
Invesco Institutional Indexing

Case Study: Choosing an index is an active decision

A closer look at the similarities and differences between the S&P 500[®] Index and the Russell 3000[®] Index.

Institutional Indexing Case Study

1 Similar investment experience

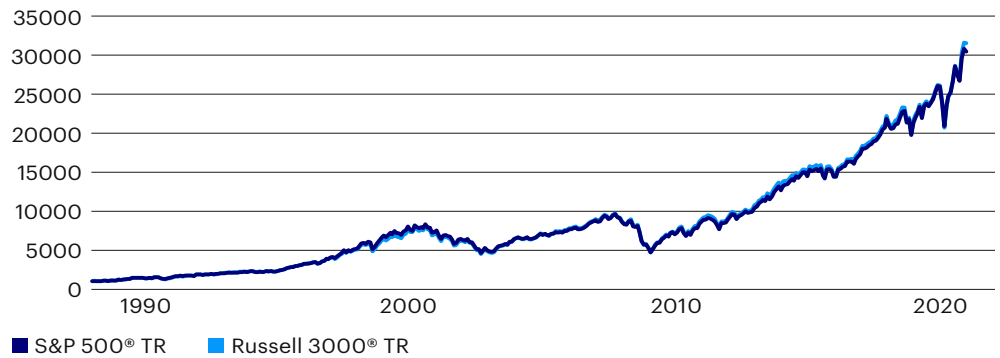
Invesco takes an active approach to its passive investments, ensuring our clients have a solid understanding of their benchmark properties, behavior and drivers of return. In a recent client engagement, we provided a deeper look into two well-known US equity indexes and discovered there are more similarities and surprising differences than you may have otherwise thought.

- Clients often use the Russell 3000® as their holistic US Equity exposure benchmark. We find this approach ignores the importance of small- and mid-cap sleeves, despite a reference to “broad” or “all-cap” exposure.
- The Russell 3000® and S&P 500® indexes have delivered comparable returns, with similar risk and broad exposure to the US equity market, further highlighting the large-cap tilt of the Russell 3000®.
- Due to the lower number of securities, the S&P 500® Index tends to be more concentrated in the top names.

Here are five insights we were able to provide to our client about the similarities and differences between the S&P 500® and the Russell 3000® indexes:

The mid-and small-cap securities in the Russell 3000® explain very little of the index’s performance, while large-cap tends to be the main driver of investment results.

Russell 3000® and S&P 500® Total Return – 1988 to 2021



Source: Bloomberg, Invesco, as of June 30, 2021. Longest available common history starting at the end of January 1988. Starting index value: 1,000. Past performance is not indicative of future results. An investment cannot be made in an index.

2 Methodologies follow different processes

Both indexes rely on a market-cap weighting approach, although many differences exist in their methodologies beyond weighting. The S&P deploys a subjective committee for security inclusion, whereas Russell has a more objective, rules-based methodology.

S&P 500® Index

The S&P 500® Index measures the performance of the largest 500 US companies representing approximately 80% of the investable US equity market. The index is a subset of the S&P 1500 Composite.®

Inclusion in the index is subject to eligibility, as are most indexes, although a final committee vote leaves the S&P methodology to subjective decision-making.

Sector balance is considered in the committee’s selection of companies.

Quarterly Rebalance: March, June, September, December.

Russell 3000® Index

The Russell 3000® Index measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market.

Russell indexes are objectively constructed and based on transparent rules, with no subjectivity included in the methodology.

Less than 10% of market cap is classified as “small,” ensuring minimal redundancy for investors with a dedicated small-cap exposure.

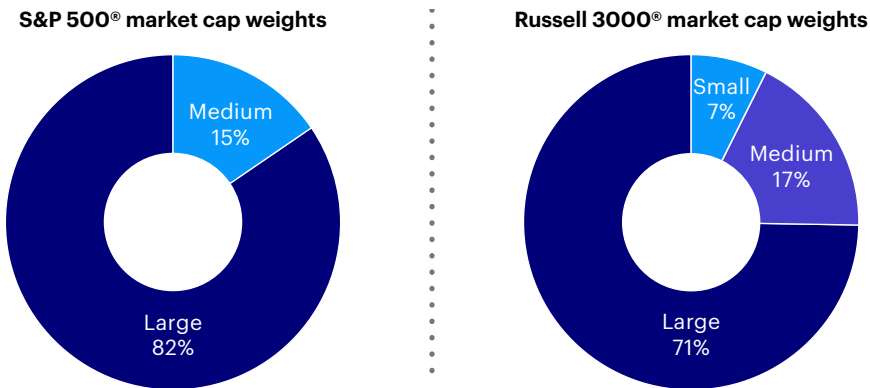
Annual reconstitution: June.

3 Exposures differ, but only at the margin

The similar behavior of these indexes can be attributed to their composition.

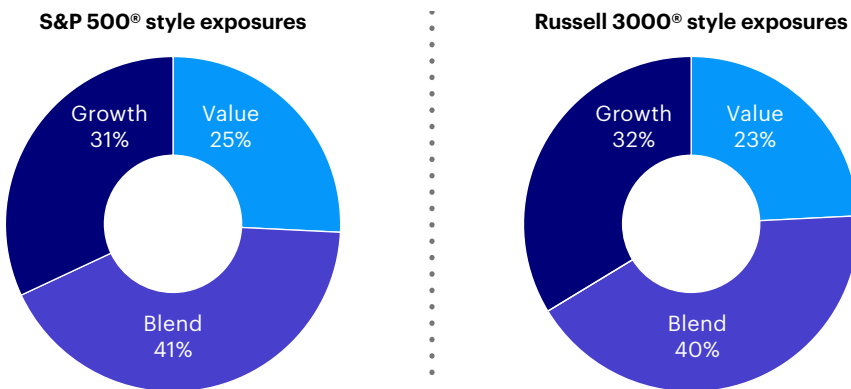
Index Decomposition by Market Capitalization

Large/mid-cap dominance with some exposure to small-cap in the Russell 3000®



Index decomposition by Morningstar style box

Virtually identical style exposures



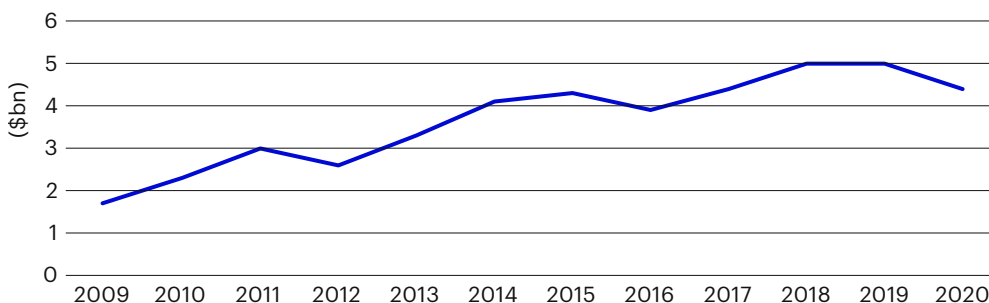
Source: Style box data is from Morningstar as of February 10, 2021 and reflects ETF proxy weights, IWV, SPY and IWM. ETF proxies are used as they closely resemble the exposure of the underlying indexes they track. Index Market Cap data is sourced from Morningstar Direct as of December 31, 2020 and may not add to 100%.

4 Your all-cap mandate may not be giving you the small-cap exposure you wanted

The Russell 3000 index, a total market approach to US equities, may not be providing a holistic all-cap experience due to its market-cap weighting methodology. Despite 2,000 of the index's securities (or 2/3) being classified as small-cap, the market-cap weighted methodology results in the larger-cap securities driving most of the return and risk. As seen above, small caps only represent roughly 7% of the Russell 3000 index based on market capitalization. For investors who value the importance of small-cap securities as a driver of return, or diversifier, a dedicated small-cap mandate may be additive.

As evidenced below, one of the most widely used small cap indexes, the Russell 2000, has seen its largest market capitalization by holding more than double in the past 10 years. To capture the illiquidity premium often sought after when investing in small-caps, micro-caps have also become a portfolio diversifier, offsetting the growing market-caps of the domestic equity universe.

Largest Market-Cap in Russell 2000 Index



Source: Invesco, FTSE Russell

5 Concentration risk remains a concern for large-cap US equities

Relative to the Russell 3000®, the S&P 500® is more concentrated given a lower number of index constituents.

Top Holdings

Ticker	Name	Sector	Russell 3000® Weight (%)	S&P 500® Weight (%)
AAPL	APPLE INC	IT	4.9	5.9
MSFT	MICROSOFT CORP	IT	4.6	5.6
AMZN	AMAZON COM INC	Discretionary	3.4	4.1
FB	FACEBOOK CLASS A INC	Communication	1.9	2.3
GOOGL	ALPHABET INC CLASS A	Communication	1.7	2.0
GOOG	ALPHABET INC CLASS C	Communication	1.6	2.0
TSLA	TESLA INC	Discretionary	1.2	1.4
BRKB	BERKSHIRE HATHAWAY INC CLASS B	Financials	1.2	1.5
NVDA	NVIDIA CORP	IT	1.1	1.4
JPM	JPMORGAN CHASE & CO	Financials	1.1	1.3

% Assets in top 5 Holdings 16.4 19.9

% Assets in top 10 Holdings 22.5 27.4

Source: Morningstar as of June 30, 2021. Holdings are from ETF proxies, tickers IVV (iShares S&P 500® ETF) and IWV (iShares Russell 3000® ETF).

6 The bottom line

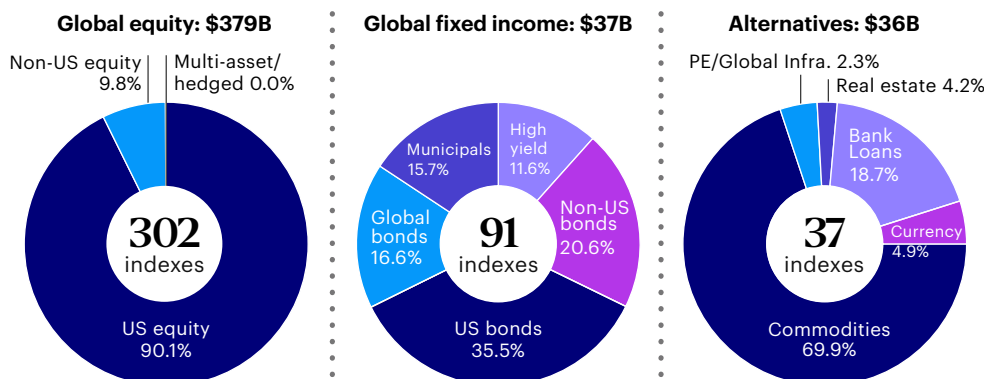
While both the Russell 3000® and the S&P 500® have a comparable index construction methodology and share similarities across the risk and return spectrum, the weighting mechanisms of stocks included in each index may position clients to be overly exposed to large-cap companies. Investors looking to diversify their market exposure should seek a more balanced mix of large-, mid- and small-cap companies through additional index exposures. Although the “All Cap” aspect of the Russell 3000® provides exposure to mid- and small-cap companies, it is minimal for investors seeking a more targeted representation.

The Invesco Institutional Index team can support your organization’s efforts to find diversifying, return-enhancing or risk-reducing strategies to complement your existing passive US large cap exposure. By starting with an objective review of your portfolio’s risk exposures, we can provide solutions to meet your plan’s unique objectives.

Custom Indexing to Meet your Unique Needs

In the era of indexation, institutions are increasingly shying away from off-the-shelf products in favor of bespoke creations to address their investment challenges. Whether its enhanced returns, diversification, or another stated objective, Invesco is well-suited to meet a client's needs.

Invesco has long been a pioneer in developing and implementing leading index solutions. Over 20 years ago, for example, we created the industry's first smart beta index. Today, we manage nearly \$400 billion across equity, fixed income, and alternative asset indexes.



Source: Invesco as of June 30, 2021

What you can expect as a client

01

Analytics

Use of our proprietary analytics engine, Invesco Vision, which includes risk and return data on 12,000 + indices

02

Custom Solutions

Tailored to the preferences of each client across a variety range of elements (e.g. sector-specific) and vehicle types (e.g. ETFs)

03

Expertise

Access to firm-wide experts spanning investment disciplines, asset classes and regions

Meeting the evolving needs of investors is a key tenet of our firm's philosophy, which puts us at the forefront of index innovation and organic growth. Whatever your specific goals, Invesco can work with you to create a cost-effective index as unique as your organization. We look forward to helping you develop the sophisticated custom solution you deserve.

Customized solutions to address your beta needs

Third party replication



Deep and broad expertise in managing replication strategies. Currently replicating over **350+ indexes**.

Invesco core beta



Investor-designed indexes, maintained using a **transparent, rules-based methodology**

Invesco custom factor



Academically-based, with foundational universe that is **modular, flexible, and customizable**

Invesco custom ESG

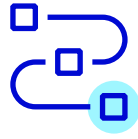


Competitive pricing with focus on **minimizing tracking error**

All Data Sources: Invesco as of June 30, 2021

Your One-Stop Destination for Institutional Indexing

Partnership that extends beyond index management



Strong Investment Foundation

Ability to deliver across all vehicle types, with flexibility to co-create new strategies and structures



Portfolio Analytics and Tools

Market-leading portfolio tools including best of breed third party and proprietary analytics



Low Total Cost

Simple and transparent fee and expense structure that rewards larger and deeper relationships



Client-centric Model

Dedication to a **collaboration** that creates a “win-win” for both parties

For more information, please visit [invesco.com/institutional-indexing](https://www.invesco.com/institutional-indexing) or speak with your Invesco representative.

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