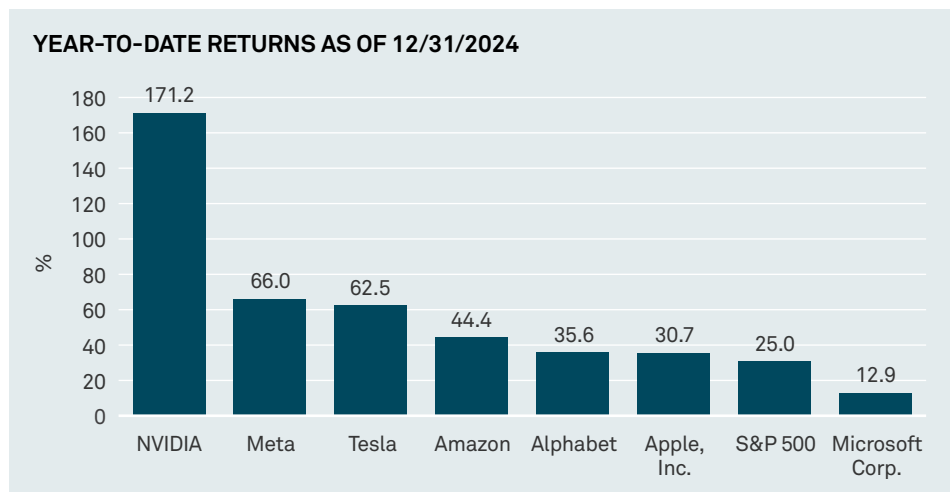


# IS THERE A NEED FOR MORE VALUE (AND TRUE VALUE) PORTFOLIO EXPOSURE?

A key tenet of portfolio construction is to diversify across asset classes, and one such view in US large cap equities (generally, securities with \$5 billion or more in market capitalization) is to diversify between growth and value.

A growth tilt over value has helped some investors in the past 10 years as the Russell 1000 Growth outperformed the Russell 1000 Value by about 2:1 (16.78% vs. 8.49% annualized).<sup>1</sup> In recent years, US large cap growth (and the S&P 500) have become highly skewed due to a small basket of names delivering outsized returns (both on the upside and downside). The composition of the basket has changed over recent time from FAANG to FAAMG<sup>2</sup> to Mag 7 with some now referring to NVIDIA as the Magnificent 1. One should not assume that just because a basket of names (or individual stocks) has driven outsized returns in the past, that they may do so going forward. For example, the names within the Mag 7 have moved around considerably in recent years:



Source: BNY Investments Portfolio Solutions Group using data from Morningstar Direct as of December 31, 2024. **The performance quoted represents past performance which is no guarantee of future results.** Charts are provided for illustrative purposes and are not indicative of the past or future performance of any product. The Magnificent 7 represents a Bloomberg total return index tracking the performance of Microsoft (MSFT), Apple (AAPL), Alphabet (GOOGL), Amazon (AMZN), NVIDIA (NVDA), Meta (META), and Tesla (TSLA). The holdings listed should not be considered recommendations to buy or sell a security.

## OBSERVATION

The S&P 500 index may not be a good diversifier. We believe some investors have more growth in their portfolios than they realize. Certain indices are highly correlated to one another. For example: The S&P 500 index is highly correlated to the Russell 1000 Growth index with an average correlation of 0.96.<sup>3</sup> (This is also echoed by Morningstar implementing a change to their Equity Style Box<sup>TM</sup>).<sup>4</sup>

## EVALUATE

Carefully consider how much Magnificent 7 (Mag 7) exposure and how much “true” growth vs. value exposure may be needed. Is the portfolio truly diversified across style or is there an unintended bias?

## ACTION

Quality large value managers may be an alternative to diversify from Mag 7 and S&P 500 exposures that may offer risk mitigation when markets experience volatility and drawdowns. We believe the BNY Mellon Dynamic Value strategy is one of the most consistent style pure strategies in the US Large Value universe.

<sup>1</sup> Morningstar Direct as of December 31, 2024. <sup>2</sup> FAANG and FAAMG are acronyms that refer to Meta (META, formerly known as Facebook), Amazon (AMZN), Apple (AAPL), Netflix (NFLX), and Alphabet (GOOG, formerly known as Google). <sup>3</sup> Morningstar Direct as of December 31, 2024. <sup>4</sup> Framework aiding investors in deciphering equity funds’ style and size characteristics relative to the broader investment universe.

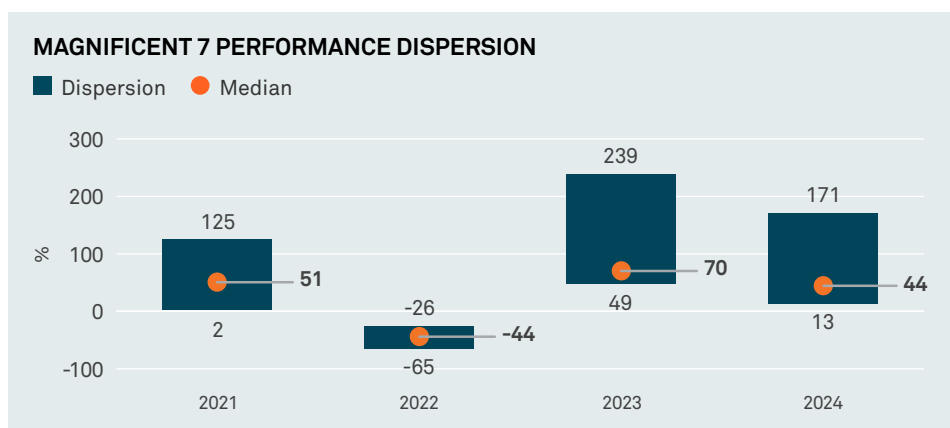
It is hardly surprising that once an acronym of a basket of stocks is defined, that it subsequently changes when a stock becomes out of favor, or one dominant name appears. This has happened through Q3 of 2024 with Microsoft underperforming and NVIDIA outperforming — hence the basket's allure declining and interest in NVIDIA (i.e., a single stock) growing. NVIDIA alone drove about 22% of the performance of the S&P 500 index year-to-date.<sup>5</sup>

Behavioral traits such as FOMO (Fear of Missing Out) and YOLO (You Only Live Once) have driven some retail investors to chase this rally and their performance experience going forward may be different than longer-term investors that may have held the names for some time.

## So how should we potentially consider allocating going forward? Should we add to growth or diversify into areas such as large value?

There is no question that we are in the early stages of adoption of Artificial Intelligence (AI) into all walks of life and therefore exposure in AI-related investments may be warranted — however, as we can see above, performance of the Mag 7 sector, considered a way to play AI (although not the only way), is varied. Diversification across growth and value may be prudent but how do various implementations between growth and value through ETFs and indices look when we look at the actual stocks that are held in such indices?

The movement in the Mag 7 has highly skewed commonly held US large cap indices and some US large cap mutual funds towards growth. Large cap growth indices (and some large-growth mutual funds) have moved even more towards growth, large cap core indices (and some large-core mutual funds) have become



Source: BNY Investments Portfolio Solutions Group using data from Morningstar Direct as of December 31, 2024. **The performance quoted represents past performance which is no guarantee of future results.** Charts are provided for illustrative purposes and are not indicative of the past or future performance of any product. The Magnificent 7 represents a Bloomberg total return index tracking the performance of Microsoft (MSFT), Apple (AAPL), Alphabet (GOOGL), Amazon (AMZN), NVIDIA (NVDA), Meta (META), and Tesla (TSLA). The holdings listed should not be considered recommendations to buy or sell a security.

more growth in style and large cap value indices (and some large value funds) have drifted towards core. These biases may mean that some investors have much more growth in their portfolios than they realize. In addition, certain indices are highly correlated to one another.

## You may not have as much value in your portfolio as you think.

A growth index like the Russell 1000 Growth index is not designed to have value exposure. Similarly, a value index like the Russell 1000 Value index is not designed to have growth exposure. However, the drift and skewness of these certain companies have distorted the actual composition and make up of certain indices.

Morningstar has implemented changes to their Equity Style Box. The changes look to address the impact of a handful of highly correlated names dominating the US equity market, which has led to a growth skew for the US large-cap equity universe in particular. The changes

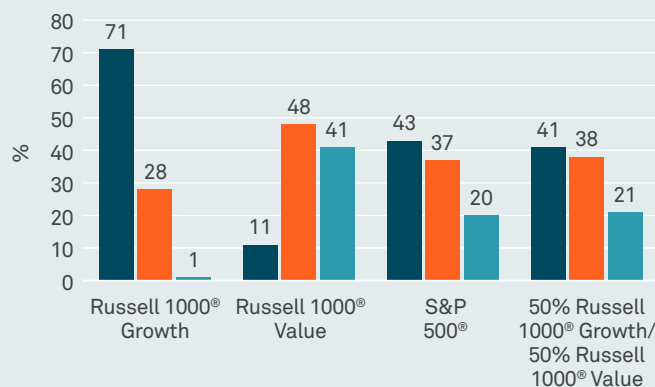
seek to ensure that each style universe, considered as its own portfolio, scores exactly at the midpoint of the value-growth spectrum. The net result of this shift could mean that certain large-cap core managers may be pushed back towards the value style category and hence there may be an opportunity for managers in the large value category, that are not consistently style pure in large value, to be more considered in the value peer group. This change may allow less style pure managers to be included in the category; but those managers will not necessarily change their investment processes or holdings and hence the resultant performance may not change.

While the indices maintain its holdings, style shifts have occurred via Morningstar's methodology update. Prior to the update, the Russell 1000 Growth index had just a 1% allocation to value names whereas the Russell 1000 Value index had 11% growth.<sup>6</sup> For example, investors seeking value exposure through an ETF which tracks the Russell 1000 Value may not be getting the true value exposure they may desire. In addition, the S&P 500 had 43% growth, 37% core and 20% value;<sup>7</sup>

<sup>5</sup> Bloomberg as of December 31, 2024. <sup>6</sup> Morningstar Direct as of June 30, 2024. <sup>7</sup> Morningstar Direct as of June 30, 2024. Morningstar classifies funds as being value, blend, or growth based on the value-growth orientation of a fund's stock holdings.

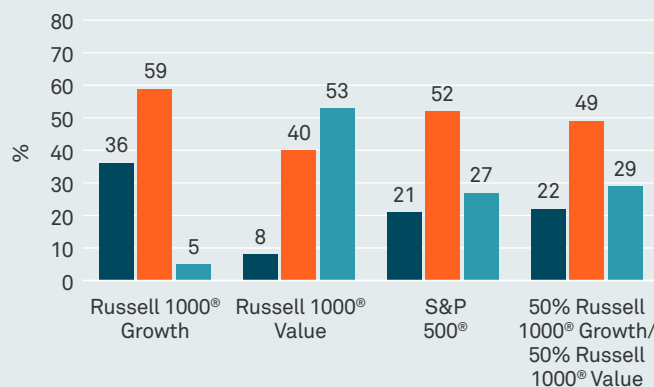
## INDICES STYLE BOX — PRE-MORNINGSTAR UPDATE

■ Growth ■ Core ■ Value



## INDICES STYLE BOX — POST-MORNINGSTAR UPDATE

■ Growth ■ Core ■ Value



Source: BNY Investments Portfolio Solutions Group using data from Morningstar as of December 31, 2024. **The performance quoted represents past performance which is no guarantee of future results.** Charts are provided for illustrative purposes and are not indicative of the past or future performance of any product.

it was a core-growth index with a 2:1 growth:value tilt. Therefore, investors that are using US large cap value and S&P 500 ETFs may have much more growth exposure and less value exposure than they realize. For example, an investor with a diversified 50/50 portfolio between the Russell 1000 Growth and Russell 1000 Value had a 2:1 ratio between growth and value. In an environment that growth may take a tumble, this investor may be more exposed because of both their large growth position and their large value positioning (from the index becoming more core-growth). We know that most drivers of the S&P 500's recent performance are growth given that the Mag 7 makes up around 34% of the index.<sup>8</sup> An S&P 500 allocation is likely to compound downward performance in this scenario. Adding in a 20% allocation to the S&P 500 to the 50/50 portfolio can move the resultant portfolio to become even more growth focused and potentially questions the validity of owning such an ETF.

## Our views on portfolio considerations

- The S&P 500 may not be a good diversifier to a portfolio of large growth and large value ETFs. We believe moving out of the S&P 500 index into “the wings” is worth considering. This may help to “dial up or down” the value to growth tilt more easily.
- Carefully consider how much Mag 7 exposure and how much “true” growth vs. value exposure may be needed.
- Quality large value managers may be an alternative to diversify from Mag 7 and S&P 500 exposures that may potentially offer risk mitigation when markets experience volatility and drawdowns.

## What role may the S&P 500 have in a diversified portfolio?

- The S&P 500 can potentially increase exposure to the Mag 7 and therefore growth sectors like technology and healthcare.
- 377 names in the S&P 500 underperformed the S&P 500 through Q4 2024.<sup>9</sup>
- 172 stocks in the index were negative through Q4 of 2024. This represented around 18% of the index weight. This was even when the S&P 500 returned 25.01%.<sup>10</sup>
- The S&P 500 is sensitive to movements in the Mag 7: 75% of the time that the Mag 7 had negative months, the S&P 500 was also negative.<sup>11</sup>
- The S&P 500 is highly correlated to the Russell 1000 Growth with an average correlation of 0.96. The two indices co-move 92% of the time (i.e., they are both up or both down).<sup>12</sup>

<sup>8</sup> Morningstar Direct as of December 31, 2024. <sup>9</sup> Morningstar Direct as of December 31, 2024. <sup>10</sup> Morningstar Direct as of December 31, 2024.

<sup>11</sup> Morningstar Direct as of September 30, 2024. Data range from January 2022–September 30, 2024. <sup>12</sup> Morningstar Direct as of December 31, 2024. Data range from January 31, 1979–December 31, 2024.

## BNY Mellon Dynamic Value Strategy: Style-pure focus/actively managed

- Empowers manager with decision-making discretion in a rapidly changing environment.
- Can differentiate securities and/or weightings compared to a passive strategy, which will follow an index composition.

- Potential to outperform — not simply track — the benchmark.
- Seeks greater flexibility and potential to mitigate risk, particularly during market downturns, compared to passive strategies, which must remain fixed to an index.
- Value Catalyst-driven strategy — value opportunities, not readily recognized by the larger market.
- Seek style purity in an active manager within large core and large value.

We believe the BNY Mellon Dynamic Value strategy is one of the most consistent style pure strategies in the US Large Value universe. The strategy can potentially complement existing large growth managers, and be a diversifier away from the S&P 500. The BNY Mellon Dynamic Value strategy strives for a true value quality approach, one that is true to its investment process. For example, one of the large representative accounts managed under the strategy has been classified as Large Value on Morningstar's Equity Style Box 98% of the time for the previous 40 quarters.<sup>13</sup>

<sup>13</sup> Morningstar Direct as of June 30, 2024.

## LEARN MORE

Call 1-800-373-9387 or visit [bny.com/investments](https://bny.com/investments).

**All investments involve risk including loss of principal. Certain investments involve greater or unique risks that should be considered along with the objectives, fees, and expenses before investing.**

No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment.

**Past performance is no guarantee of future results.**

**Asset allocation and diversification cannot assure a profit or protect against loss.**

Neither Morningstar nor any of its information providers can or do guarantee the accuracy, completeness, timeliness, or correct sequencing of any of the information available through this application, including, but not limited to, information originated by Morningstar, licensed by Morningstar from its information providers, or gathered by Morningstar from publicly available sources. There may be delays, omissions, or inaccuracies in the information. "BLOOMBERG" and the Bloomberg indices listed herein (the "Indices") are service marks of Bloomberg Finance L.P. and its affiliates, including Bloomberg Index Services Limited ("BISL"), the administrator of the Indices (collectively, "Bloomberg") and have been licensed for use for certain purposes by the distributor hereof (the "Licensee"). Bloomberg is not affiliated with Licensee, and Bloomberg does not approve, endorse, review, or recommend the financial products named herein (the "Products"). Bloomberg does not guarantee the timeliness, accuracy, or completeness of any data or information relating to the Products.

The Russell 1000® Growth Index measures the performance of the large cap growth segment of the US equity universe.

The Russell 1000® Value Index measures the performance of the large cap value segment of the US equity universe.

S&P 500® TR Index is an index designed to track the performance of the largest 500 US companies.

Indexes are unmanaged and one cannot invest directly in an index. Growth stocks generally are stocks that have higher growth rates (in share prices, revenue, profits or cash flow) than the overall market. Value stocks are generally priced lower than their intrinsic values measured by their fundamentals (e.g., price to book ratio) compared to the overall market. Core holdings generally are established, large capitalization companies that are financially healthy with proven records of stable growth.

References to specific securities are for illustrative purposes only and are not intended as recommendations to purchase or sell securities.

This material has been provided for informational purposes only and should not be construed as investment advice or a recommendation of any particular investment product, strategy, investment manager or account arrangement, and should not serve as a primary basis for investment decisions. Prospective investors should consult a legal, tax or financial professional to determine whether any investment product, strategy or service is appropriate for their circumstances. Views expressed are those of the author stated and do not reflect views of other managers or the firm overall. Views are current as of the date of this publication and subject to change. This information contains projections or other forward-looking statements regarding future events, targets, or expectations, and is only current as of the date indicated.

There is no assurance that such events or expectations will be achieved, and actual results may be significantly different from that shown here. The information is based on current market conditions, which will fluctuate and may be superseded by subsequent market events or for other reasons. References to specific securities, asset classes and financial markets are for illustrative purposes only and are not intended to be and should not be interpreted as recommendations. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission.

BNY Investments Portfolio Solutions Group offers products and services including investment strategies that are developed by affiliated BNY investment firms.

Personnel of certain of our BNY affiliates may act as: (i) registered representatives of BNY Mellon Securities Corporation (in its capacity as a registered broker-dealer) to offer securities and certain bank-maintained collective investment funds, (ii) officers of The Bank of New York Mellon (a New York chartered bank) to offer bank-maintained collective investment funds, and (iii) Associated Persons of BNY Mellon Securities Corporation (in its capacity as a registered investment adviser) to offer separately managed accounts managed by BNY firms.

BNY Investments is one of the world's leading investment management organizations, encompassing BNY's affiliated investment management firms and global distribution companies. BNY is the corporate brand of The Bank of New York Mellon Corporation and may be used to reference the corporation as a whole and/or its various subsidiaries generally.

© 2024 BNY Mellon Securities Corporation, distributor, 240 Greenwich Street, 9th Floor, New York, NY 10286.

**Not FDIC-Insured. Not Bank-Guaranteed. May Lose Value.**