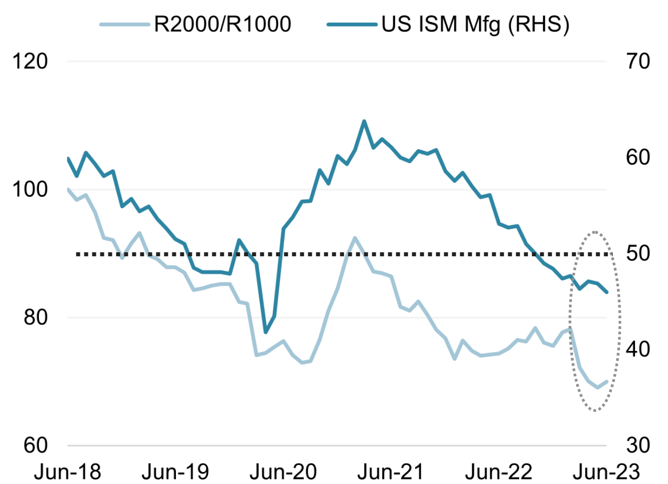
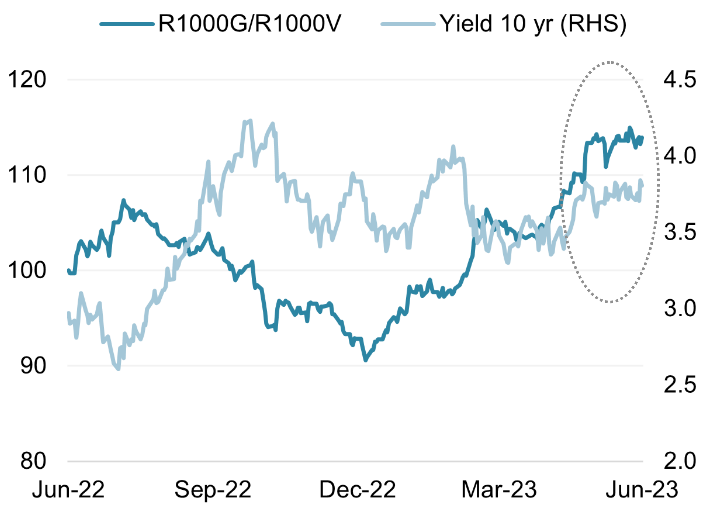
Large-caps remained in favor over small-caps in Q2 as leading indicators continued to point to a slowing US economy.



Growth stocks continued their winning streak in Q2, spurred by the excitement over AI and the relative steadiness of long bond yields.



Source: FTSE Russell / Refinitiv. Data as of June 30, 2023. Past performance is no guarantee of future results. This report should not be considered 'research' for the purposes of MIFID II. Please see the end for important legal disclosures. For professional investors only.

Russell US Index Performance — Second Quarter 2023

Key Observations

US stocks continued to build on their momentum in the second quarter, overcoming lingering worries about the US bank system and upheaval in May caused by the Congressional impasse over extending the US debt ceiling. The Russell 1000 climbed 8.6%, far outstripping the small-cap index's 5.2% rise. Both surpassed the respective gains of 2.8% and 0.9% for the FTSE All-World ex US and FTSE Emerging benchmarks for the quarter. Following their first-half rallies, both size indexes returned to positive territory for the last 12 months, with large-caps solidly in the lead (with respective increases of 19.4% and 12.3%).

Once again, Russell 1000 Growth was the hands-down winner of the quarter and YTD, soaring 12.8% and 29.0%, respectively, and trouncing the other style indexes. Much of large-cap Growth's Q2 outperformance came in June, fueled by the surge into mega-cap Tech and other potential beneficiaries of the recent advances in artificial intelligence (AI). This added to the already strong favoritism this year for larger, financially healthier companies deemed less vulnerable to an economic slowdown.

The style indexes also ended the 12-month period in positive territory, with both Growth indexes soaring past their Value peers. Russell 1000 Growth is now in the forefront for the longer-term span, with its rise of 27.1% surpassing all other style indexes by a wide margin. Small-cap Value was the biggest laggard among the style indexes, up only 6.0% for the 12 months.

Chart 1: The Russell 1000 and its Growth offshoot once again topped the charts in Q2 and now lead for the 12 months. Both large- and small-cap Value indexes were the worst performers in both periods.

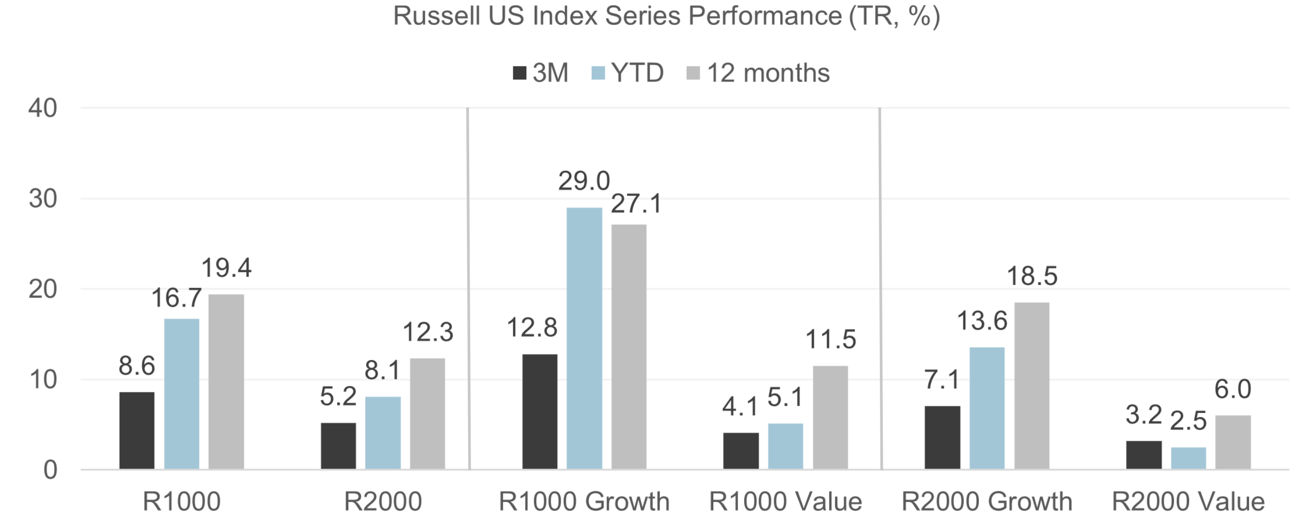
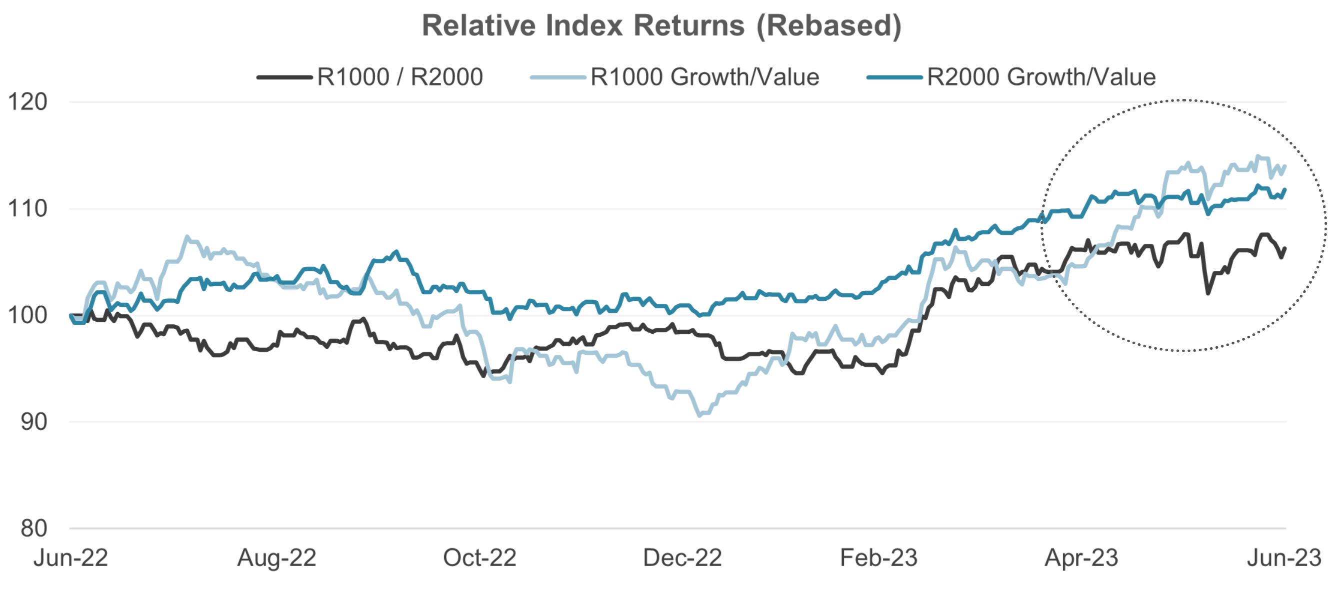


Chart 2: The Russell 1000 outpaced its small-cap peer in Q2, propelled by a robust rebound in Tech and other growth stocks amid the fervor over new advances in AI. Relatively steady long-term bond yields also buoyed Growth valuations.



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Macro Drivers – Second Quarter 2023

Market anxieties remained high in Q2 amid lingering worries about US bank stability and the upheaval in May caused by the protracted battle in Congress over raising of the US debt. The US economy's continued resilience in the face of still-high inflation and tight financial conditions drove big swings in the outlook for rates and the pace of future Fed monetary policy.

After slowing the pace of rate hikes late last year and pausing this June, Fed policymakers grew increasingly hawkish in their inflation-fighting rhetoric. While short-end Treasury yields surged in response, long bond yields stayed in a narrow band, reflecting relatively well-anchored expectations for longer-term inflation and rates (Chart 1). The 10yr/2yr spread widened to negative 1% at Q2-end amid renewed fears of a Fed-induced recession, approaching levels at the height of the banking crisis in early March.

Economists continue to expect the US economy to cool this year and to remain sluggish in 2024. However, prompted by recent stronger-than-projected economic readings, many forecasters modestly raised their GDP growth estimates for 2023 (Chart 2).

The ISM US Manufacturing Index fell more deeply into contractionary territory in Q2 (below 50). Weaker data fueled a rotation into large-cap and higher-growth stocks (Chart 3) deemed less sensitive to economic vagaries, as well as better positioned to take advantage of new technological advances. Growth valuations also benefited from the recent steadiness in long bond yields (Chart 4) as markets still anticipate an imminent end to the Fed tightening cycle.

Chart 1: Short yields reacted more sharply than long yields to hawkish Fed signals; the yield curve inversion deepened.

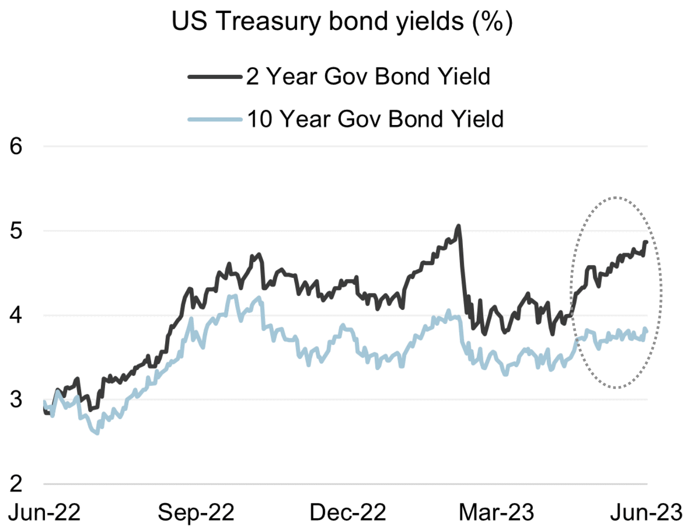


Chart 2: Prompted by recent data, economists lifted GDP growth estimates for 2023 but still see lower GDP for 2024.

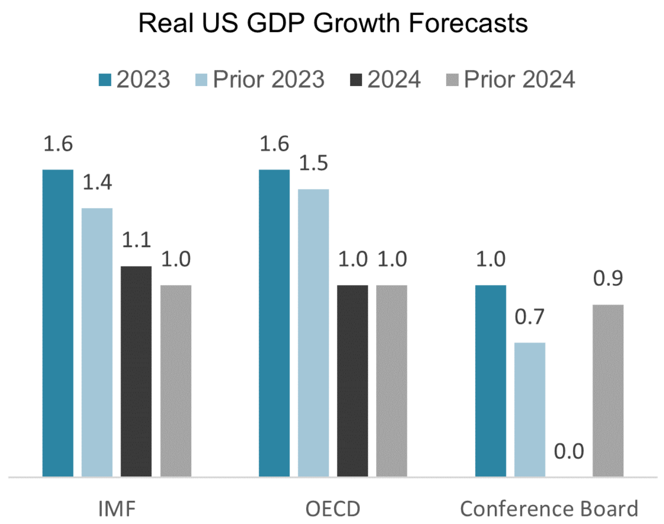


Chart 3: With leading indicators still signaling recession, investors favored larger, less cyclically sensitive stocks.

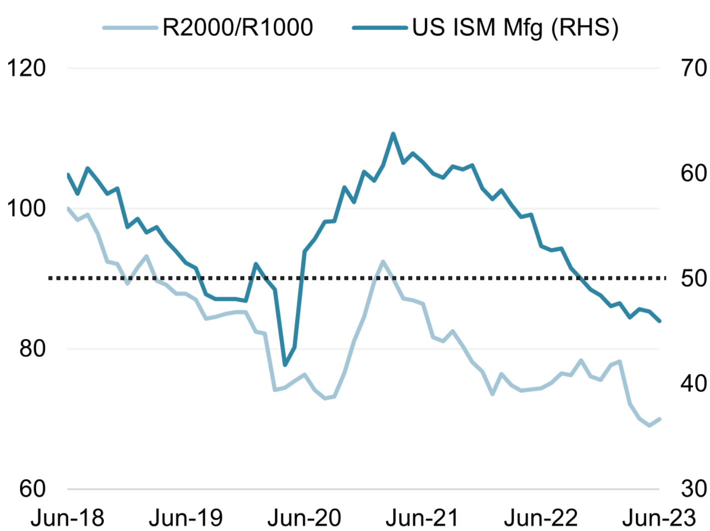
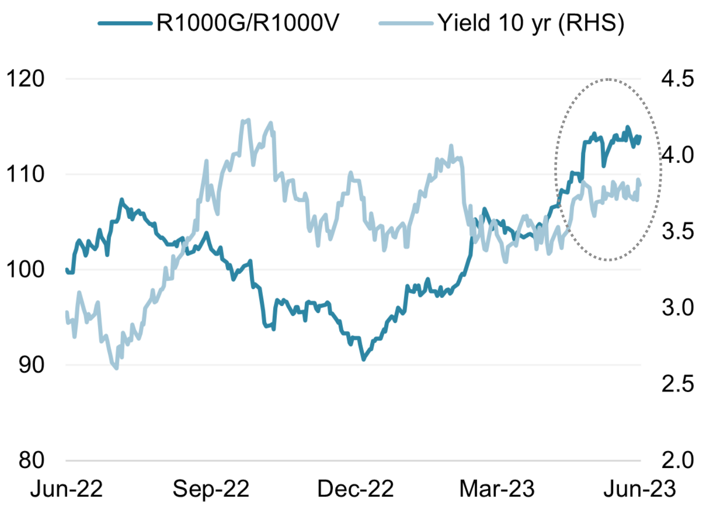


Chart 4: Growth valuations benefitted from well-anchored market expectations of an imminent end to Fed tightening.



Source: FTSE Russell / Refinitiv / International Monetary Fund World Economic Outlook Reports / Organization for Economic Cooperation and Development (OECD) and The Conference Board. Data as of June 30, 2023. Past performance is no guarantee of future results. Please see the end for important legal disclosures. For professional investors only.

Industry Returns and Exposures – Russell 1000 & Russell 2000

Key observations

Industry returns diverged widely and narrowed to a few big winners for Q2, with growth-oriented stock groups significantly outpacing commodity-sensitive and defensive groups for both size indexes.

- Tech, Discretionary and Financials contributed most of the Russell 1000's outperformance vs the Russell 2000 in Q2.
- The same three industries also drove the large-cap index's lead over its small-cap counterpart for the 12 months.
- For the quarter, Tech and Discretionary stocks dominated large-cap gains, while Health Care and Industrials led small-cap gains; for both size indexes, Utilities, Telecom, Staples and Materials were among the worst performers.
- Most industries finished the 12 months higher, with Tech, Discretionary and Industrials contributing most to the Russell 1000, while Industrials, Energy and Discretionary topped the charts for the Russell 2000.
- Real Estate, Utilities, Telecom and Staples were the worst performers for both size indexes for the longer-term period.

Chart 1: Bigger gains in Tech, Discretionary and Financials led Russell 1000 outperformance vs the Russell 2000.

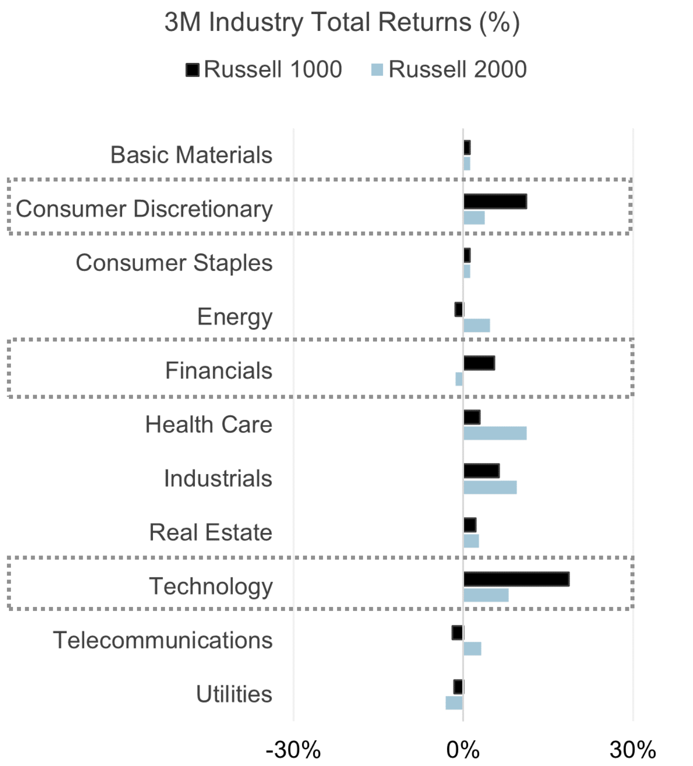
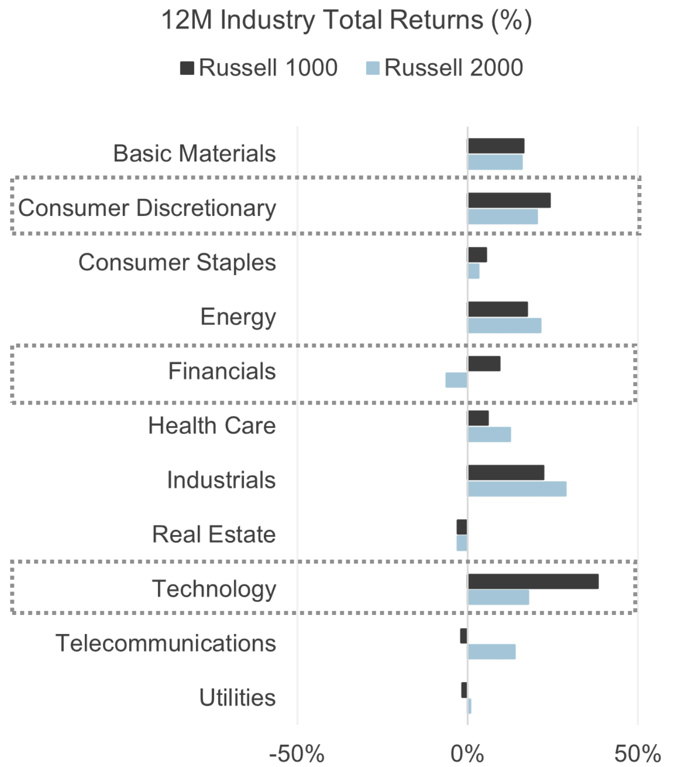
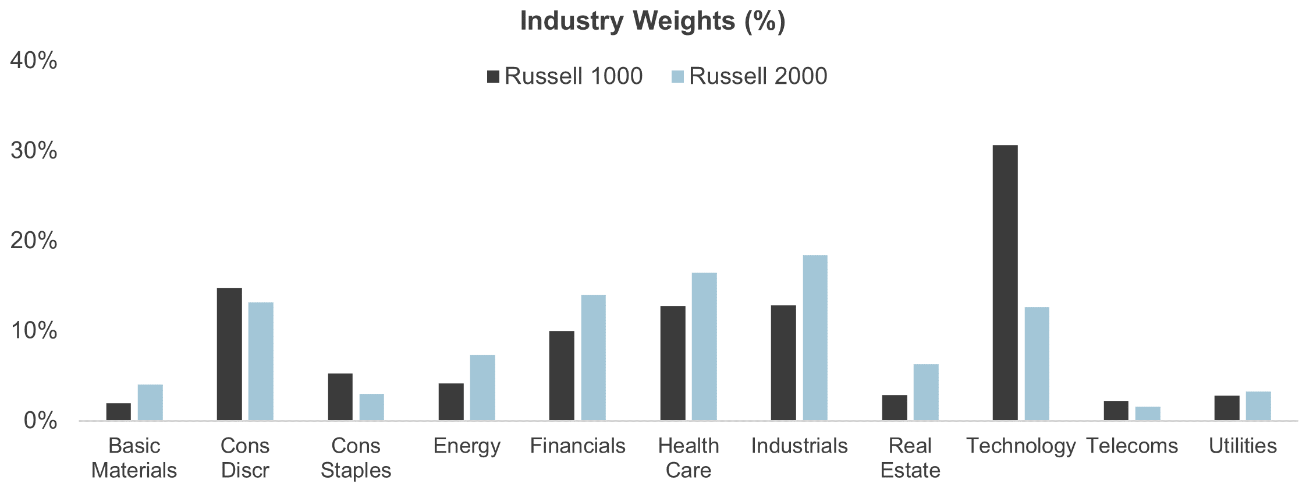


Chart 2: Preferences for large-cap Tech, Discretionary & Financials also drove R1000 outperformance for the 12M.





Source: FTSE Russell / Refinitiv. Based on Industry Classification Benchmark data as of June 30, 2023. Past performance is no guarantee of future results. Please see the end for important legal disclosures. For professional investors only.

Industry Returns & Exposures – Russell 1000 & 2000 Growth & Value

Key observations

Amid widespread gains, Growth prevailed over Value in Q2 and for the 12 months, particularly among large-caps.

- Within large-caps, Growth beat Value in 6 of 11 industries in Q2, led by Discretionary, Utilities & Materials. In a major trend reversal, Growth also beat Value for the 12 months (6 of 11), particularly within Discretionary, Utilities & Materials.
- Within small-caps, Growth outdistanced Value in 6 of 11 industries, with Staples, Health Care & Financials driving most of the performance gap. Growth also beat Value for the 12 months (7 of 11), led by Staples, Health Care & Telecom.
- For the quarter, Tech, Discretionary, Industrials & Health Care tallied the strongest gains across all style indexes, while Staples, Utilities & Telecom were among the biggest laggards, on average.
- For the 12 months, Tech, Discretionary & Industrials were also the top performers, more so for both Growth indexes than their Value counterparts. Rate-sensitive Real Estate, Utilities & Telecom trailed the most, particularly for the Value indexes. Declines in Staples and Financials also weighed on small-cap Value returns.

Chart 1: Tech, Discretionary & Utilities drove most of Russell 1000 Growth's lead vs the other style indexes.

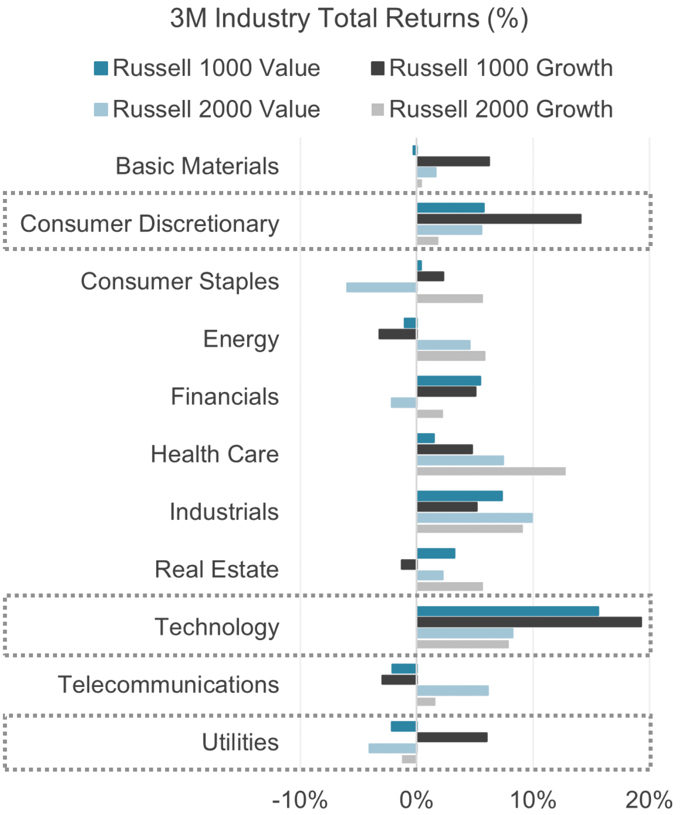
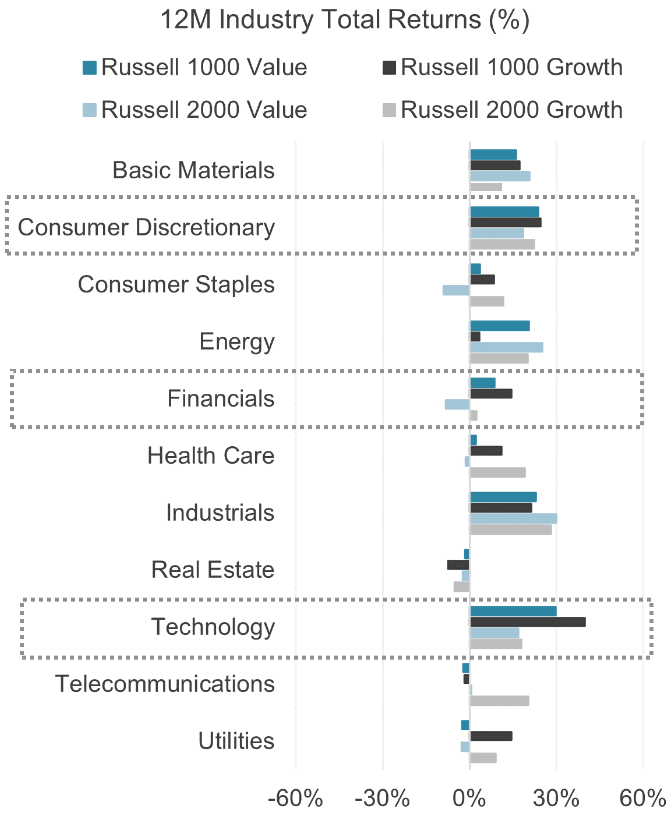
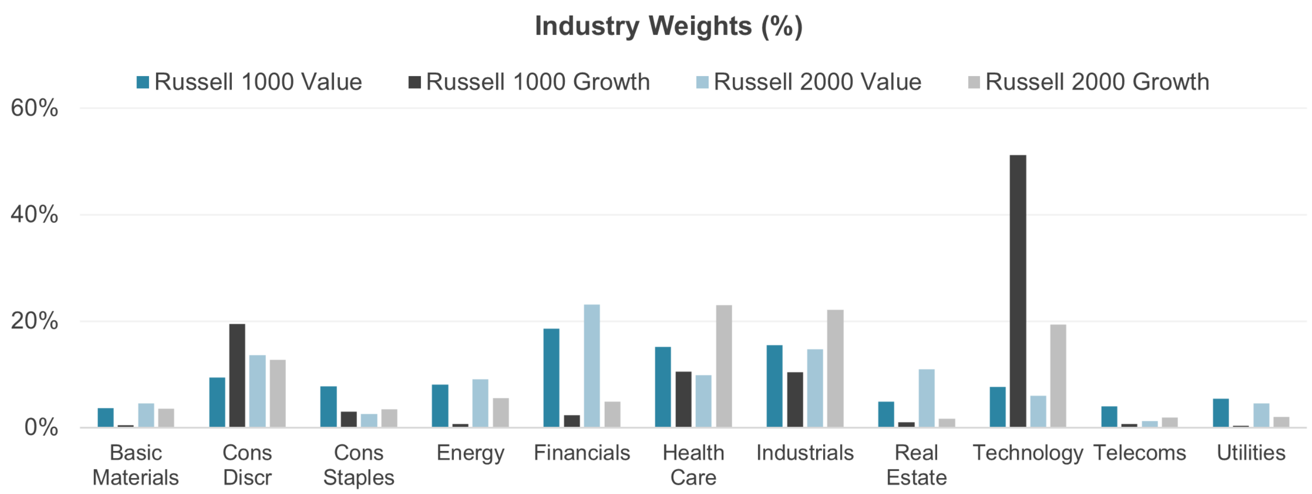


Chart 2: In 12M, Growth beat Value in most industries for both size indexes, led by Tech, Discretionary & Financials.





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Russell 1000 Sector Weights & Contributions to Return*

Key observations — Second Quarter 2023

Drilling deeper into the sector performances within the 11 Russell 1000 industries in Q2, we highlight the following key points:

- By far the best-performing large-cap industry in Q2, Technology's rebound was powered by robust contributions from both software and hardware components.
- Discretionary was the next best performer, led by the Autos/Auto Parts and Retailers, which together contributed the bulk of the industry's upsurge for the period.
- For the worst-performing industry in Q2 – Telecom – the biggest sector decliners were Service Providers, although Equipment stocks also ended lower.
- The Electricity and Gas, Water and Multi-utilities sectors contributed all of the losses for the second worst-performing industry, Utilities.
- Up next among the decliners, both sectors within Energy finished lower, led by Oil, Gas and Coal stocks.

Table 1: Both Tech Hardware and Software stocks were the standout sector contributors to large-cap industry returns in Q2, followed by Autos and Retailers. Sectors within Telecommunications, Utilities & Energy were the biggest drags.

Sector	Avg. Weight	Q2 2023 Contrib.
Basic Material		
Chemicals	64.3%	1.67%
Industrial Materials	4.5%	-0.14%
Industrial Metals and Mining	25.2%	0.47%
Precious Metals and Mining	6.0%	-0.73%
Consumer Discretionary		
Automobiles and Parts	12.2%	2.47%
Consumer Services	3.7%	0.64%
Household Goods & Home Construction	2.6%	0.44%
Leisure Goods	4.0%	0.19%
Media	10.6%	0.55%
Personal Goods	5.8%	-0.50%
Retailers	41.7%	4.71%
Travel and Leisure	19.4%	1.63%
Consumer Staples		
Beverages	29.3%	0.34%
Food Producers	22.8%	-0.39%
Personal Care Drug & Grocery Stores	37.4%	1.12%
Tobacco	10.5%	0.30%
Energy		
Alternative Energy	3.2%	-0.63%
Oil, Gas and Coal	96.8%	-0.87%
Financials		
Banks	29.7%	1.51%
Finance and Credit Services	6.9%	0.66%
Investment Banking and Brokerage Svcs	39.7%	2.22%
Life Insurance	4.2%	0.27%
Mortgage Real Estate Investment Trusts	0.6%	0.06%
Non-life Insurance	18.8%	0.77%

Sector	Avg. Weight	Q2 2023 Contrib.
Health Care		
Health Care Providers	18.4%	0.71%
Medical Equipment and Services	32.4%	1.17%
Pharmaceuticals and Biotechnology	49.3%	1.11%
Industrials		
Aerospace and Defense	13.0%	0.11%
Construction and Materials	6.3%	1.14%
Electronic and Electrical Equipment	8.6%	0.54%
General Industrials	16.1%	1.32%
Industrial Engineering	8.6%	0.60%
Industrial Support Services	34.6%	2.13%
Industrial Transportation	12.9%	0.71%
Real Estate		
Real Estate Investment & Services Dev.	6.8%	1.19%
Real Estate Investment Trusts	93.2%	1.11%
Technology		
Software and Computer Services	56.0%	9.10%
Technology Hardware and Equipment	44.0%	7.98%
Telecommunications		
Telecommunications Equipment	40.4%	-1.17%
Telecommunications Service Providers	59.6%	-2.06%
Utilities		
Electricity	67.1%	-1.37%
Gas, Water and Multi-utilities	23.2%	-1.03%
Waste and Disposal Services	9.7%	0.88%

Source: FTSE Russell. *Indexes data shown here are from the Russell Capped Index Series, except for the Real Estate Industry. Data as of June 30, 2023. Past performance is no guarantee of future results. Please see the end for important legal disclosures. For professional investors only.

EPS Growth Outlook and Revision Cycle – Russell 1000 & Russell 2000

The EPS growth picture for both the Russell 1000 and Russell 2000 has brightened considerably over the past few months, fueled by the surprising resilience of the US economy this year (underpinning by a strong job market), as well as easing inflation and long-term interest-rate expectations.

Though consensus forecasts for both indexes remain well below year-ago levels, analysts now anticipate Russell 1000 earnings to advance 7.8% for the next 12 months, up from estimates of around 5% at the end of Q1 (Chart 1).

Russell 2000 forecasts have also risen materially since last quarter (Chart 2), with consensus now pegging 12-month forward growth at 15.5%, up from 12.4% at March-end. These trends were driven largely by upgrades to Tech, Discretionary, Industrials and Financials following recent stronger-than-expected quarterly earnings results, which have far outpaced those for Energy, Real Estate and Materials companies affected by the recent collapse in commodity prices and rising near-term interest rates.

Analysts' revisions for both indexes have also grown less pessimistic over the past year. Both 12-month EPS forecasts and revisions improved early in the quarter (with upgrades outnumbering downgrades for both indexes) but stabilized or worsened somewhat at the end of the quarter (Chart 3).

Chart 1: Russell 1000 earnings prospects have brightened considerably, with forward EPS growth now forecast at 8%.

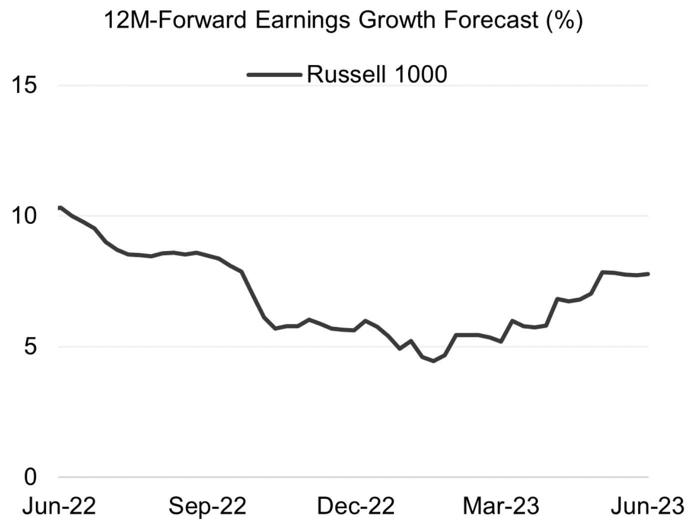


Chart 2: Small-cap forward EPS growth is seen reaching 16%, but remains dramatically below year-ago forecasts.

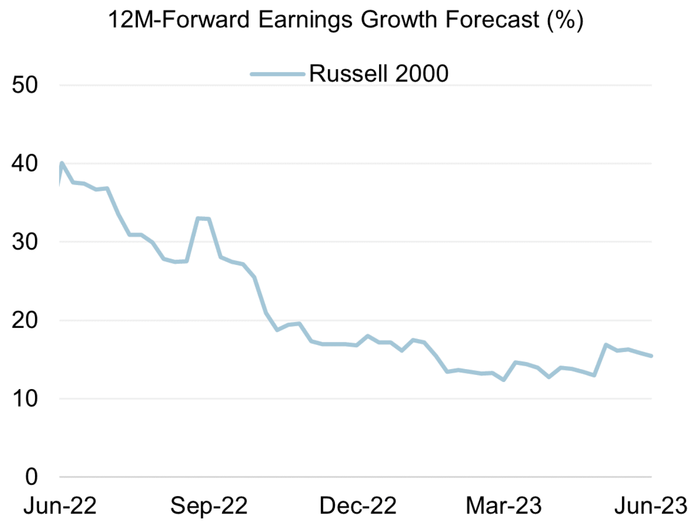
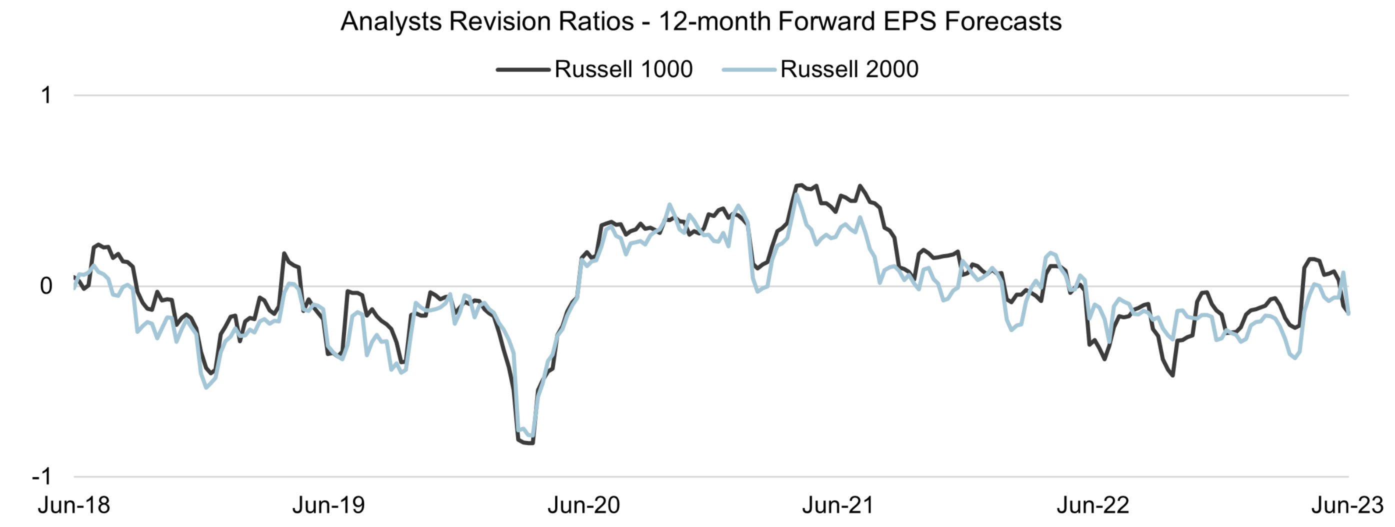


Chart 3: Revision cycles for the Russell 1000 and Russell 2000 have improved markedly since last June, with the large-cap index seeing more upgrades than downgrades in early Q2. However, ratios turned negative for both more recently.



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EPS Growth Outlook and Revision Cycle – R1000 & R2000 Growth & Value

As in the case of the two size benchmarks, the earnings growth outlook for the Russell US style indexes has also perked up this year, though much more so for the large-cap offshoots than their small-cap peers.

Consensus now pegs 12-month-forward EPS growth at nearly 16% for Russell 1000 Growth, up from estimates as low as 11% earlier this year and in line with those of a year ago. Forecasts look for EPS growth of around 3% for Russell 1000 Value, up from an estimated low of no growth in February but still far below year-ago expectations (Chart 1). This improvement has been driven largely by upgrades to Tech, Discretionary, Industrials and Financials following stronger-than-anticipated quarterly results, which have far exceeded those for Energy, Materials and Real Estate (comprising a larger share of the Value index than its Growth peer). As Chart 2 illustrates, revision cycles have stabilized for both large-cap indexes from the steep downtrends of a year ago, though more so for Growth than Value.

The profit outlook for the small-cap style indexes has also brightened. Consensus 12-month forward forecasts for Russell 2000 Growth anticipate gains of nearly 18%, down sharply from year-ago estimates (the chart is capped at 50%) but well above the low of less than 14% in Q1. The small-cap Value forecast climbed to roughly 14% from the 11% in Q1 trough. As Chart 4 shows, upgrades now modestly outnumber downgrades for both small-cap style indexes.

Chart 1: Earnings forecasts for large-cap Growth are back in line with year-ago levels, widening the gap versus Value.

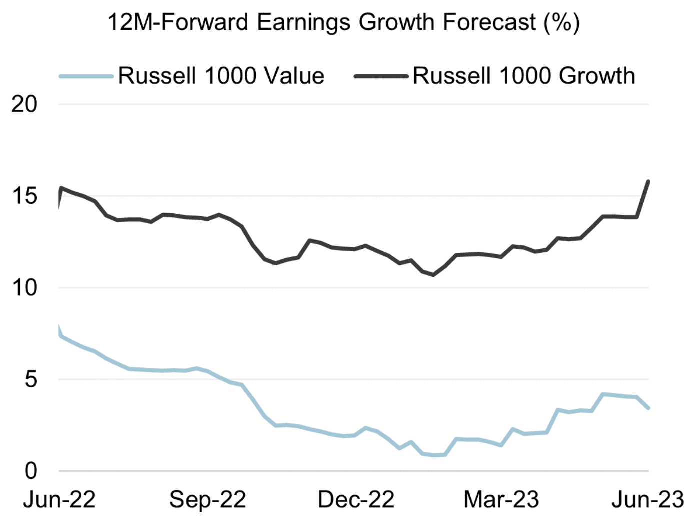


Chart 2: Revision cycles have stabilized for both large-cap style indexes since last June, but more so for Growth.

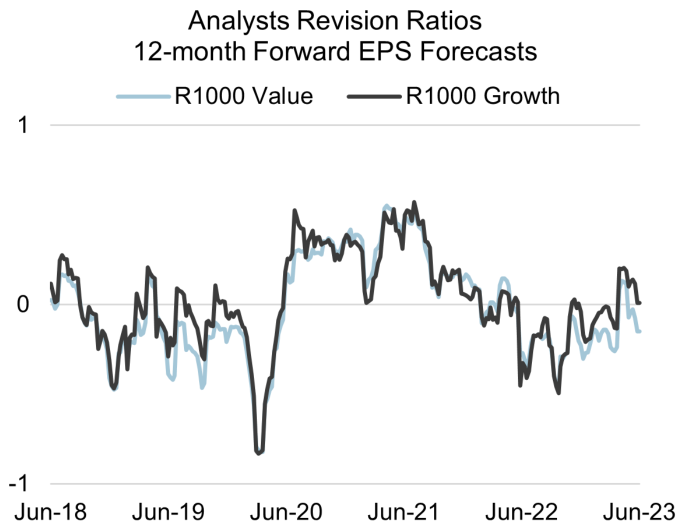


Chart 3: EPS growth forecasts also rose for the small-cap style indexes this year, modestly more so for Growth.

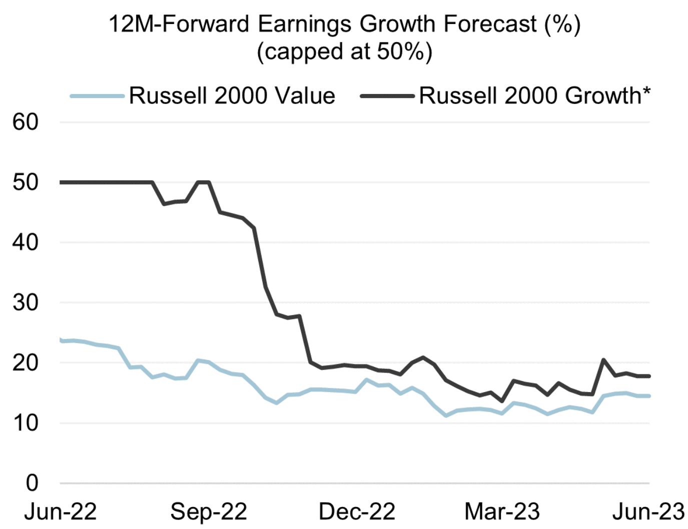
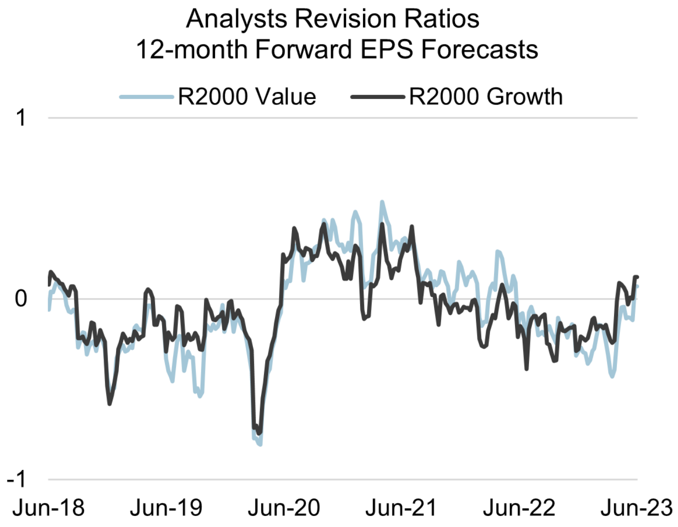


Chart 4: Upgrades modestly outnumbered downgrades for both small-cap style indexes in Q2, more so for Growth.



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Trailing 12-Month Dividend Yields

Dividend yields have been steadily rising across the flagship Russell US Indexes over the past year as corporate profitability and cash flows have normalized from the depressed Covid-era levels. Even so, only Russell 2000 and its Value offshoot have seen their dividend yields recover close to pre-pandemic averages.

Value indexes typically pay higher dividend yields than their Growth counterparts, an outgrowth of the former's bigger weights in traditionally steadier and more generous dividend payers among Telecom, Utilities and Financial companies and far smaller weights in Technology and other higher-growth companies that tend to pay little or no dividends. As Charts 2 and 3 illustrate, dividend yields for both Value indexes have risen far more significantly than for their Growth counterparts since 2021 (particularly among small-caps), despite the strong outperformance of Value stocks over most of that period. At June-end, the Russell 2000 Value offered a dividend yield of 2.5%, roughly matching its pre-pandemic high. This was only slightly higher than the 2.3% of the large-cap Value index.

Dividend yields have also climbed for the Russell 1000 and Russell 2000 since their Q2 2021 troughs (Chart 1), though not as steeply as those of their Value offshoots. At June-end, both size benchmarks offered dividend yields of 1.6%.

Chart 1: Both large and small-cap indexes have seen dividend yields climb over the past year, though they eased in Q2 (more so for the former), reflecting the strong outperformance of Growth stocks, which typically pay no or lower dividends.

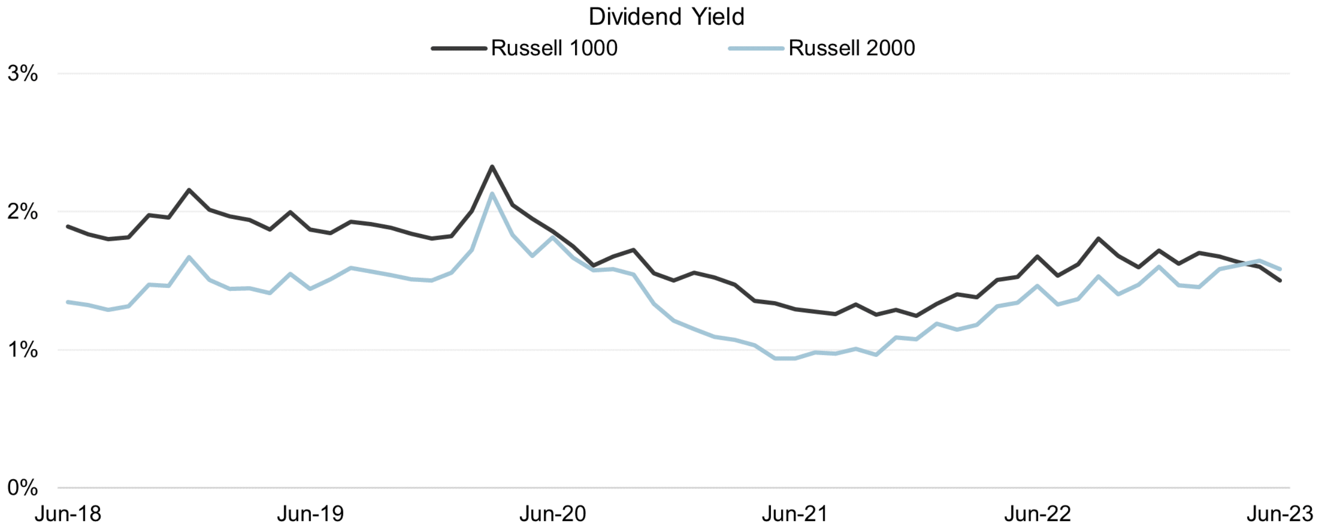


Chart 2: Large-cap Value widened its dividend-yield gap vs its Growth peer in Q2, reflecting recent underperformance.

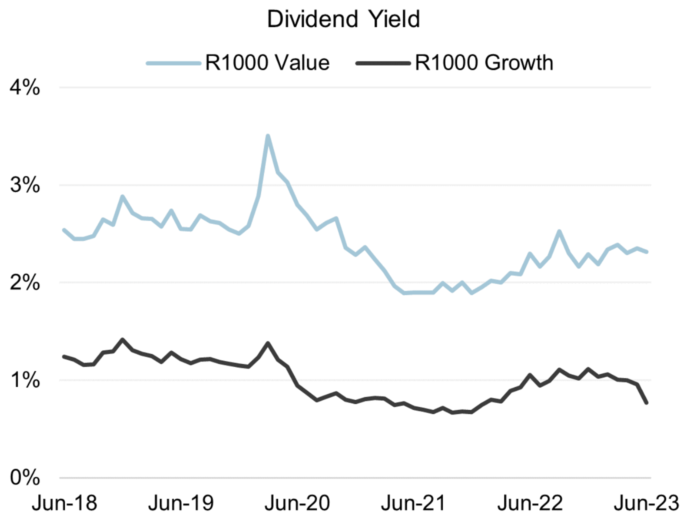
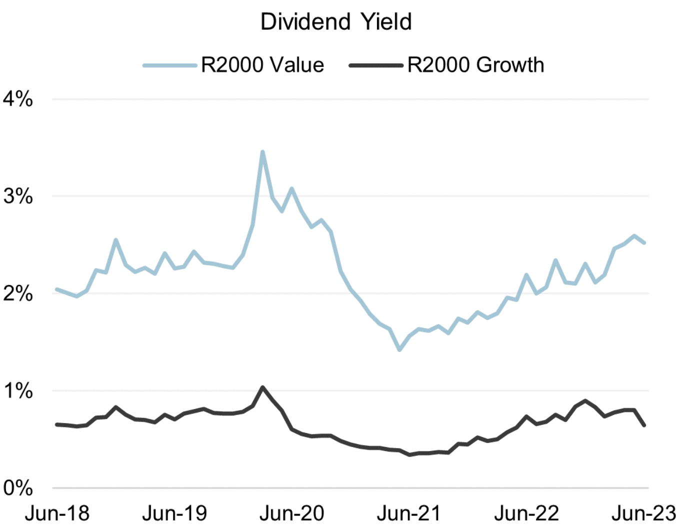


Chart 4: Russell 2000 Value offered a dividend yield of 2.5% at Q2-end, roughly matching its pre-pandemic high.



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Valuation Comparisons – 12-Month Forward P/Es

The multi-year contraction in forward P/Es appears to have stabilized or reversed course along with the broad rallies across the Russell US indexes since late last year, bringing forward multiples for most Russell indexes back to levels in line with pre-pandemic averages. The exception is Russell 2000 Growth, which remains below its five-year lows. All trade at significant premiums to the FTSE All-World ex US, which stood at 12.8 times forward EPS estimates at June-end.

The Russell 2000 currently trades at 22.6 times 12-month EPS forecasts, down sharply from its pandemic peak but up considerably from its low of 16.5 times last June (Chart 1); it's also below its 10-year average of 24.8 times. The Russell 1000 uptick was more modest, ending the quarter at 19.0, up from its low of 15.5 last October, but at a premium to its 10-year average of 17.8. Though the valuation gap between the two indexes has widened over the past year, the small-cap premium is narrower than its historical average, even factoring out the huge small-cap rally during the reopening euphoria in early 2021.

Forward multiples have also climbed across the style indexes this year (Charts 2 and 3), more so for Russell 1000 Growth (now 25.5) and Value (now 14.6) than for their small-cap counterparts (28.9 and 18.1, respectively). The Value indexes are below or in line with 10-year averages while both Growth benchmarks trade well above their historical norms. Though Growth typically trades at a premium to Value, the gap between the large-cap style indexes expanded significantly after Growth's huge Q2 rally.

Chart 1: Forward P/Es for both the Russell 1000 and Russell 2000 continued to normalize in Q2, with both indexes enjoying re-ratings since last June. Large-cap outperformance in Q2 narrowed the discount vs its small-cap counterpart.

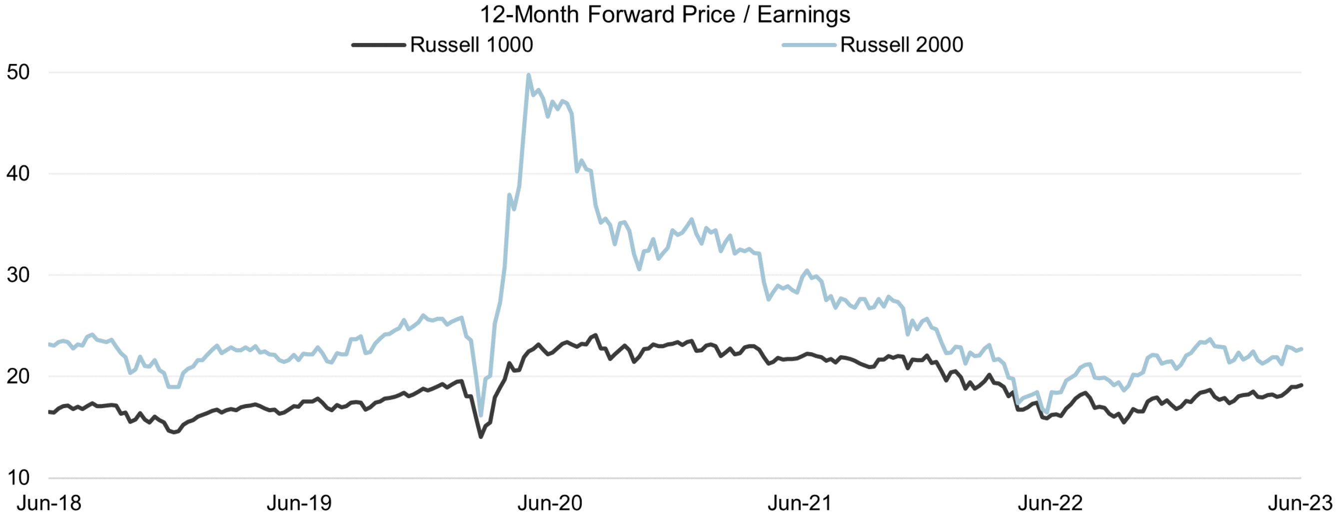


Chart 2: R1000 Growth extended its already huge premium vs its Value cohort, reflecting its outsized Q2 price gains.

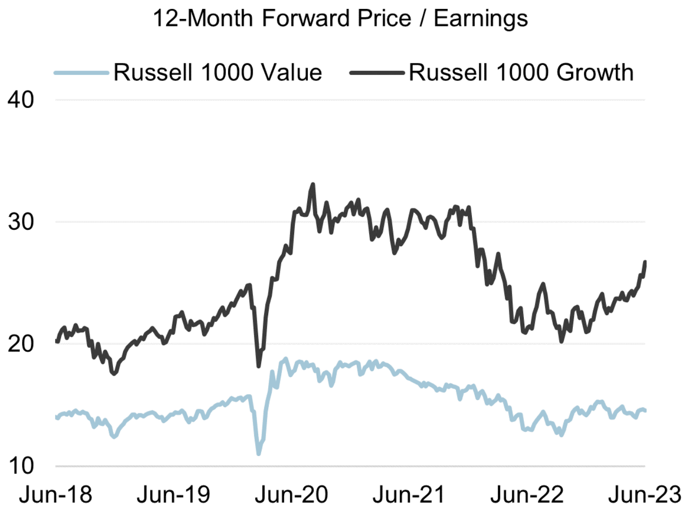
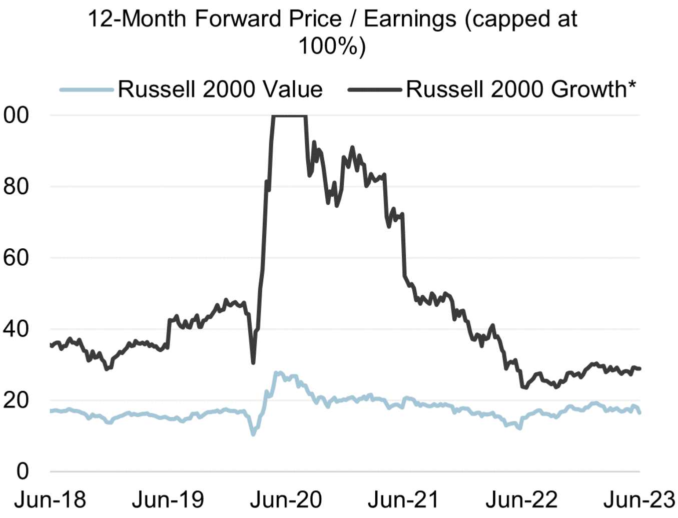


Chart 3: R2000 Growth vs Value premium widened in Q2 but remained significantly below its 10-year average.



Source: FTSE Russell / Refinitiv. Data as of June 30, 2023. Past performance is no guarantee of future results. Please see the end for important legal disclosures. For professional investors only.

IPO Additions to Russell US Indexes – Second Quarter 2023

FTSE Russell adds eligible initial public offerings (IPOs) to its Russell US Indexes on a quarterly basis, ensuring that the indexes are always an accurate reflection of the markets they are designed to represent. Examining the history of such activity and its industry composition offers insights into market trends and investor sentiment.

While the number of IPOs each quarter tends to ebb and flow, the falloff over the past year and a half has been particularly dramatic, a likely effect of extreme market volatility. IPO activity for the Russell 1000 remained dormant (Chart1), while the Russell 2000 added three newcomers in Q2, down from four in the prior quarter and 17 in the same period a year ago. In a departure from longstanding trends, there were no Health Care IPOs in Q2 (Chart 2), but Energy and Industrials added one and two new companies, respectively. For more information, see [Russell US Index IPO additions and reports | FTSE Russell].

Chart 1: The Russell 2000 added three newcomers in Q2 (down from four in Q1 and 17 in the year-ago period). The Russell 1000 IPO activity remained moribund. The US large-cap index has added only one IPO over the past 12 months.

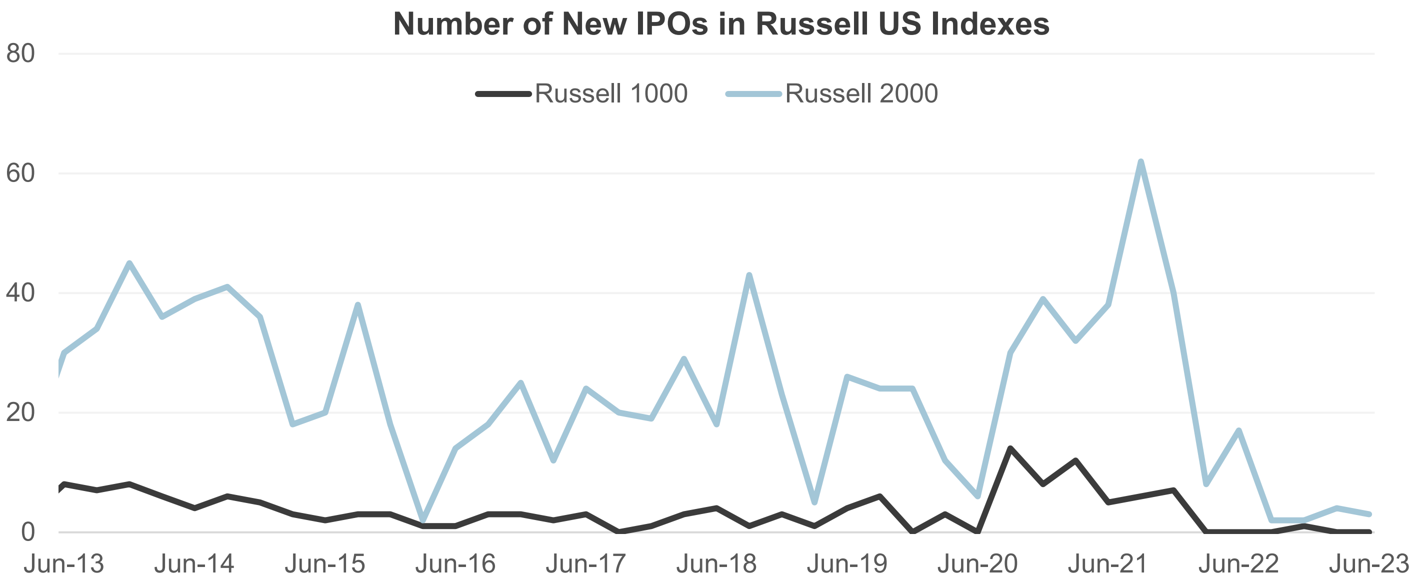
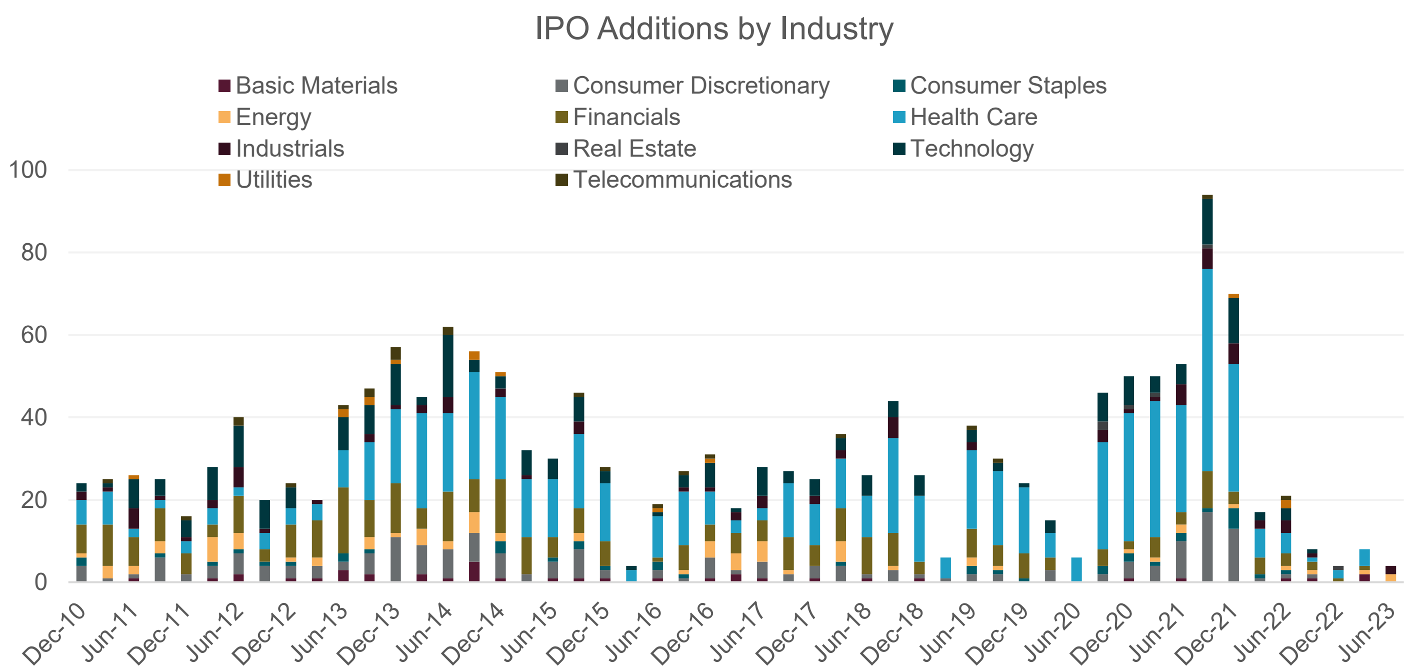


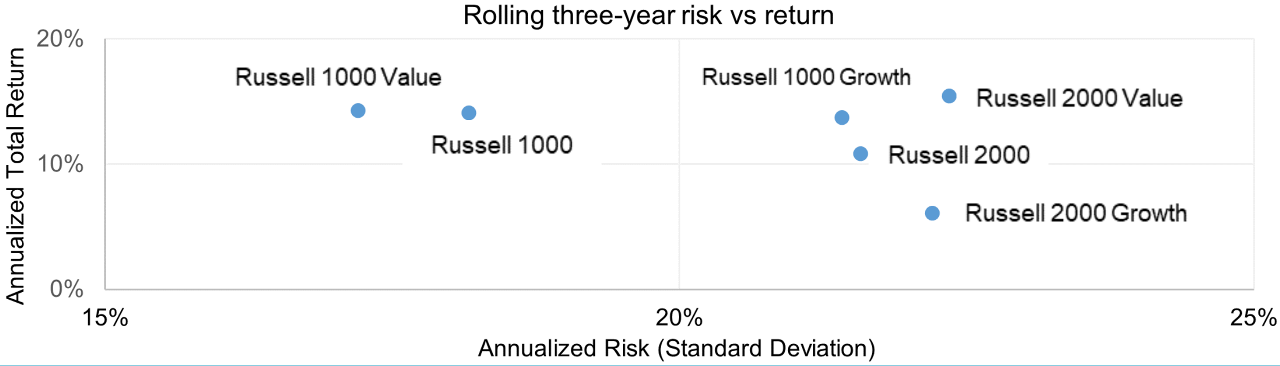
Chart 2: In a departure from a long-running trend, there were no new Health Care IPOs in Q2, but the Russell 2000 added one Energy (for a total of two additions this year) and two Industrial companies for the period.



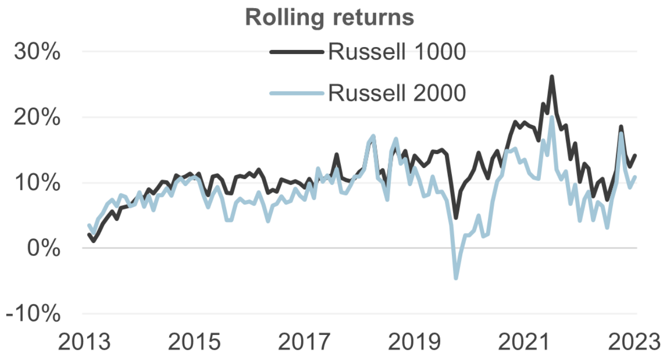
Source: FTSE Russell / Refinitiv. Based on Industry Classification Benchmark (ICB) data as of June 30, 2023. Past performance is no guarantee of future results. Please see the end for important legal disclosures. For professional investors only.

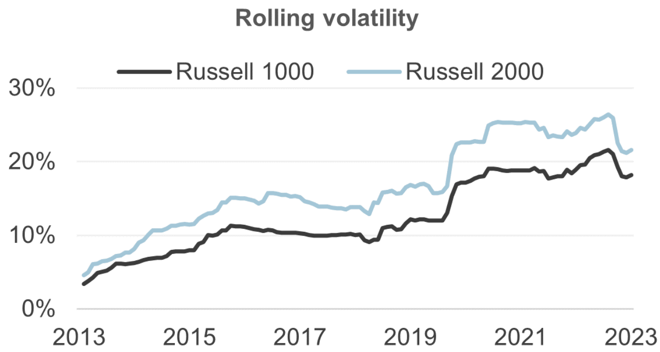
Return & Risk – Rolling Three-Year Patterns

In the most recent 3-year period, Russell 1000 outpaced Russell 2000 with far less risk, as did large-cap Growth vs its small-cap peer. R2000 Value outpaced R1000 Value, but with far more risk. The charts below show rolling 3-yr patterns over time.

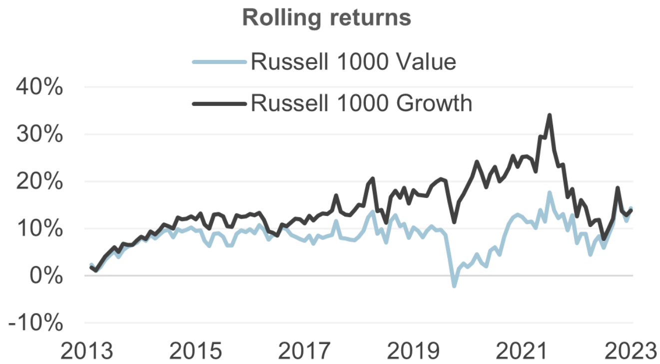


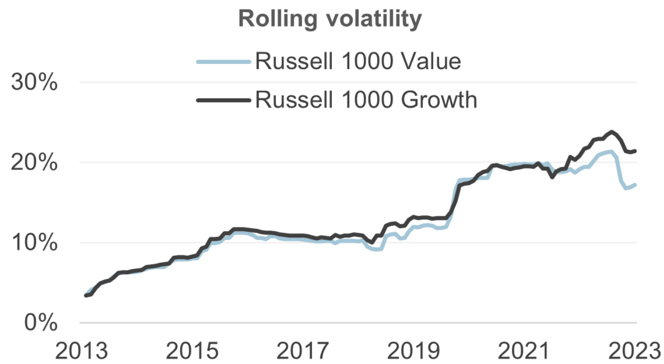
R1000 has slightly outperformed R2000 with far less risk recently, though volatility has risen for both over the Covid era.



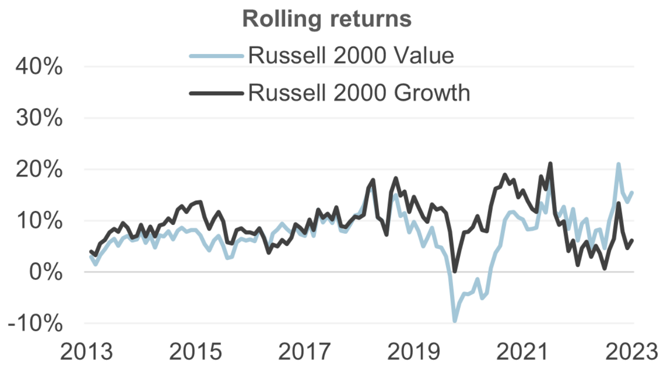


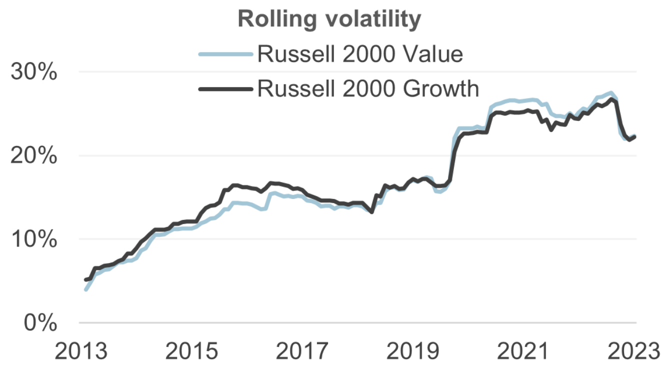
R1000 Growth has performed in line with its Value cohort since the Covid outbreak, but has grown more volatile recently.





R2000 Value surpassed R2000 Growth in the most recent 3-year period, finishing with comparable volatility.





Source: FTSE Russell / Refinitiv. All data through June 30, 2023. Past performance is no guarantee of future results. Please see the end for important legal disclosures. For professional investors only.

Source: Equity markets data is based on the following: FTSE All-World® (World), FTSE All-Share® (UK), FTSE 100(UK large caps) FTSE 250 (UK mid caps), Russell 2000® (US small caps), Russell 1000® (US large caps), FTSE World ex UK, FTSE Europe ex UK (Eurozone), FTSE World ex US, FTSE Japan, FTSE Asia Pacific ex Japan and FTSE Emerging (emerging markets) Indexes.