Why Now is the Time for Active Management in US Equities

Confidence must be earned

Amundi
ASSET MANAGEMENT

Key Insights

- We believe active equity managers are positioned to outperform passive approaches for the next few years.
- The reason has to do with market concentration. We believe market concentration is set to decrease from its recent peak, which should be a tailwind for active equity managers who underweight the largest five stocks for diversification[1] reasons.
- In 2000-2002, after the dot-com bubble burst, more than 60% of active managers outperformed their benchmarks.[2] We believe the next few years could follow a similar pattern if index concentration declines, which, in our view, is likely.
- A shift toward value stocks and away from growth, as well as elevated market volatility, may further support the performance of active managers.
- The average top-quartile active large blend manager (as measured by Morningstar) outperformed the S&P 500 by a wide margin during each market correction since 2000, demonstrating that skilled active managers can outperform the Index in down markets.

[1] Diversification does not assure a profit or protect against loss. [2] Source: Bloomberg, as of April 30 (see chart page 4).

Why Passive Managers Have Outperformed in Recent Years

We believe a contributing factor to the outperformance of passive over active managers in recent years has been high levels of market concentration.

Since 2013, as shown below, concentration in the S&P 500 Index among the ten largest stocks has increased. These stocks have outperformed the Index as they have increasingly dominated their industries over the past decade, and benefited from the pandemic-induced stay-at-home environment in which people increasingly used technology to communicate, shop, and work.

During this period, the majority of active managers lagged the return of the S&P 500 Index. Most recently, in 2021, only 19% of active US large-cap blend managers outperformed, according to Strategas Data. As of year-end 2021, the ten largest stocks in the S&P 500 represented just below 30% of the Index, far higher than at the peak in the previous cycle of concentration during the dot-com bubble. We believe the reason active managers have struggled to keep pace in recent years is that they have tended to underweight the largest stocks in the S&P 500 for diversification and risk control purposes.

Historical Weights of the 10 Largest Stocks in the S&P 500

Top 10 as of 6/14/22	Weight	Fwd PE
S&P 500	**100%**	**16.3**
Apple	6.5%	22
Microsoft	5.8%	24
Alphabet	3.9%	16
Amazon.com	2.8%	36
Tesla	1.8%	52
Berkshire	1.6%	20
J&J	1.4%	17
UnitedHealth	1.4%	21
Exxon	1.3%	9
NVIDIA	1.3%	29
Total | Avg	**27.8%**	**24**

Source: Bloomberg and Amundi Research as of 6/14/22. **Forward Price-Earnings Ratio (Fwd PE)** is the current price of a stock divided by the consensus analyst estimates of 1-year projections of its earnings per share. Securities listed are not meant to represent any current or future holding of an Amundi US portfolio, and should not be considered recommendations to buy or sell any security. The **S&P 500 Index** is a commonly used measure of US stock market performance. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index.**Past performance is no guarantee of future results.**

Why Now Might Be the Time to Invest with an Active Approach

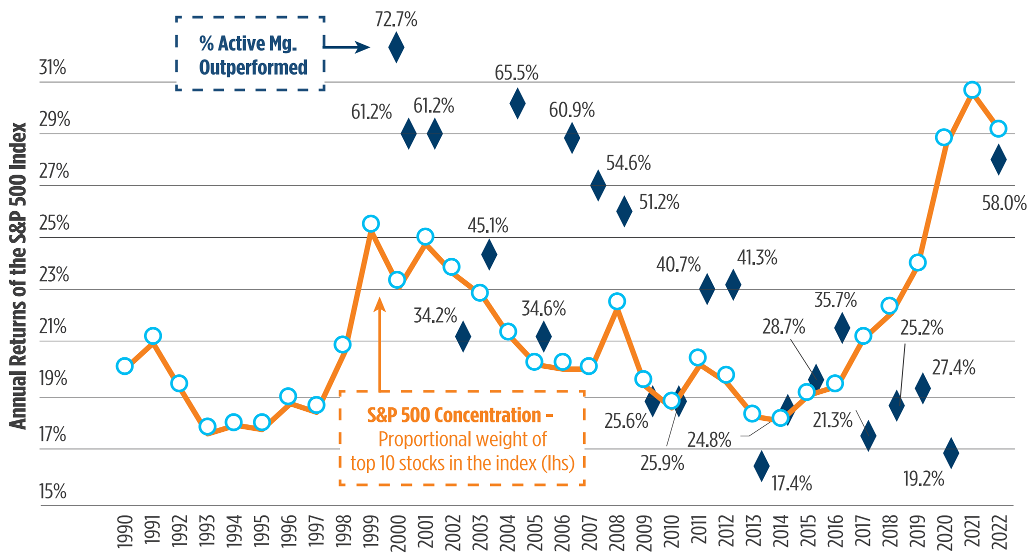
S&P 500 Index concentration, in our view, may be peaking. While companies such as Amazon and Microsoft may remain dominant in their industries, their gigantic revenue bases could make it difficult to sustain earnings growth rates at the pace needed to justify their stock valuations. In addition, regulatory risks could prevent big tech from favoring their own products in search results, and from taking competitive actions against smaller companies. There is also execution risk. Tesla is facing increased competition from traditional car manufacturers, while shares of Meta Platforms dropped precipitously in early 2022, falling out of the top five, after reporting lower than expected financial results.

The market, recognizing that mega-cap companies are not the only ones with the potential to generate earnings growth, has begun to broaden its focus. The S&P 500 Equal Weight Index has outperformed its big tech dominated, capitalization-weighted counterpart, the S&P 500 Index, since October 2020. In addition, the equal-weighted versions of seven of the eleven S&P 500 sectors outperformed their cap-weighted counter-parts year-to-date through March 2022.[3]

For historical context, the last time concentration in the S&P 500 Index fell precipitously was after the dot-com bubble burst, as can be seen below. The percentage of active large blend managers that outperformed from 2000-2002 was above 60% each year, according to Strategas Data.

Although the stability of their earnings streams may help big tech stocks hold up well in the near-term if a recession occurs, we believe the next few years may follow a pattern similar to that of 2000-2002. With growth for the largest companies maturing, and regulation increasing, investors may look elsewhere for returns, causing the S&P 500 to become less concentrated. If this occurs, active managers that are underweight big tech may be positioned to benefit.

More than Half of Active Managers Outperformed After the Last Peak in S&P 500 Concentration



Source: Amundi US and Bloomberg, as of 30 April 2022. Percent of active manager outperformance based on Lipper Large Cap Core Universe 12/29/00 - 4/30/22. Source: Strategas. The **S&P 500 Index** is a commonly used measure of US stock market performance. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index.

[3] Source: Bloomberg as of April 30, 2022.

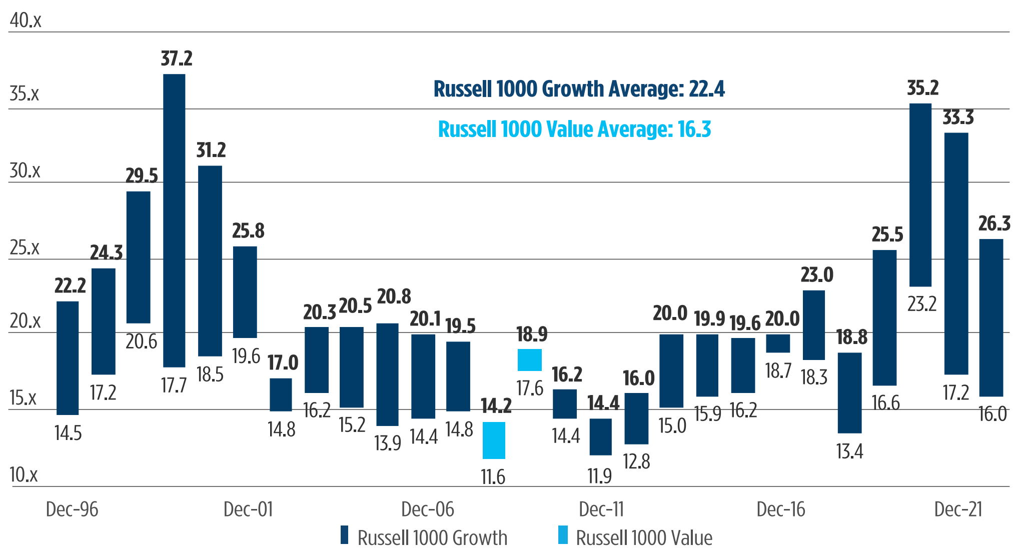
A Value Rotation Supports Active Management

According to Morningstar data, the S&P 500 stylistically sits on the growth side of the core universe, while the Morningstar US Active Fund Large Blend Average, which is a simple average of all active managers in Morningstar's Large Blend category, is slightly less growth oriented. When growth has outperformed value, active blend managers have had difficulty outperforming the S&P 500 unless they have even more growth exposure than the S&P 500, which can be difficult to achieve while still residing in the large core style box. Conversely, active blend managers – especially those with more exposure to value than the S&P 500 – have benefitted when value outperformed growth. This trend appeared to play out in the first quarter of 2022, when value outperformed growth and 44% of active US large cap blend managers outperformed the S&P 500 (still not over 50%, but much higher than in 2021)[4].

We Believe Value Will Continue to Outperform Growth For Two Reasons

Valuation: As shown below, the Russell 1000 Growth Index traded at an 10.3x multiple point premium to the Russell 1000 Value Index as of April 30. This premium is twice as high as it has been on average over the past 26 years. While growth stocks deserve a premium in our view due to their faster growth and higher profitability than value stocks, the premium is currently unsustainably high in our view and may narrow.

Growth's P/E Premium to Value is Wide by Historic Standards



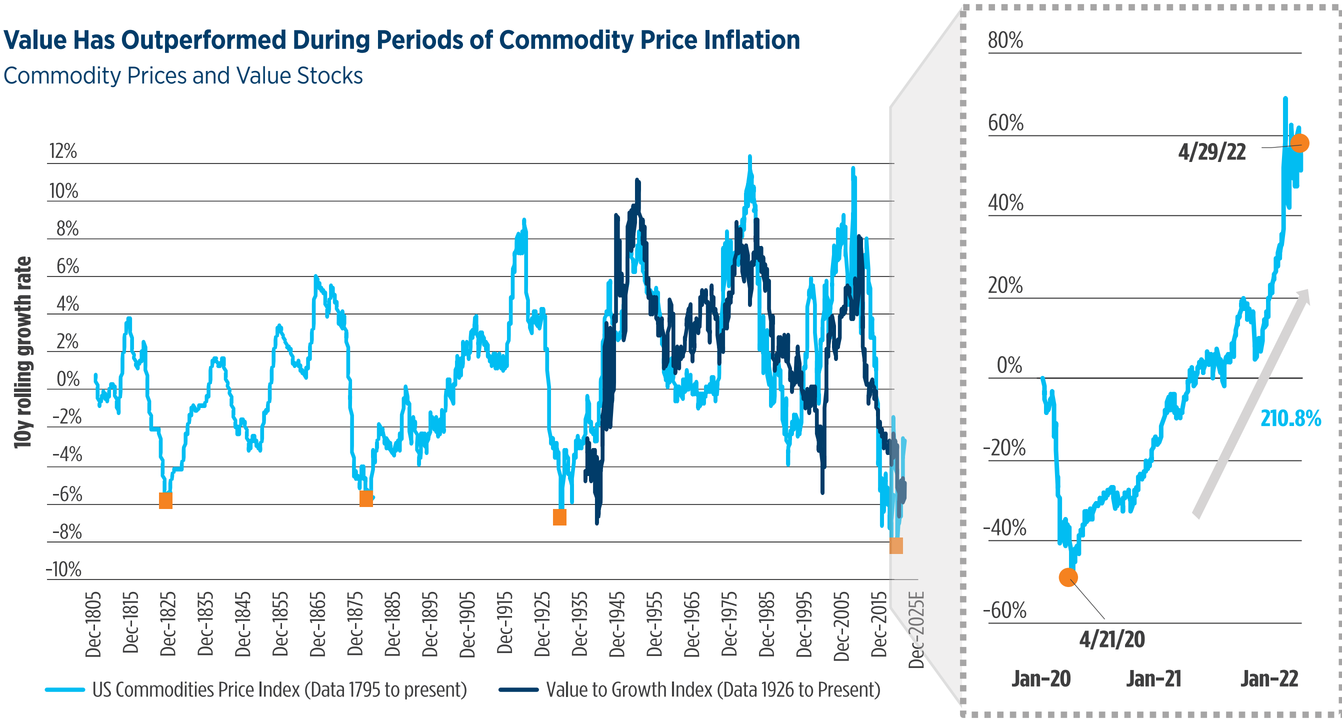
Source: Amundi US and Bloomberg, as of 30 April 2022. Averages since 12/31/96. The **Russell 1000® Value Index** measures the performance of large cap US value stocks. The **Russell 1000® Growth Index** measures the performance of large cap US growth stocks. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index. **Past performance does not guarantee future results.**

[4] As of April 30, the Morningstar Large Cap Blend category was outperforming the S&P 500 Index YTD.

Inflation: There has been a strong historical link between changes in commodity prices and the outperformance of value stocks relative to growth stocks. The reason has been the value universe's greater exposure than growth to commodity-oriented sectors such as energy, industrials, and materials. The largest value sector, financial services, also has typically benefitted from higher inflation as interest rates and banks' net interest margins increase. Higher interest rates can also increase the cost of capital, negatively affecting the valuations of large-cap growth stocks, many of which have been contributing to market concentration.

Value Has Outperformed During Periods of Commodity Price Inflation

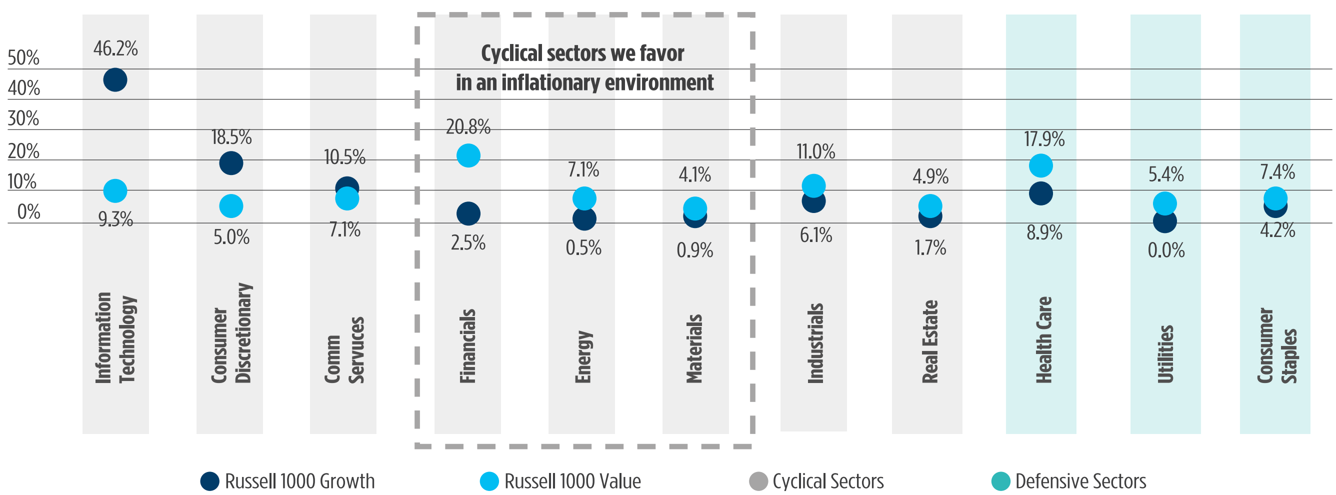
Commodity Prices and Value Stocks



Left Chart: Source: Stifel Equity Research. Data as of April 30, 2022. **Blue line** represents US Commodity Price Index, a weighted average of selected commodity prices. **Indices used in Stifel research:** Warren & Pearson Commodity Index (1795-1912), WPI Commodities (1913-25) and equal-weighted (one-third each). PPI Energy, PPI Farm Products and PPI Metals (ferrous and non-ferrous) ex-precious metals (1926-56), Refinitiv equal weight (CCI) index (1956-94) and Refinitiv core commodity CRB Index (1994 to present). Value vs. growth links the Fama/French (Dartmouth/Tuck web-hosted) series from 1926-77 and the Russell 1000 Total Return Index, 1978 to present. **Right chart:** Goldman Sachs Commodities Index, Source: Bloomberg for period shown.

Value Has More Exposure to Commodity and Financial Sectors

Sector Exposures of the Russell 1000 Value vs. Russell 1000 Growth Indexes



Source: Bloomberg as of April 28, 2022. Bottom figures represent the weight of the oppositely colored measurement.

How Active Management Has Fared in Down Markets

With market volatility rising, a question worth considering is how active managers have fared when markets decline. We believe the answer is: well. As seen below, there have been nine market corrections (10% or greater decline) since 2000.

On average, active managers, as measured by the Morningstar Large Blend category, outperformed the S&P 500 Index in five of the nine periods by a small margin, indicating that active managers may fare better during market corrections. Of course, past performance does not guarantee future results.

The story is even more compelling when we turn to the performance of top-quartile active managers. Top-quartile active large blend managers, on average, outperformed the S&P 500 by wide margins over all nine periods of market correction, making a strong case that skilled active large blend managers can potentially outperform the index in down markets.

This also holds true when we turn to the performance of active managers during bear markets. More than half of active managers in Morningstar's Large Blend category outperformed in each of the four periods since 1987 when the S&P 500 declined by more than 20%, making a strong case that active managers have historically outperformed during bear markets.

Top Quartile Active Managers Have Outperformed During Market Corrections

Start Date	End Date	S&P 500 Index	Morningstar US Active Large Blend	Relative Performance	US Active Top Quartile	Relative Performance
9/2/00	**10/9/02**	-47.41%	-48.37%	-0.96%	-20.24%	**27.17%**
10/10/07	**3/9/09**	-55.25%	-54.84%	**0.41%**	-46.12%	**9.13%**
424/10	**7/2/10**	-15.63%	-15.78%	-0.15%	-12.86%	**2.77%**
4/3/11	**10/3/11**	-18.64%	-20.91%	-2.27%	-16.01%	**2.63%**
7/21/15	**8/25/15**	-12.04%	-11.60%	**0.44%**	-9.81%	**2.23%**
11/4/15	**2/11/16**	-12.71%	-13.89%	-1.18%	-9.96%	**2.75%**
1/27/18	**2/8/18**	-10.10%	-9.76%	**0.34%**	-8.82%	**1.28%**
9/21/18	**12/24/18**	-19.36%	-19.28%	**0.08%**	-16.17%	**3.19%**
2/19/20	**3/23/20**	-33.47%	-33.33%	**0.14%**	-30.89%	**2.58%**

Source: Morningstar as of April 30, 2020. **Past performance does not guarantee future results.**

More than Half of Active Managers Have Outperformed During Bear Markets

Start Date (Beginning of Month as Proxy)	**End Date** (Beginning of Month as Proxy)	**% of Morningstar US Active Large Blend Managers Outperforming**
8/25/87	**12/4/87**	77%
3/24/00	**10/9/02**	61%
10/9/07	**3/9/09**	65%
2/19/20	**3/23/20**	55%

Source: Morningstar as of April 30, 2022, Bernstein Analysis. **Note:** Active manager performance data is monthly. Periods are rounded to the nearest month-end. **Past performance does not guarantee future results.**

A Potential Near-Term Risk for Active Managers

As the US Federal Reserve begins a tightening cycle to address rising inflation, and as the global economy faces additional headwinds resulting from the Russia-Ukraine conflict, there is a possibility that we could enter an economic recession. A recession could cause investors once again to favor the earnings stability of mega-cap tech stocks for a period. Despite this near-term risk, we remain optimistic that active managers are likely to outperform over the next few years.

Conclusion

As we depart an era of low inflation and easy access to capital and enter a period marked by higher inflation, higher commodity prices, and higher interest rates, we believe the market is set to rotate out of the narrow cohort of mega-cap growth stocks that have been leading the market. We believe active managers may benefit from this shift as excessive concentration levels in US equities unwind, providing greater market breadth. In an increasingly favorable environment for active managers, and at a time when there is increasing pressure on investors to invest responsibly, we believe investors should consider allocating to active managers with proven track records.

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