



Monday Moves: Timely Resources and Upcoming Events for Advisors

**QUESTION OF THE WEEK:** How can I address narratives that suggest small cap performance expectations may have changed?

July's US [small cap value resurgence](#) was a welcome development, with small value outperforming large growth by a cumulative return spread of 14.83 percentage points from July 11 to 17.<sup>1</sup> This was a good reminder that capturing the premiums—which can be unpredictable and occasionally show up in bunches—requires consistent exposure.

Unfortunately, subsequent [market volatility](#) in early August may have jolted some investors, especially those pursuing the size premium. During tough periods, narratives can emerge that seek to explain why small cap performance expectations may have changed. Below, we evaluate four leading headlines you may encounter.

**1. Stock Migration:** Stocks that migrate from the small cap segment into the large cap segment have been an important contributor to historical size premiums (Fama and French 2007). While migration patterns can vary year-to-year, the most recent outcomes show that migration activity remains in line with historical levels (see [Exhibit 1](#)).

**Exhibit 1: Average Percentage of US Stocks Migrating from Small to Large each Year 1926–2023**

June 1926 – June 2023	10.5%
June 2003 – June 2023	10.2%

*Post performance is no guarantee of future results. Actual returns may be lower. In USD. Source: Dimensional using CRSP/Compustat data. Market caps are based on end of month as of June year t. Portfolios are formed at the end of June each year. The beginning samples include all the firms in the Fama/French US Total Market Research Index. Small stocks are defined by the Fama/French US Small Cap Research Index and large stocks are defined by the Fama/French US Large Cap Research Index. See "Index Descriptions" in the Appendix for descriptions of index data. Migration is calculated as the percentage of market cap that are small stocks at year t and are large stocks at year t+1, scaled by the total market cap of small stocks at year t. The Fama/French Indices represent academic concepts that may be used in portfolio construction and are not available for direct investment or for use as a benchmark. Data provided by Fama/French, Eugene Fama and Ken French are members of the Board of Directors of the general partner of, and provide consulting services to, Dimensional Fund Advisors LP.*

**2. Number of Stocks in the Market:** The number of stocks in the US market has declined from a high of more than 6,600 in 1997 to about 3,500 at the end of 2023. A popular subplot suggests the stock count decline has important implications for the size premium. One way to think about concerns with a shrinking opportunity set is to look at the size premium across different markets. While the historical magnitude of the size premium has varied across countries, there's no evidence this variation is tied to the number of stocks. The largest size premium observed within developed markets, 5.09%, came from Ireland, with which has a stock market population of just 40 on average (see [Exhibit 2](#)).

**Exhibit 2: Average Number of Stocks and Size Premiums for Developed Markets 1994–2023**



*Post performance, including hypothetical performance, is no guarantee of future results. Source: Dimensional using data from Bloomberg. Filters were applied to data retroactively and with the benefit of hindsight. Groups of stocks and their returns are hypothetical, are not representative of indices, actual investments or actual strategies managed by Dimensional, and do not reflect costs and fees associated with an actual investment. Start date determined by availability of all cap coverage across countries. Size premium is defined as the return difference between small cap and large cap securities in each country. Small cap returns exclude companies with the lowest profitability and highest relative price as well as those companies with the highest asset growth within the small cap universe in each country. Within each country, small stocks and large stocks are defined as the bottom 12.5% and top 87.5%, respectively, of cumulative market cap ranked on firm size. Stock counts exclude the smallest 0.1% of market capitalization in each market, REITs, UTIs, and Investment Companies. The sample is restricted to exchange traded stocks that meet minimum liquidity and listing requirements. Assumes annual rebalancing.*

**3. Changes in Small Cap Characteristics:** Not all small caps are created equal. [Exhibit 3](#) shows that the decline in firm profitability within US small caps is largely concentrated in a subset of small cap growth stocks with low profitability. Dimensional excludes these stocks to improve performance and deliver the size premium in a more reliable manner. The remainder of the small cap universe has exhibited relatively stable financial characteristics.

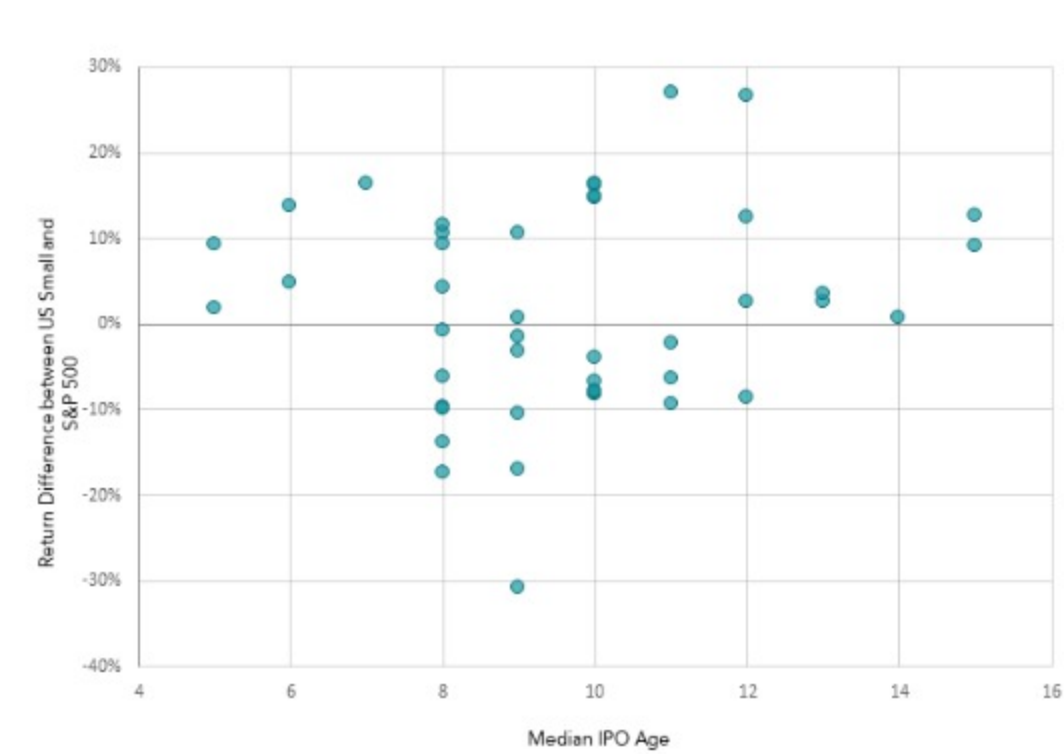
**Exhibit 3: Aggregate Price-to-Book and Weighted Average Profitability in US Small Caps 1975–2023**



*Post performance is no guarantee of future results. Actual returns may be lower. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Index returns are not representative of actual portfolio and do not reflect costs and fees associated with an actual investment. See "Index Descriptions" in the Appendix for descriptions of Dimensional index data. Profitability is measured as operating income before depreciation and amortization minus interest expense, scaled by book equity.*

**4. IPO Activity:** This stability includes the relationship between the size premium and IPO activity (see [Exhibit 4](#)). The post-2000 sample period is characterized by lower IPO frequency and slightly higher IPO firm age, though IPOs remain mostly small cap firms. Fewer IPOs is one factor in the broader decline in the number of US-listed stocks, but this trend does not have direct implications for investors pursuing the size premium.

**Exhibit 4: Median IPO age and Annual Return Difference Between the Dimensional US Small Cap Index and the S&P 500 Index, 1980–2023**



*Post performance, including hypothetical performance, is no guarantee of future results. In USD. Each dot represents one year. Source: Median IPO age data from Jay Ritter's IPOs (July offerings of initial public offerings), Inclusion: US market IPO data only. IPO firm age is the number of years between company founding date and IPO offering date. IPOs with an offer price below \$5 per share, unit offers, ADRs, closed-end funds, oil and gas limited partnerships, acquisition companies, REITs, bank and S&P IPOs, and firms not listed on CRSP are excluded. US small represented by the Dimensional US Small Cap Index. See "Index Descriptions" in the Appendix for descriptions of index data. S&P data © 2024 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.*

Overall, history suggests that giving up on small cap stocks after their worst stretches could be a mistake. Investors should avoid making asset allocation decisions based on narratives like those above. Remaining disciplined will allow investors to be properly positioned to capture the premiums when they materialize.

**JOIN UPCOMING WEBCAST: Is It Different This Time?**

Is there a topic you'd like to see addressed in a future edition? Send us your questions!

**FEATURED RESOURCES**

- [Here's Why You Should Invest in All the Sectors, Not Just One](#) – New Quick Take
- [2024 Global Advisor Study Executive Summary](#)
- [Election Resources Collection](#)
- [Market Volatility Collection](#)
- [Dimensional Research](#)

**UPCOMING WEBCASTS**

**Is It Different This Time?**

Monday, August 26, at 1:00 pm CT

- We help navigate a year that has seen shifting leaders in stocks, a yield curve that remains inverted, an unpredictable US election season, and other developments that can challenge investors' resolve.

**Talking Elections and Taxes: Insights from Tax Policy Expert Scott McCandless**

Tuesday, September 10, at 10:30 am CT

- Scott McCandless, a tax policy expert with PwC, will discuss tax law in 2024 and beyond, the outlook for the upcoming presidential and congressional elections, and the potential impact on tax policy.

**UPCOMING CONFERENCES**

Dimensional hosts a variety of events throughout the year for many types of investment professionals.

Our [2024 conference program](#) is designed to provide valuable insights into investment theory, strategy, and application, as well as the soft skills that we believe are needed to build a successful business. We supplement major events with more-targeted study groups and workshops designed around practice management ideas.

Please reach out if you are interested in attending any of our approaching major events, which are listed below.

**Foundations Conference (Santa Monica)—August 28**

- Focuses on Dimensional's investment philosophy and approach to capital markets while exploring multiple aspects of integrating Dimensional strategies into an advisory business. Attendees leave with a strong understanding of how Dimensional can support their overall investment offering, client communications, and business strategy.

**Applied Communications Workshop (Santa Monica)—August 29**

- Designed to assist advisors in structuring a more effective communication strategy with clients and prospects. The sessions aim to provide advisors a framework that can be applied to a variety of conversations and questions, focusing on methods that resonate with different learning styles.

**Applied Investments Conference (Charlotte)—September 4–5**

- Explores investment-related themes in much greater detail than Foundations Conference while focusing on strategy implementation. Leaders throughout the firm speak on a diverse range of topics, including market themes and how academic research should be applied to the investment process.

We wish you and your family a great end of the summer and back-to-school season. As we look toward the last few months of 2024, please don't hesitate to reach out if we can support your business in any way.

Best,  
Your Dimensional Support Team

**APPENDIX: Index Descriptions**

**Fama/French index descriptions:** Results shown during periods prior to each index's inception date do not represent actual returns of the respective index. Other periods selected may have different results, including losses. Backtested index performance is hypothetical and is provided for informational purposes only to indicate historical performance had the index been calculated over the relevant time periods. Backtested performance results assume the reinvestment of dividends and capital gains. Profitability is measured as operating income before depreciation and amortization minus interest expense scaled by book equity. Eugene Fama and Ken French are members of the Board of Directors of the general partner of, and provide consulting services to, Dimensional Fund Advisors LP.

**Fama/French US Small Cap Research Index:** July 1926-present: Fama/French US Small Cap Research Index. Courtesy of Fama/French from CRSP and Compustat securities data. Includes NYSE securities (plus AMEX equivalents since July 1982 and NASDAQ equivalents since 1973) in the lower 90% market equity range of NYSE firms; rebalanced annually in June.

**Fama/French US Large Cap Research Index:** July 1926-present: Fama/French US Large Cap Research Index. Courtesy of Fama/French from CRSP and Compustat securities data. Includes NYSE securities (plus AMEX equivalents since July 1982 and NASDAQ equivalents since 1973) in the upper 90% market equity range of NYSE firms; rebalanced annually in June.

**Dimensional index descriptions:** The Dimensional indices have been retrospectively calculated by Dimensional Fund Advisors LP and did not exist prior to their index inception dates. Accordingly, results shown during the period prior to each index's index inception date do not represent actual returns of the index. Other periods selected may have different results, including losses. Backtested index performance is hypothetical and is provided for informational purposes only to indicate historical performance had the index been calculated over the relevant time periods. Backtested performance results assume the reinvestment of dividends and capital gains.

**Dimensional US Small Cap 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 of the eligible market. The eligible market is composed of securities of US companies traded on the NYSE, NYSE MKT (formerly AMEX), and Nasdaq Global Market. Exclusions: non-USD companies, REITs, UTIs, and Investment Companies. From January 1978 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 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 for the Dimensional US Small Cap Index was amended on January 1, 2014, to include profitability as a factor in selecting securities for inclusion in the index. The calculation methodology for the index was amended in December 2019 to include asset growth as a factor in selecting securities for inclusion in the index.

**Dimensional US Small Cap Growth Low Profitability Index** was created in February 2018 and is compiled by Dimensional. January 1978-present: Consists of companies with market capitalizations in the lowest 8% of the total market capitalization of the eligible market whose relative price is in the top 50% of all small cap companies after the exclusion of utilities, companies lacking financial data, and companies with negative relative price. The index emphasizes companies with lowest profitability. Profitability is measured as operating income before depreciation and amortization minus interest expense scaled by book. The eligible market is composed of securities of US companies traded on the NYSE, NYSE MKT (formerly AMEX), and Nasdaq Global Market. Exclusions: non-USD companies, REITs, UTIs, and Investment Companies. 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 each month of the year.

<sup>1</sup> Based on returns for the Russell 2000 value index and Russell 2000 growth index. Post performance is not a guarantee of future results. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell indices. Indices are not available for direct investment; therefore their performance does not reflect the expenses associated with the management of an actual portfolio.

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