FTSE Russell

An LSEG Business

Russell US Indexes Spotlight

QUARTERLY REPORT: **JANUARY 2023**

FOR PROFESSIONAL INVESTORS ONLY

Large-caps and Value prevail in grueling year for US stocks

The Russell 1000 outpaced the Russell 2000 in the Q4 rally and fared modestly better in the full-year sell-off, as investors favored larger, less volatile players across sectors. The Value indexes held up better than their Growth peers for the full year, buoyed by outperformances in Energy and their lower exposure to the wreckage in pricier Tech and other growth sectors.

Highlights

Value carries the day in brutal year

The Value rotation went into high gear in the Q4 rally, particularly among large-caps, extending its advantage over Growth for the full year. (page 2-3)

Large-caps retain edge vs small-caps

Large-caps regained the lead over small-caps in Q4 and lost less for the full year, buoyed by outperformances in Health Care, Energy and Staples. (pages 4-6)

EPS forecasts drift lower

Forward EPS forecasts continued to see downgrades into Q4, with the small-cap and Value indexes taking the biggest hits. (page 7-8)

Valuations rebound in Q4

After a year of retrenchment, forward P/E multiples ticked higher across the Russell US indexes amid robust Q4 price gains. (page 9)

A lackluster year for Russell IPOs

Despite a modest pickup in Q4, IPO activity dwindled to a trickle in 2022, in stark contrast to last year's record pace. (page 10)

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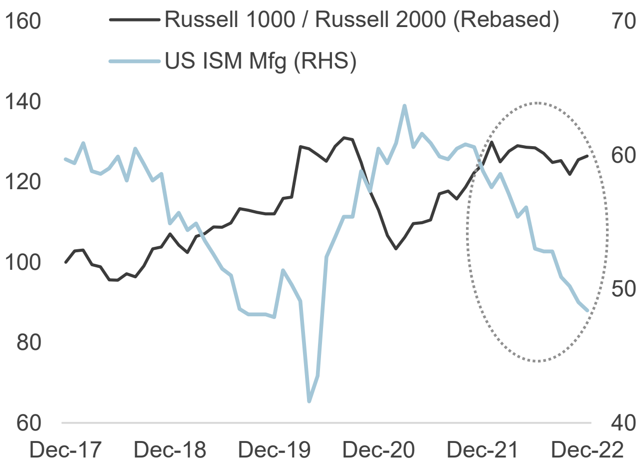
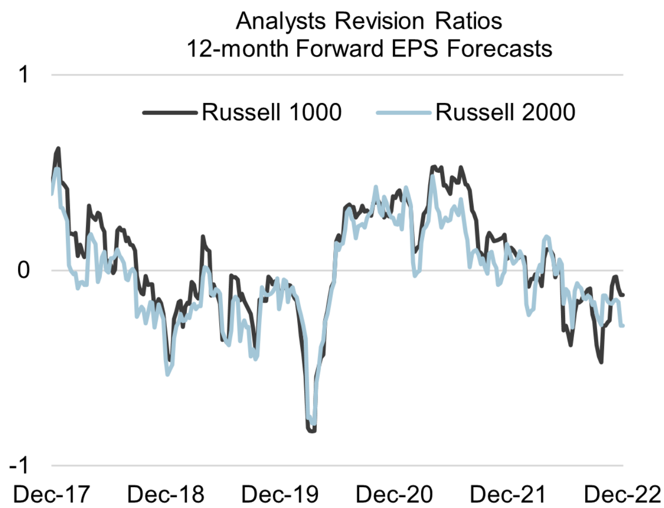
Leading indicators of US economic activity fell steadily last year, intensifying the worst rout in US stocks in more than a decade.



Forward EPS revisions continued their downhill path in Q4, with downgrades outnumbering upgrades across the US indexes.



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Russell US Index Performance – 3M & 12M (%)

Key Observations – Fourth Quarter and Full Year 2022

For the first time all year, all six Russell US indexes ended Q4 with gains, an upbeat finish to the worst rout in US stocks since the financial crisis in 2008. The Russell 1000 climbed 7.2%, outstripping the small-cap index's 6.2% jump. However, both lagged the respective rallies of 14.4% and 8.6% of the FTSE All-World ex US and FTSE Emerging indexes for the quarter. Despite the Q4 improvement, the Russell 1000 fell 19.1% for the full year, slightly better than the Russell 2000's 20.4% slump. These losses exceeded the respective declines of 15.2% and 16.9% for the non-US and emerging markets.

As Chart 1 illustrates, both large- and small-cap Value indexes outpaced their Growth counterparts in the Q4 rally. Progress on the inflation front, the Fed's softening anti-inflation rhetoric and the easing of China's zero-Covid policies helped calm earlier recession jitters, reigniting favor for the cyclically sensitive sectors that comprise a bigger share of the Value indexes, particularly among large-caps.

As a result of the Q4 rebound, both large- and small-cap Value indexes regained much of the ground lost to their Growth cohorts in the summer rally (Chart 2), and significantly trimmed their losses for the year. The Russell 1000 Value cemented its lead across the Russell US indexes for the year, falling 7.5% — half the loss of the Russell 2000 Value index and a quarter of damage endured by the two Growth benchmarks.

Chart 1: The Russell 1000 outpaced the Russell 2000 in the Q4 rally and fared better in the full-year market sell-off. Large-cap Value delivered double-digit gains in Q4, eclipsing all other Russell indexes, and lost far less for the full year.

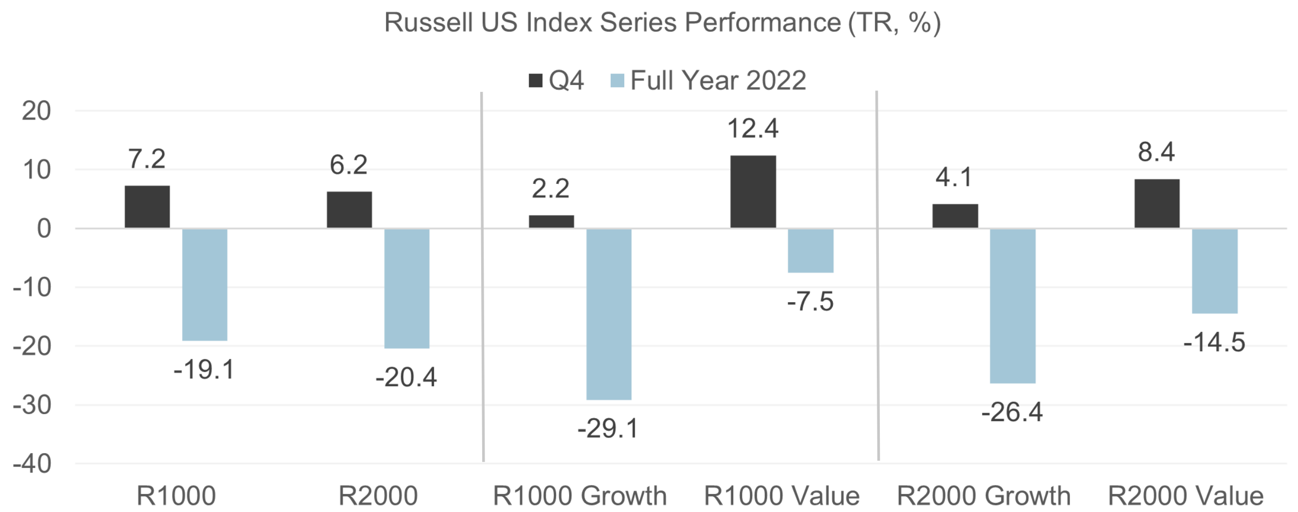
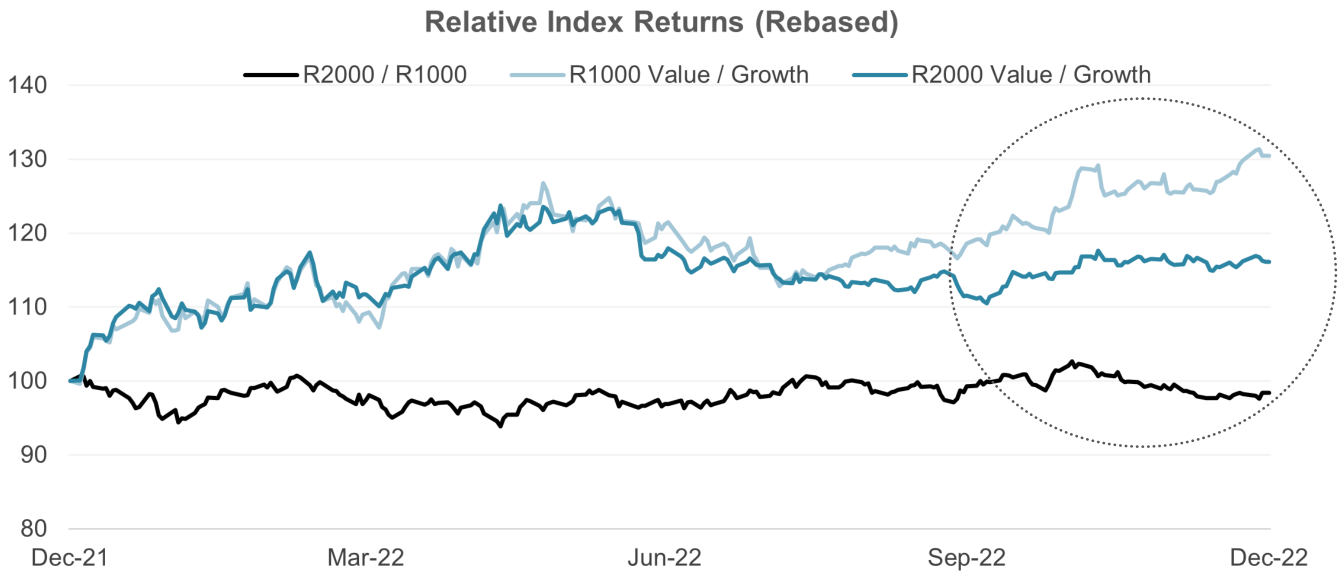


Chart 2: The Russell 1000 regained the lead in Q4, bringing its full-year loss modestly below that of the Russell 2000. After robust Q4 outperformances, Value prevailed over Growth for the full year, particularly among large caps.



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Macro Drivers – Full Year 2022

Markets anxieties ran high last year, stoked by the triple threats of stubbornly high US inflation, the Fed's unwavering efforts to bring it under control and a rapidly deteriorating global economic outlook, amplified by the aftereffects of Russia-Ukraine war and zero-Covid policies in China.

Key portions of the US yield curve have been inverted since July (Chart 1), a reaction to a series of jumbo Fed rate hikes and US policymakers' vows to keeping fighting inflation 'until the job is done'. After raising the benchmark rate 50bp in December, the central bank also lowered its 2023 GDP growth forecast to 0.50% and indicated that rate cuts were unlikely until 2024.

This, in turn, triggered wild swings in inflation expectations (Chart 2). Breakevens climbed in October and November on stronger-than-expected CPI readings, then eased again in December as the Fed reiterated its hard-line stance. The recent pullback suggests growing confidence the Fed can ultimately prevail in its fight against inflation, though not without an economic toll.

The ISM US Manufacturing Index continued to decline in Q4, slipping into contractionary mode (below 50) in December (Chart 3), as have other key leading economic indicators. Economists forecast a sharp slowdown for the US economy in 2023 and a recovery the following year (Chart 4).

Chart 1: US yield curves remain inverted but spreads widened in December amid hopes for a Fed policy pivot.

Chart 2: US inflation expectations continued to ease in Q4, signaling growing confidence in the Fed's inflation fight.

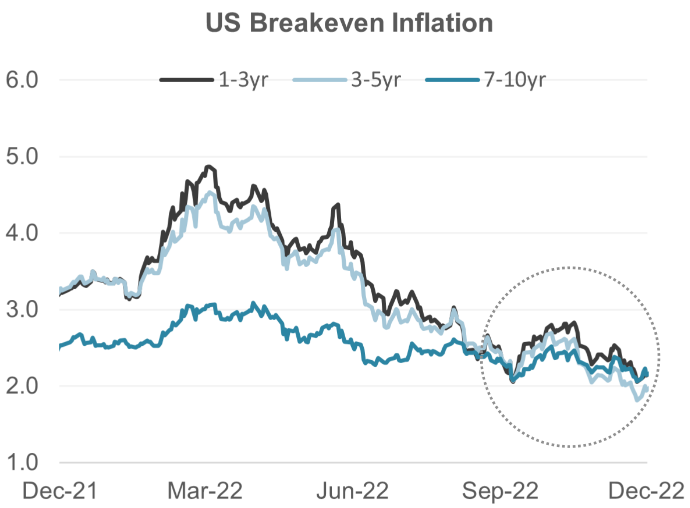


Chart 3: The sharp deterioration in leading US economic indicators last year was a stiff headwind for US stocks.

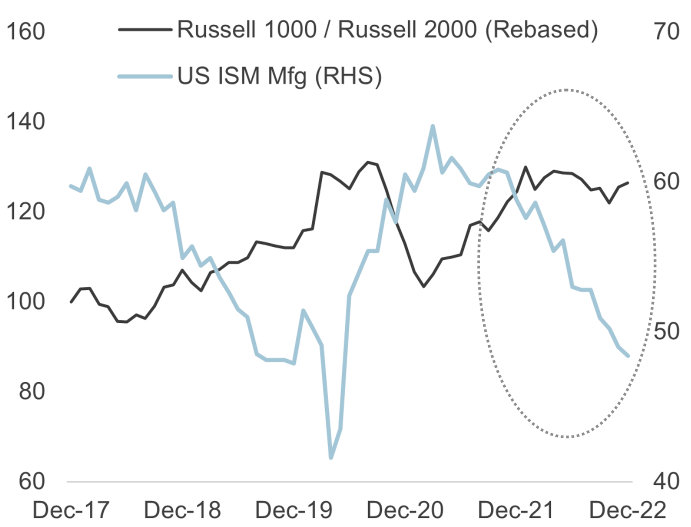
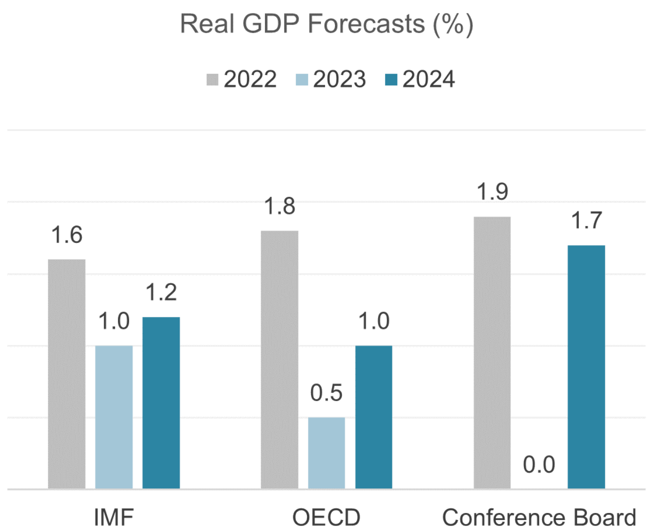


Chart 4: Economists expect the US economy to stagnate in 2023 (but no recession) and a recovery in 2024.



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 December 31, 2022. 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

Most industry groups gained in the Q4 rally and, except for Energy, suffered losses in the 2022 rout for both size indexes. The Russell 1000 outpaced the Russell 2000 in Q4, reversing the Q3 trend, but held up only modestly better than the small-cap index for the full year.

- Large-cap gains outstripped those of small caps in most industries (7 of 11) in Q4.
- Outperforming Health Care, Telecom & Financials contributed most to R1000's edge vs R2000 in Q4.
- For 2022, large-cap industries held up better than small-cap peers in all but Discretionary and Telecom (9 of 11).
- For 2022, Health Care, Energy & Staples added the most to R1000's edge over R2000.
- Energy stocks were the best performers for both size indexes in Q4; large-cap Discretionary and small-cap Health Care were the sole decliners for the period.
- Energy also topped the charts for the full year; Discretionary and Technology stocks posted the biggest losses for both size indexes last year.

Chart 1: Large-caps outpaced small-caps in most industries in the Q4 rally, led by Health Care, Telecom & Financials.

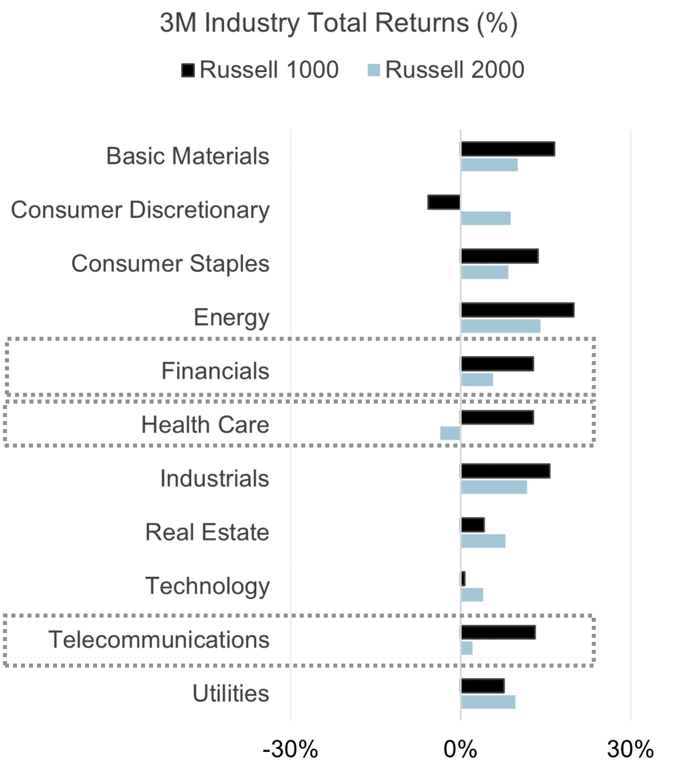
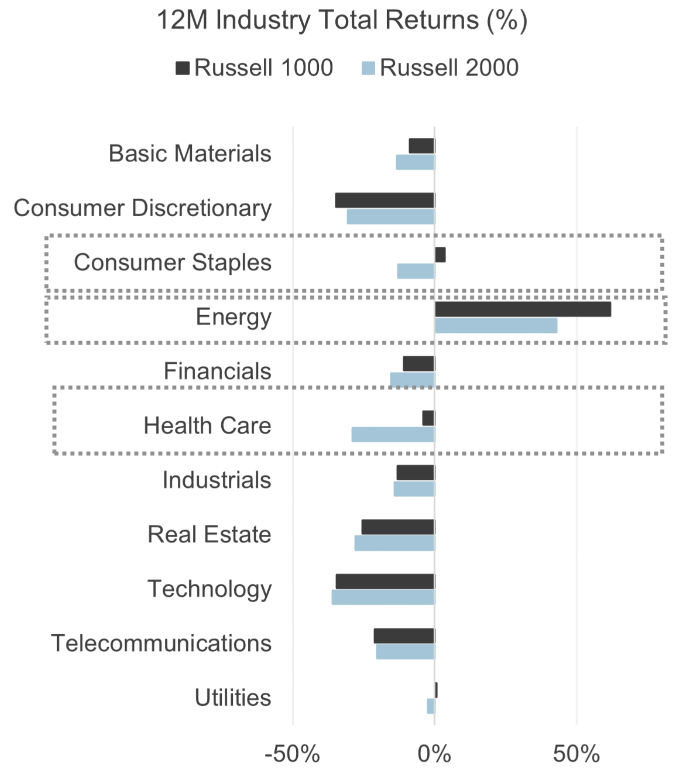
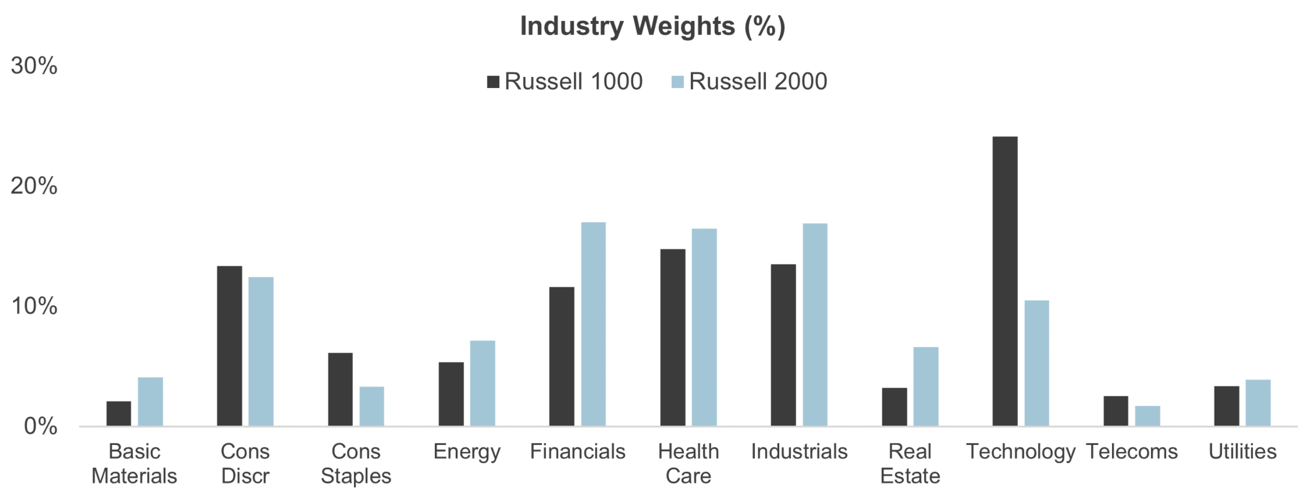


Chart 2: Large-cap industries fared better than small-cap peers in all but Discretionary and Telecom in 2022.





Source: FTSE Russell / Refinitiv. Based on Industry Classification Benchmark data as of December 31, 2022. 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

Both large- and small-cap Value indexes broadly outpaced their Growth counterparts in the Q4 rally and lost less in the full-year market collapse. The surge in Energy stocks was a major driver of Value outperformance for both periods.

- Within large-caps, Value outstripped Growth in 9 of 11 industries in Q4, led by Discretionary, Materials & Energy. Value also held up better in all but Staples for the full year (10 of 11), particularly in Energy, Telecom & Discretionary.
- Within small-caps, Value beat Growth in most industries in Q4 (7 of 11), with Materials, Industrials & Financials providing the biggest edge. Value also fared better for the full year (9 of 11), led by Energy, Utilities & Financials.
- In Q4, Energy, Materials & Industrials tallied the strongest gains across all style indexes, while Discretionary, Health Care & Technology ranked among the biggest laggards.
- For the full year, Energy was by far the best performer, and the only industry to post gains across all four style indexes. Staples & Utilities also fared relatively well. On average, Tech, Discretionary & Real Estate suffered the biggest losses.

Chart 1: Value outpaced Growth across most industries in the Q4 market rebound, particularly among large-caps.

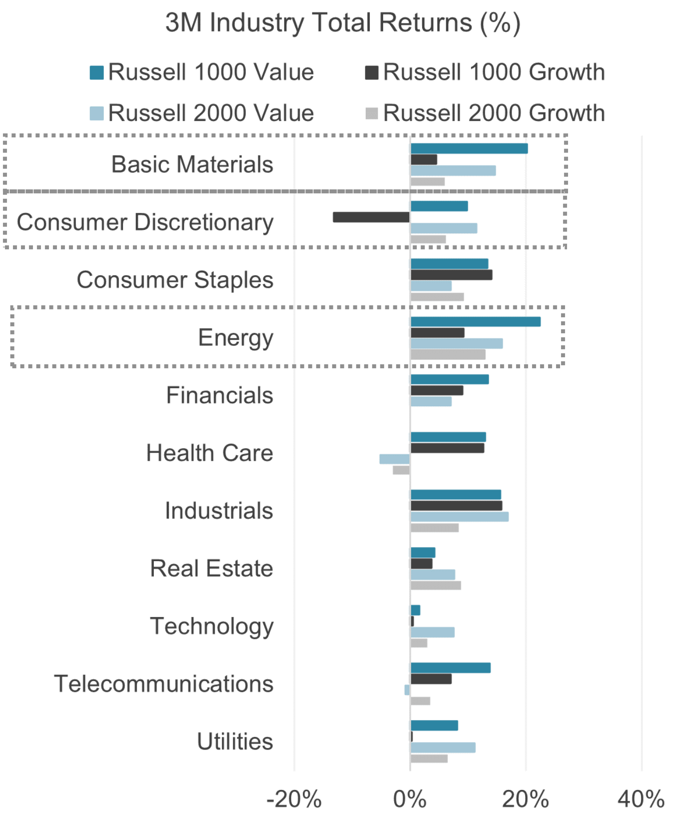
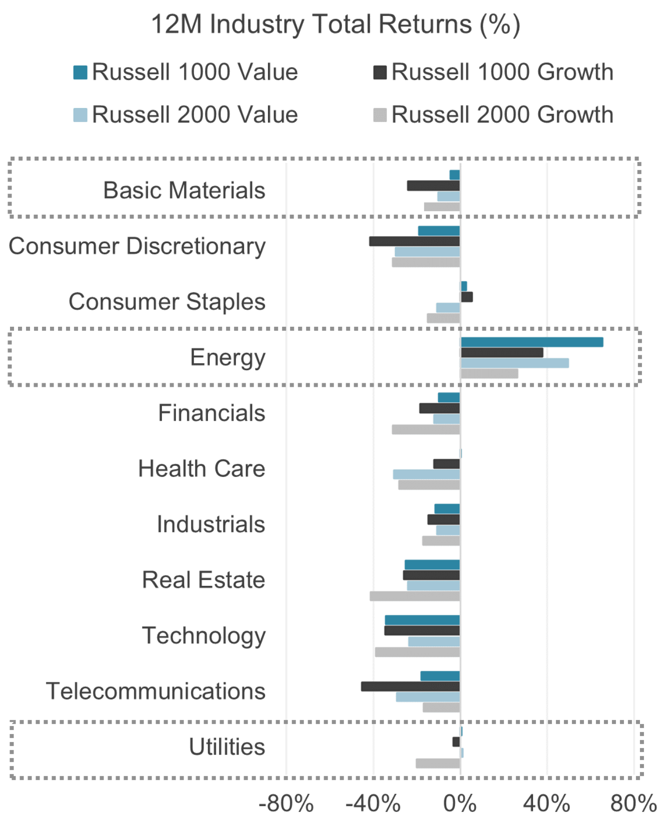
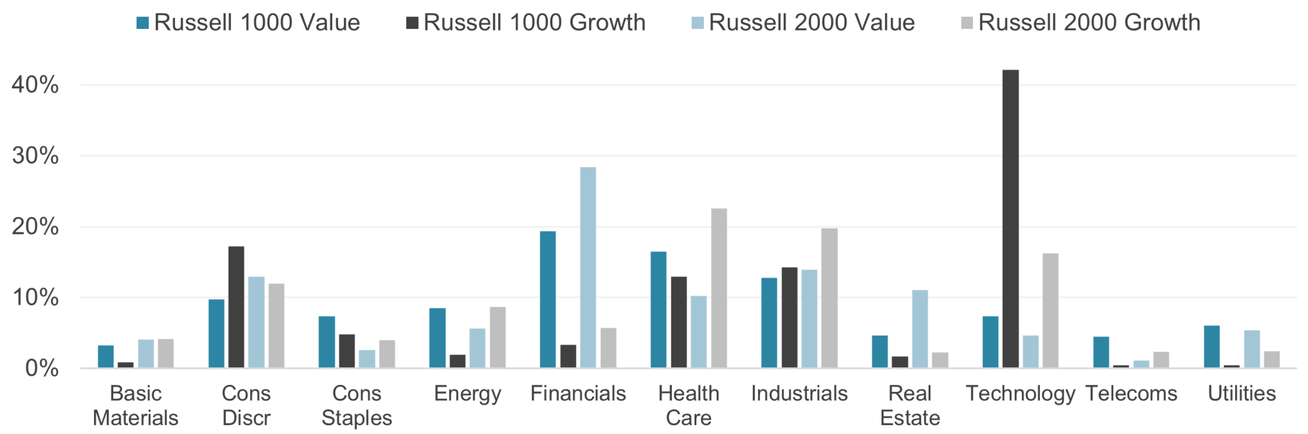


Chart 2: Value fared better than Growth in most industries, particularly among large-caps. Energy was a major driver.



Industry Weights (%)



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Russell 1000 Sector Weights & Contributions to Return*

Key observations — Fourth Quarter 2022

Drilling deeper into the sector performances within the 11 Russell 1000 industries in Q4, we highlight the following key points:

- As by far the best-performing large-cap industry in Q4, Energy owed much to its large exposure to the continued outperformance of Oil, Gas & Coal stocks, accounting for all of the industry's quarterly gain.
- Chemicals was the next best sector gainer in Q4. As the largest weight within Basic Materials (the second-best performing industry), the sector accounted for more than half of the industry's quarterly gain. Up next was Pharmaceuticals & Biotech, contributing more than half of the Health Care industry's rise.
- Notably, the three largest sectors within Industrials (Industrial Support Services, General Industrials and Aerospace & Defense) contributed roughly equally to the industry's increase, the third-best performer within the large-cap index.
- In the worst-performing industry in Q4 – Consumer Discretionary – the biggest sector decliners were Autos & Auto Part and Retailers (accounting for the bulk of the industry's loss).

Table 1: Amid widespread gains, Oil, Gas & Coal stocks were the standout sector contributors to large-cap industry returns in Q4, followed by Chemicals and Pharma. Autos & Parts and Retailers were by far the biggest detractors.

Sector	Avg. Weight	Q4 2022 Contrib.
Basic Material		
Chemicals	64.4%	8.99%
Industrial Materials	4.8%	0.60%
Industrial Metals and Mining	24.5%	5.81%
Precious Metals and Mining	6.2%	0.85%
Consumer Discretionary		
Automobiles and Parts	12.1%	-4.90%
Consumer Services	3.5%	0.16%
Household Goods & Home Construction	2.2%	0.41%
Leisure Goods	4.3%	0.06%
Media	10.5%	0.25%
Personal Goods	6.4%	1.56%
Retailers	41.7%	-0.44%
Travel and Leisure	19.2%	2.14%
Consumer Staples		
Beverages	29.3%	3.26%
Food Producers	23.1%	2.93%
Personal Care Drug & Grocery Stores	37.3%	5.34%
Tobacco	10.3%	2.00%
Energy		
Alternative Energy	3.6%	-0.27%
Oil Gas and Coal	96.4%	20.04%
Financials		
Banks	32.9%	3.39%
Finance and Credit Services	6.2%	0.58%
Investment Banking and Brokerage Svcs	37.3%	4.81%
Life Insurance	4.8%	0.83%
Mortgage Real Estate Investment Trusts	0.6%	0.11%
Non-life Insurance	18.2%	2.89%

Sector	Avg. Weight	Q4 2022 Contrib.
Health Care		
Health Care Providers	20.0%	1.82%
Medical Equipment and Services	29.5%	3.58%
Pharmaceuticals and Biotechnology	50.5%	7.27%
Industrials		
Aerospace and Defense	13.5%	3.06%
Construction and Materials	5.6%	0.61%
Electronic and Electrical Equipment	8.7%	1.59%
General Industrials	16.1%	3.11%
Industrial Engineering	8.9%	2.14%
Industrial Support Services	34.1%	3.38%
Industrial Transportation	13.0%	1.73%
Real Estate		
Real Estate Investment & Services Dev.	6.5%	0.65%
Real Estate Investment Trusts	93.5%	3.31%
Technology		
Software and Computer Services	55.5%	0.29%
Technology Hardware and Equipment	44.5%	1.81%
Telecomunications		
Telecommunications Equipment	40.7%	5.09%
Telecommunications Service Providers	59.3%	3.17%
Utilities		
Electricity	67.6%	5.49%
Gas Water and Multi-utilities	23.5%	2.26%
Waste and Disposal Services	8.9%	-0.10%

Source: FTSE Russell. *Indexes data shown here are from the Russell Capped Index Series, except for the Real Estate Industry. Data as of December 31, 2022. 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 outlook for the Russell 1000 and Russell 2000 remains strong but weakened over recent months as macro uncertainties and bottom-line pressures continued to mount. Though still near five-year highs (Chart 1), consensus 12-month forward EPS forecasts for both indexes continued their downhill trajectory, reflecting tougher comparisons and increased strains on margins from slowing economic activity, rocketing input costs, rising wage growth and higher borrowing rates.

As Chart 2 illustrates, three-month revisions to forward EPS forecasts for the Russell 2000 turned sharply negative in the second-half of 2022, in a major reversal from the uptrend of prior quarters. This was likely in response to diminishing earnings prospects for Energy, Basic Materials, Financials and Real Estate companies, reflecting the second-half easing in commodity prices, inverting US yield curves and slowing US housing market. Stocks in these industries make up a bigger share of the small-cap index than its larger-cap counterpart. Though relatively steadier, revisions for the Russell 1000 have also turned negative in recent months.

Analysts' revision ratios show a similar pattern. Though modestly improved from Q3 trends, the number of downgrades to 12-month forward EPS forecasts continued to outnumber upgrades in Q4. The reversal in this ratio has been more pronounced for the large-cap index than for its small-cap counterpart.

Chart 1: Forward EPS forecasts for both Russell 1000 and Russell 2000 moved lower in Q4, particularly for the latter.

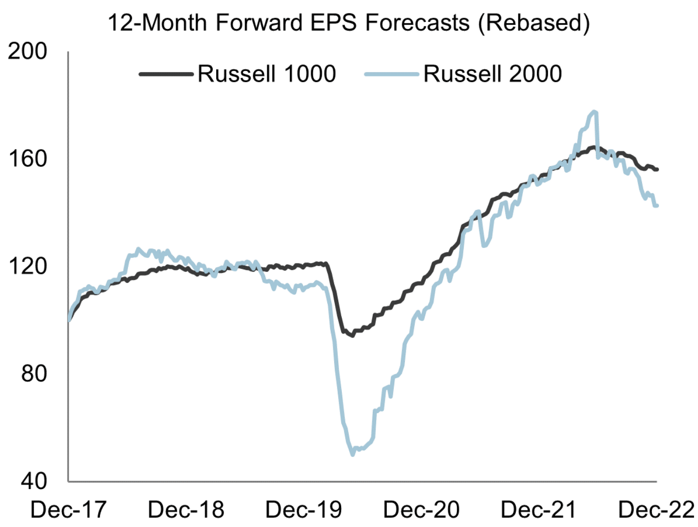


Chart 2: Revisions to forward EPS forecasts turned negative for both size indexes in the second-half of 2022.

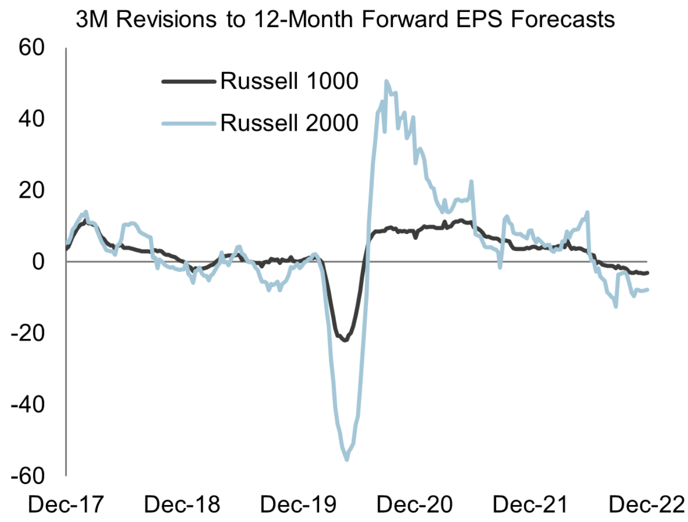
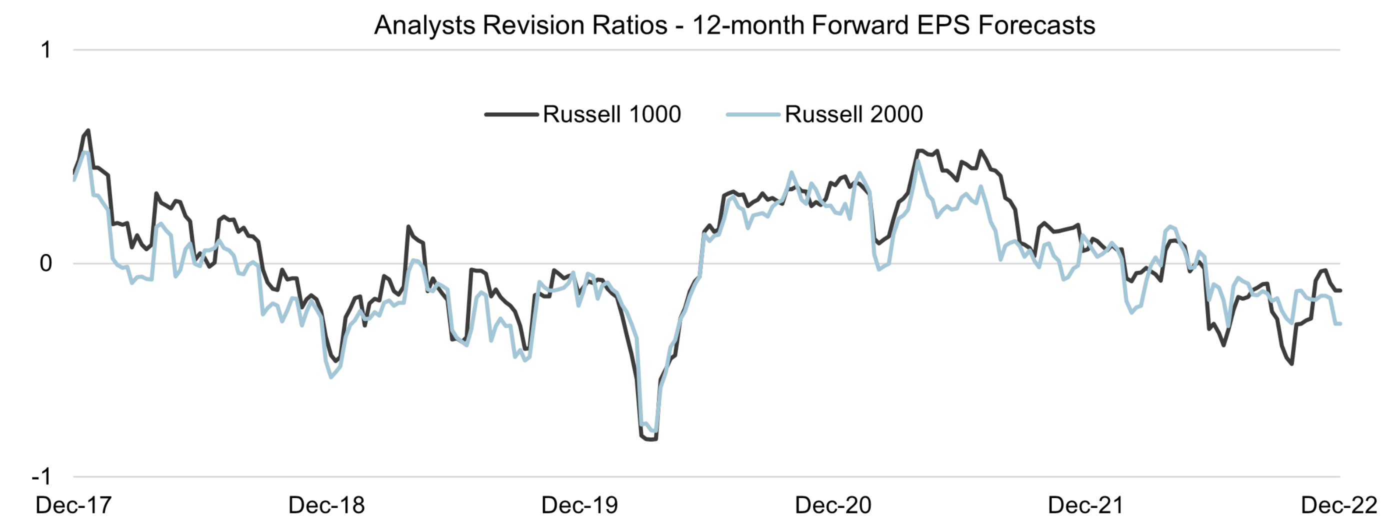


Chart 3: The post-crisis revision cycle for both the Russell 1000 and Russell 2000 continued its downward path, with analysts' downgrades outnumbering upgrades since June.



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

As in the case of the large- and small-cap benchmarks, forward EPS forecasts across the Russell US style indexes also moved lower in Q4. Even so, at quarter end, consensus 12-month forward EPS estimates were still near five-year highs for the large-cap style indexes and for small-cap Growth (Charts 1 and 2, left). Those for the Russell 2000 Value, however, have fallen sharply, erasing most of the increases in forecasts in the wake of the post-pandemic reopening.

Revisions to forward EPS forecasts for both Russell 1000 Growth and Value continued to drift lower over the past three months. The downtrend has been more pronounced for the large-cap Value index than for its Growth counterpart, though only barely so (Chart 1, right).

Revision cycles for both small-cap style indexes also entered negative territory in the second half of 2022 (Chart 2, right). Though improved since the steep downtrend in Q3, forward forecasts for the Russell 2000 Value continued to be revised lower over the past three months, likely reflecting the dimming profit outlooks for Financials, Real Estate and other rate-sensitive constituents (which comprise a larger share of the Value index than its Growth peer) amid rapidly tightening US financial conditions and the inversion of the US yield curve.

Chart 1: Though still near five-year highs, forward EPS estimates for Russell 1000 Growth and Value continued to drift lower from year-ago peaks as three-month revisions turned negative for both indexes in Q4.

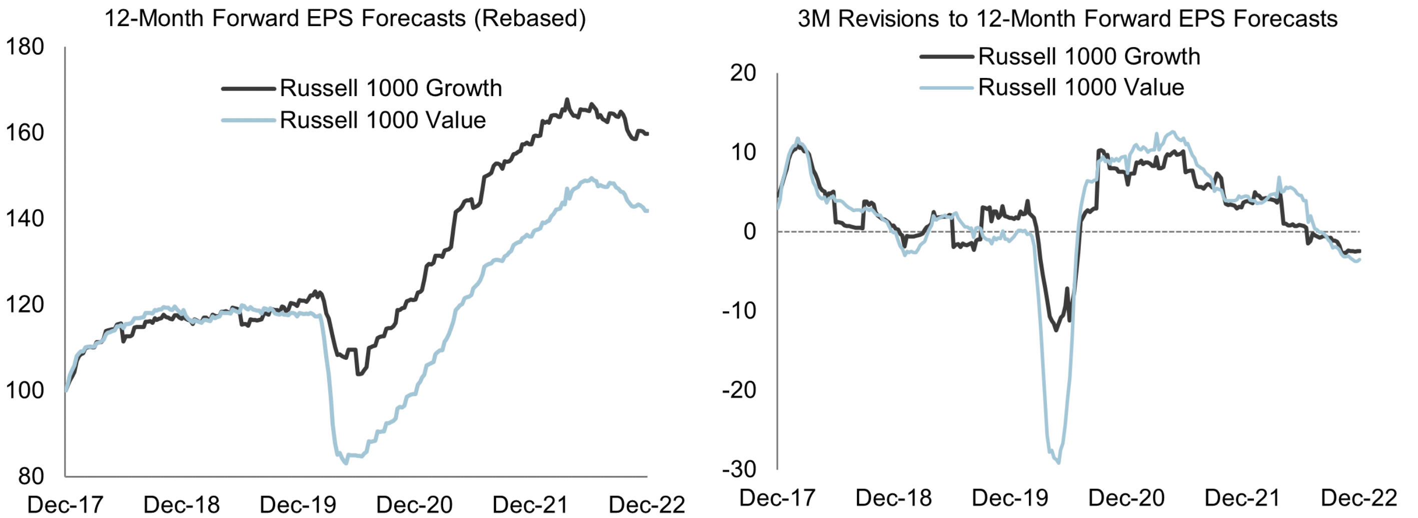
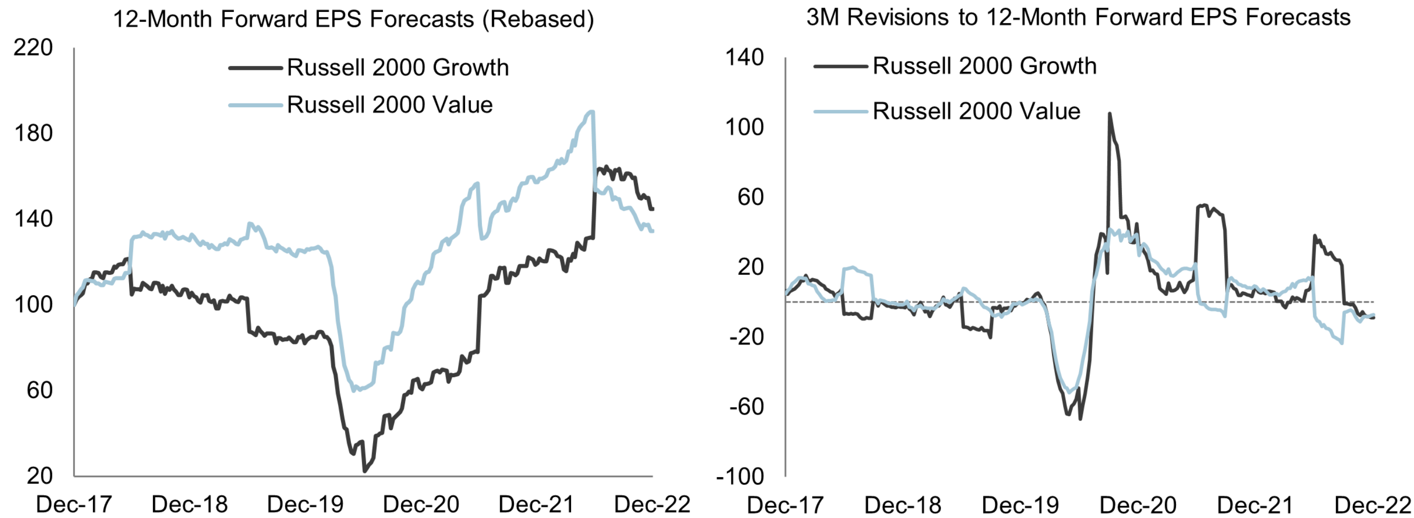


Chart 2: Russell 2000 Growth joined its Value offshoot in negative revision territory in Q4. While forward EPS estimates for small-cap Growth remain near five-year highs, those for small-cap Value have reverted back to early pandemic levels.



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Valuation Comparisons – 12-Month Forward P/Es

The yearlong contraction in forward P/Es reversed course in Q4 along with the broad rallies across the Russell US indexes, bringing forward multiples for most Russell indexes back to levels in line with pre-pandemic averages — or, in the case of Russell 2000 Growth, below five-year lows. All six indexes trade at premiums to the FTSE All-World ex USA PE of 11.8 times.

The Russell 2000 currently stands at 21.5 times 12-month EPS forecasts, down sharply from levels at the beginning of the year but up from 19.6 times at the end of Q3. The Russell 1000 uptick was more modest, ending the quarter at 17.2 times versus 16.3 times at the end of September — but still well below the 22.1 times of a year ago (Chart 1). Though the valuation gap between the two indexes has widened considerably since June, the small-cap premium remains well below its 10-year average, even factoring out the enormous upsurge amid the reopening euphoria in early 2021.

Forward multiples also edged higher across the style indexes over the past quarter (Charts 2 and 3), more so for Russell 2000 Growth and Value than for their large-cap counterparts. However, all remain well below their year-ago levels, with both large- and small-cap Growth suffering far steeper de-ratings than the two Value indexes, reflecting the massive growth-to-value rotation over the past year. Though Growth typically trades at a premium to Value, the valuation gap between the Russell 1000 Growth and Value remains well above the pre-pandemic average while it has moved closer to that norm for the two small-cap style indexes.

Chart 1: The post-pandemic contraction in forward P/Es for both the R1000 and R2000 continued to stabilize in Q4, with both indexes seeing modest re-ratings since June, more so for the small-cap index than for its large-cap counterpart.

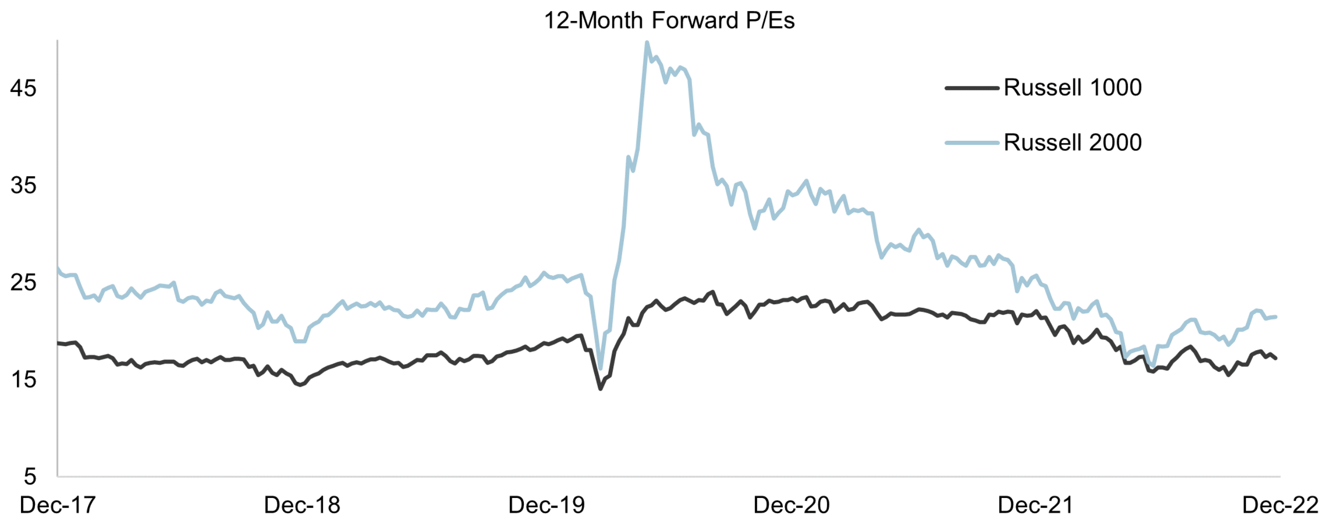


Chart 2: R1000 Growth retains a huge premium to its Value cohort, despite its far steeper de-rating this past year.

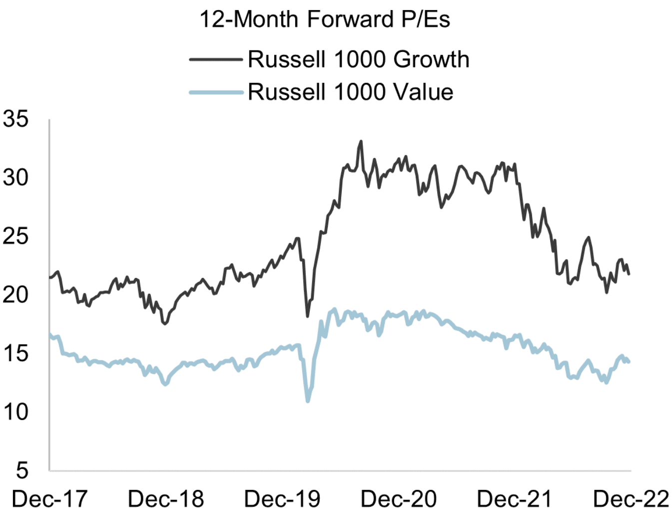
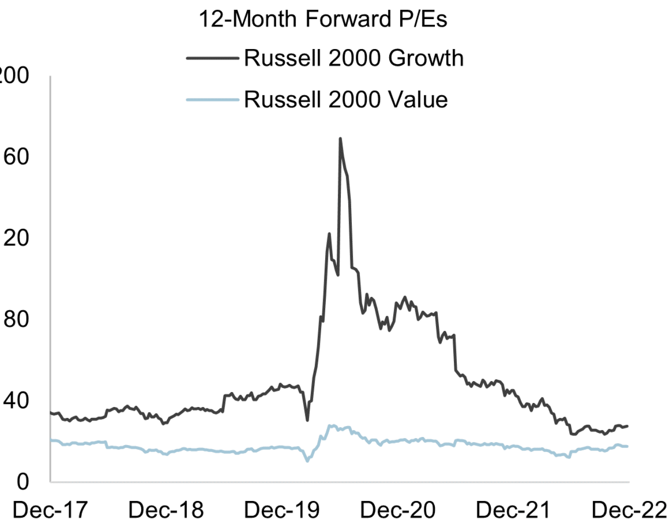


Chart 3: R2000 Growth vs Value premium continued to tighten in Q4 as the Value re-rating exceeded Growth's.



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IPO Additions to Russell US Indexes – Full Year 2022

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 this year has been particularly dramatic, a likely effect of extreme market volatility. Following a dearth of IPOs in the prior three quarters, only one new company was added to the Russell 1000 in Q4 and only two to the Russell 2000, compared to a combined 164 IPOs in the second-half 2021, and the respective seven and 40 newcomers in the same period a year ago. In keeping with a longstanding trend, Health Care dominated IPO activity in 2022 (Chart 2), adding 15 new companies (30% of the total 50), while Financials added 10, Tech and Industrials each added six and Discretionary added three. For more information, see Russell US Index IPO additions and reports | FTSE Russell.

Chart 1: Additions to the Russell US indexes fell in Q4 from last quarter, with three newcomers joining the two Russell US indexes (down from a peak of 17 in Q2 and of 202 in 2021). There was only one addition to the Russell 1000 in 2022.

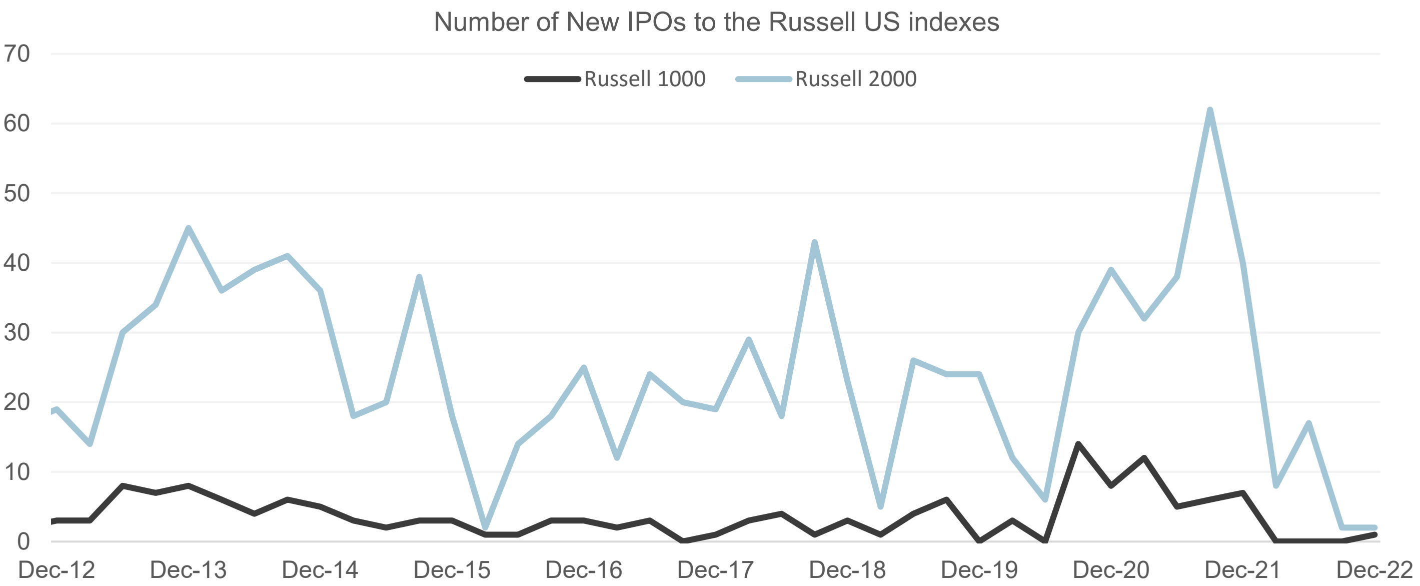
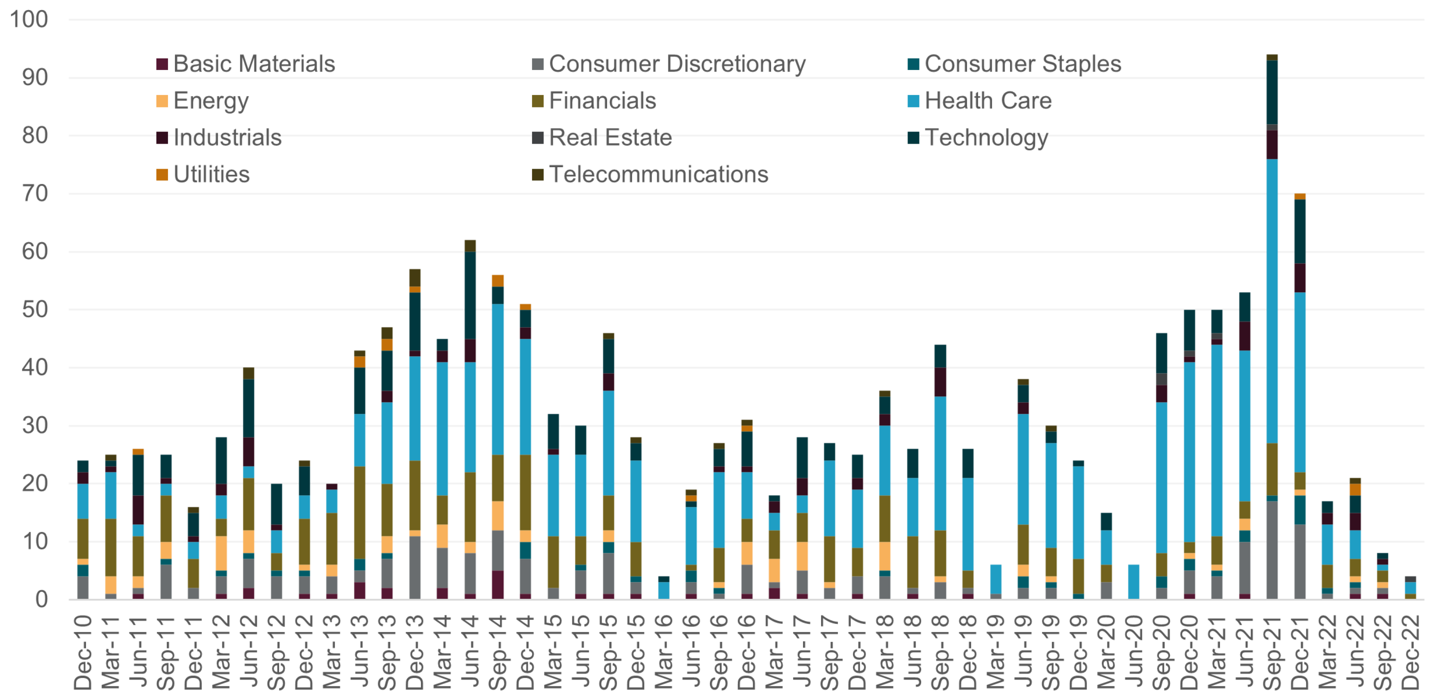


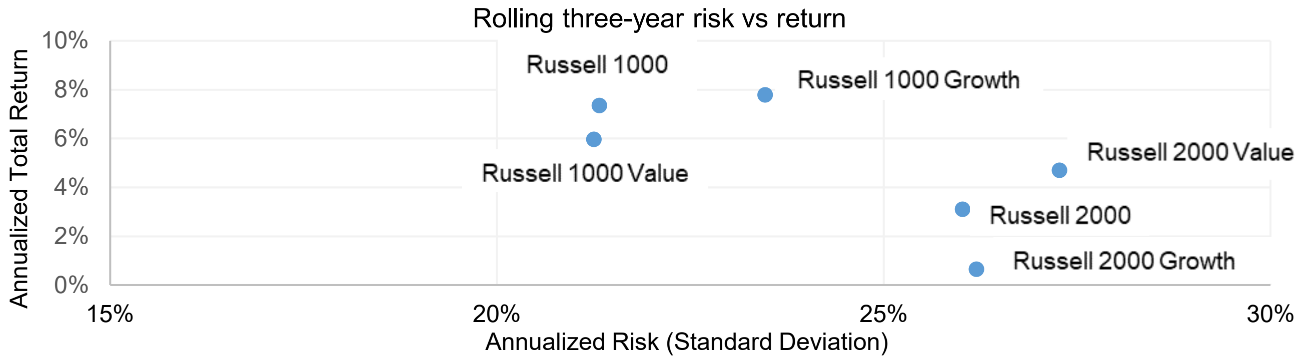
Chart 2: Health Care dominated the IPO activity for the Russell US indexes in 2022, though their number fell to 15, versus a record 139 in 2021. Financials added 10 newcomers, Tech & Industrials each added six and Discretionary added three.



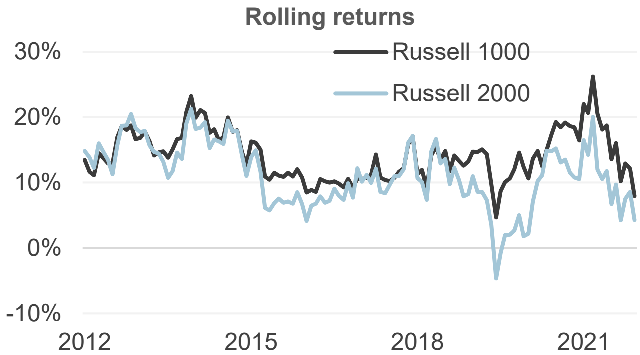
Source: FTSE Russell / Refinitiv. Based on Industry Classification Benchmark (ICB) data as of December 31, 2022. Past performance is no guarantee of future results. Please see the end for important legal disclosures. For professional investors only.

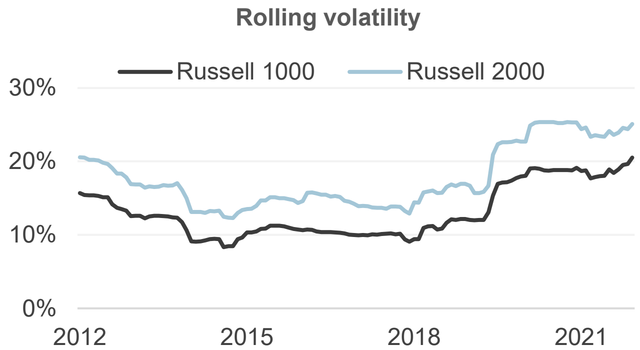
Return & Risk – Rolling Three-Year Patterns

In the most recent 3-year period, the Russell 1000 outpaced the Russell 2000 with far less volatility. Likewise for large-cap Growth and Value vs small-cap peers. The rolling 3-year charts below show return and volatility patterns over time.

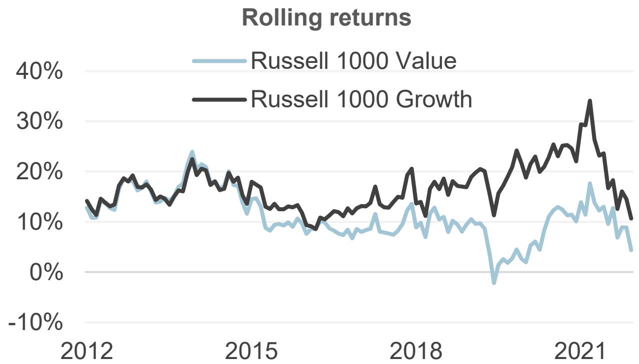


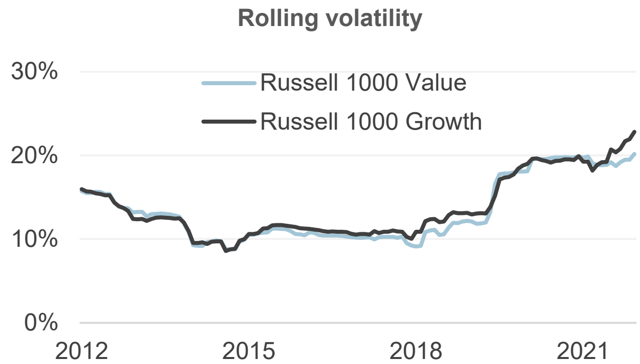
R1000 has outperformed R2000 with far less risk recently, though volatility has risen for both since the pandemic began.



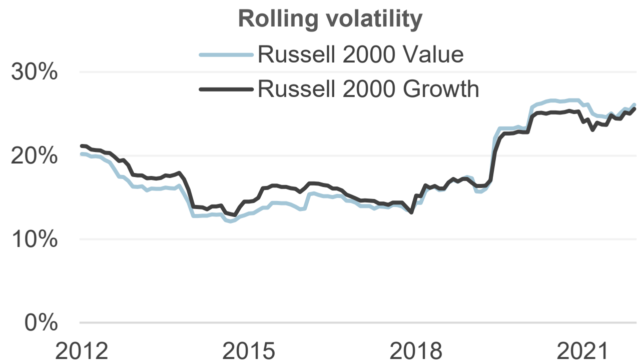


R1000 Growth narrowed its lead vs R1000 Value post-Covid crisis, though has grown more volatile in the recent period.





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



Source: FTSE Russell / Refinitiv. All data through December 31, 2022. 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.