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Stratified SmallCap:

Outperformance through Diversification

Following several years of underperformance, investors are showing a renewed interest for small cap stocks. The S&P SmallCap 600 index rose 31.3% in Q4 2020, outperforming the S&P 500 by 19.2%, its strongest quarterly outperformance since the index began in 1994. The Syntax Stratified SmallCap Index showed even stronger performance than its cap-weighted analog, rising 32.0% over the quarter (Exhibit 1). The strong performance could signal an investor preference for the growth potential of small cap companies, coupled with their reasonable valuations, especially relative to their large cap counterparts.

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Stratified Weight is a diversified way to gain exposure to an asset class. By allocating across a wider range of business groups than cap-weighted benchmarks (which typically have concentrated positions in certain stocks and industries), Stratified Weight balances exposure to different types of businesses. This means the index has at least some allocation in the best performing segments, while not over-allocating to the worst performing ones and as such is designed to generate outperformance through diversification.

Exhibit 1. Performance of S&P 600 and Stratified SmallCap index



Stratified SmallCap Index

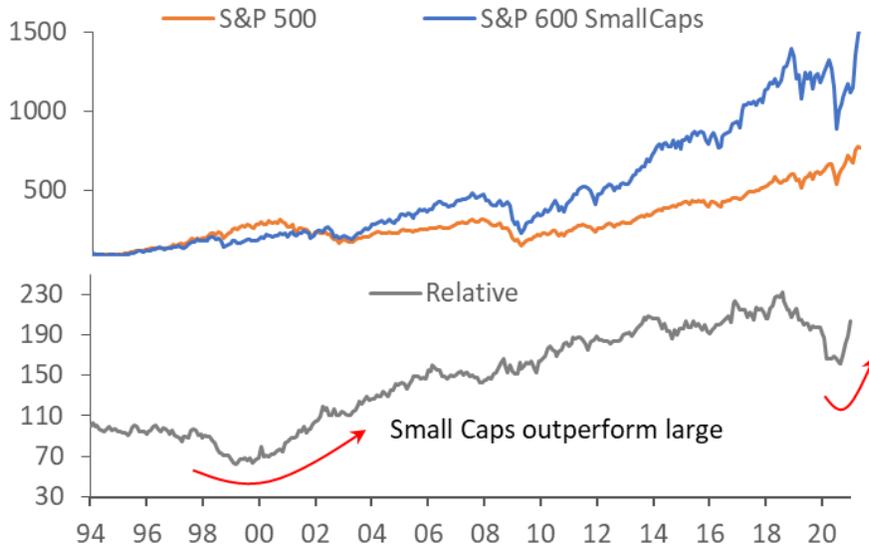
- Stratified Weight version of S&P SmallCap 600
- Index: SYSCTR
- Holdings: 601
- Calculated by S&P Dow Jones Indices

Index	Ticker	Jan 2021	Q4 2020	1 YR	3 YR	5 YR	7 YR
Stratified SmallCap	SYSC	10.4	32.0	25.4	12.9	15.0	11.4
S&P 600	SML	6.3	31.3	11.3	7.7	12.4	9.3
S&P 600 Equal Weight	SMLEWI	9.7	35.1	14.7	7.6	12.2	8.2

Source: Syntax, S&P Dow Jones Indices. Total return performance does not reflect fees or implementation costs as an investor cannot directly invest in an index. Please see important disclaimers regarding backtested data prior to inception.

From a longer-term perspective, the recent outperformance of small caps represents a reversal in the S&P 500's dominance since 2016, driven mainly by the outperformance of mega-cap tech stocks. A similar trend was seen in the late 1990s, before the DotCom bubble burst, and small caps consistently outperformed large caps over the following fifteen years (Exhibit 2).

Exhibit 2. Performance of S&P 500 vs S&P SmallCap 600 index



Source: Syntax, S&P Dow Jones Indices.

The outperformance of small caps has the potential to persist given that it is supported by attractive relative valuations, similar to those seen at the height of the DotCom bubble (Exhibit 3).

Exhibit 3. The S&P 600 trades at a historical discount to the S&P 500



Source: Bloomberg, Syntax. Price to 12-month-forward sales ratio.

On January 31st 2021, the S&P 500 was trading at 2.6x next-year's sales, whereas the S&P 600 was trading at 1.1x, a 58% discount.

The Stratified SmallCap Index consistently trades on a lower multiple than the S&P 600, as its quarterly rebalancing schedule typically reweights away from those stocks and industries that have had the strongest performance over the quarter. On January 31st 2021, the Stratified SmallCap Index was trading at 0.8x next-year's sales, a 69% discount to the S&P 500 and a 26% discount to the S&P 600.

Stratified SmallCap: Outperformance through Diversification

We believe that the outperformance of Stratified Weight versus Cap Weight within the small cap universe is a function of the weighting methodology (since the two indices are composed of the same securities, at different weights). The more diversified business risk exposure enabled the best performing sectors in Q4 (Consumer and IT) to have a significant weight in the index. Conversely, the worst performing sectors (Financials and Industrials) were not over allocated, unlike the S&P 600 (Exhibit 4).

Exhibit 4. S&P 600 has significant financials and industrials concentrations

	Stratified Small Cap	S&P 600	Relative Weight	Relative Performance Q4 2020
Large Exposure				
Industrials	13.9	23.6	9.7	-1.1%
Financials	14.1	23.5	9.4	-5.9%
Small Exposure				
Consumer	14.1	12.7	-1.4	8.1%
IT	14.9	11.0	-3.9	7.1%
Healthcare	14.8	10.4	-4.3	-6.6%
Energy & Food	14.1	9.5	-4.6	-4.3%
Information	14.1	9.3	-4.8	2.4%

Source: Syntax, S&P Dow Jones Indices. Total return performance does not reflect fees or implementation costs as an investor cannot directly invest in an index.

We believe that the Stratified SmallCap Index, with its diversified allocation and favorable valuations, represents an attractive way for investors to capture the small cap premium.

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