5/15/2024

With the resurgence of so-called "meme stocks" in the first half of May, the year-to-date advance in U.S. stocks has broadened to include small caps, which have largely underperformed large caps over the post-pandemic period. This trend has led long-term investors to question whether the Size risk premium (in Fama/French parlance) has vanished, considering the significant underperformance of U.S. small caps versus large caps in both the post-pandemic period and the last couple of decades.

The researchers at Dimensional Fund Advisors (“Dimensional”) continue to emphasize patience as they make the case for a small cap risk premium that remains robust across time and global markets. This premium has a history of reverting following periods of underperformance, offering an attractive potential for savvy investors to capitalize on.

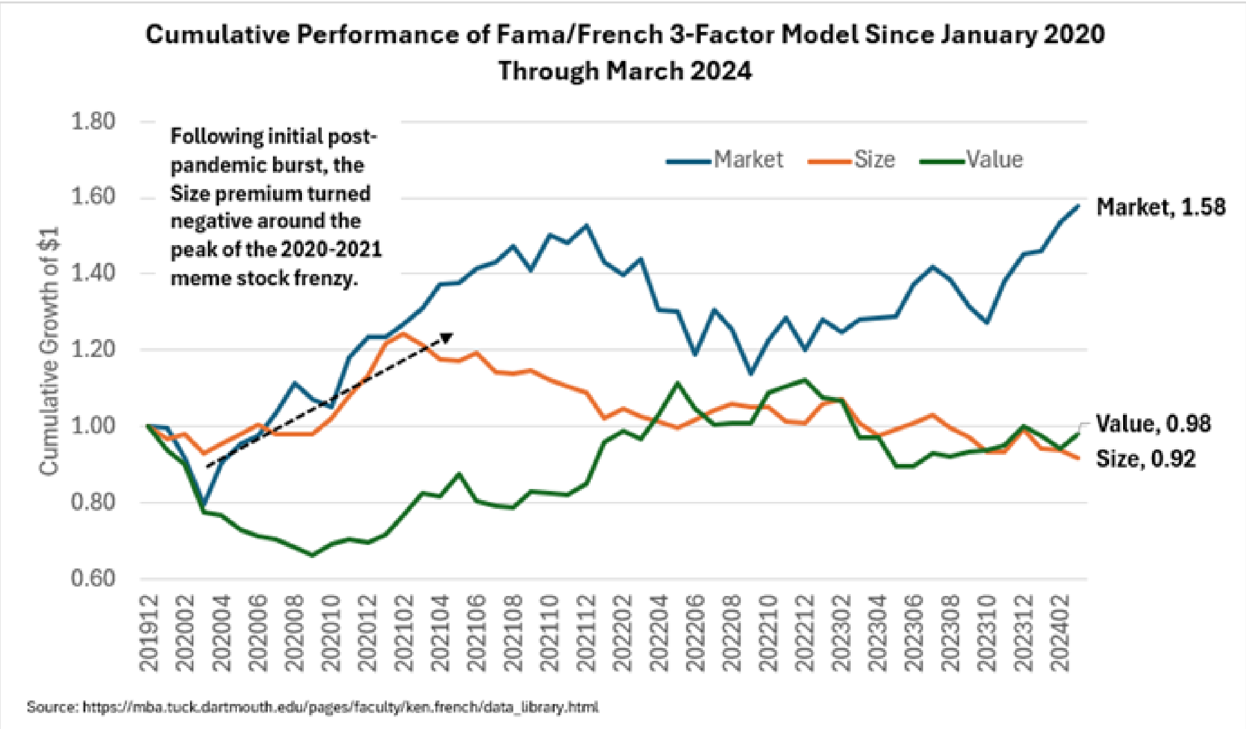
The sudden sharp advance in meme stocks resonates with the 2020-2021 post-pandemic recovery.

- Meme-stocks are broadly categorized as heavily shorted stocks targeted by the retail investment community to engineer a collective squeeze and unwind short positions. This was notably seen during the AMC and GameStop squeezes in late 2020/early 2021.
- We reference the Goldman Sachs Most Short Liquid Index as a proxy for the meme stock theme. Month-to-date through 5/14/2024, this index is up 22.1% compared to 5.7% for the Russell 2000 Index and 4.3% for the S&P 500, following reports of renewed retail buying of headline Meme stocks such as AMC and GameStop.
- Since December 2019 (the onset of the pandemic), The Most Short Liquid Index has outperformed the Russell 2000, albeit with much of the post-pandemic outperformance concentrated in the initial meme stock mania period of late-2020/mid-2021.

Source: Bloomberg

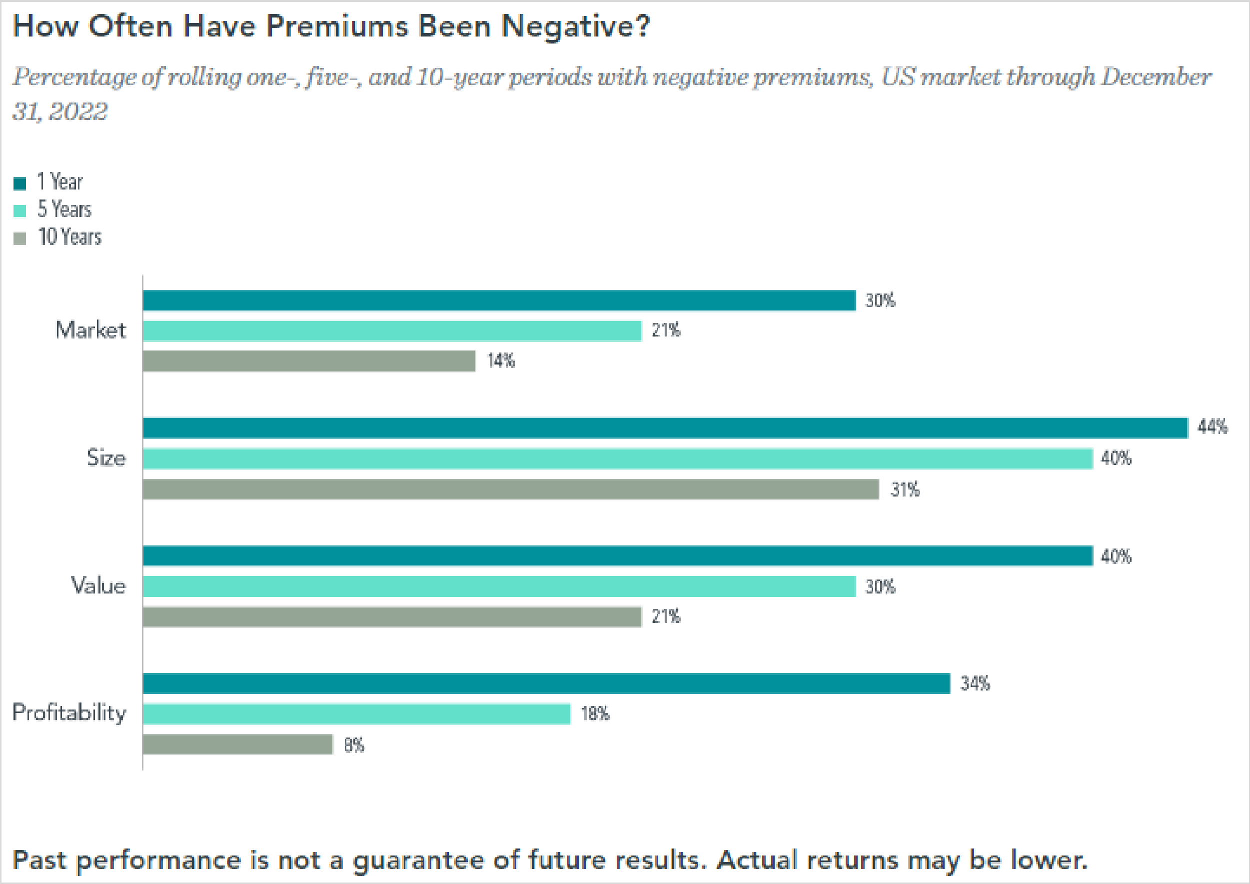
The meme stock squeeze of late 2020/early 2021 drove the last period of meaningful performance for the Size premium.

- The original Fama/French 3 Factor Model suggests that investors are compensated with observable and systematic risk premiums, including Market, Size, and Value factors.
- One would expect to be compensated for exposure to premiums beyond the Market itself, yet the post-pandemic period has seen negative performance for both Size and Value, favoring bigger and more expensive stocks.
- The chart below displays the performance of the Fama/French risk premiums since the onset of the pandemic. Notably, the last meaningful period for the outperformance of the Size premium came during late 2020/early 2021. Since then, the premium has trended down and remains negative through March 2024.
- Does this suggest that the Size premium has largely vanished in the post-pandemic era, only to resurface during fleeting moments of meme stock mania?



According to Dimensional, there can be long stretches of negative premiums, but long-term investors should stay the course.

- Although long-term history shows positive premiums, they are never guaranteed, which is the essence of risk premiums.
- The Size premium has been negative in 31% of rolling 10-year periods through 12/31/2022, compared to 14% for the Market risk premium, indicating long stretches of negativity even when the Market risk premium is positive.



Source: Dimensional, “Perspective on Premiums,” 9/19/2023

However, patience is necessary for a higher likelihood of capturing positive premiums following a period of underperformance.

- The 2nd chart below shows a historical swing back in performance following a negative 10-year period. For the Size factor, the average premium was +4.57% (-2.32% to 12.05% range) following a negative 10-year period.

Swing Back

Subsequent performance of 10-year premiums following a negative 10-year premium, US market through December 2022

	Number of Observations	Annualized Premiums for the Subsequent 10-Year Periods		
		Average	Minimum	Maximum
Market	146	9.01%	3.18%	16.57%
Size	270	4.57%	−2.32%	12.05%
Value	95	6.09%	−5.31%	13.04%
Profitability	48	4.78%	2.75%	6.71%

Past performance is not a guarantee of future results. Actual returns may be lower.

Source: Dimensional, "Perspective on Premiums," 9/19/2023

Widening your scope and horizons to other risk premiums beyond the market.

Long-term strategic allocators should consider broadening their equity allocation to increase weighting to small cap, following a long stretch of negative premiums. Consider the following strategies offered on our platform:

- Increase allocations to small and mid-cap beta exposure such as the EQIS Small Cap Value, EQIS Small Cap Growth – ETF, EQIS Mid Cap Value, or EQIS Mid Cap Growth, and their ETF equivalents.
- Managed models built on the Fama/French framework offered by 3D, Dimensional, Avantis, and Symmetry Partners.
- Actively-managed small cap strategies from our curated list of providers including Ativo Small Cap, Zacks Small Cap Equity, Glenmede Small Cap Diversified Model, Ironwood Small Cap Core, Nuveen Small Cap Select, BirdRock Small Cap Value, HJIM Global Small Cap, Sapphire Small Cap Growth, or StoneRidge Small-Mid Cap Growth.

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Except as otherwise specifically stated, all information is as of May 15, 2024.

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