

For Public Companies: Understanding the Market for US Equities

March 2023



Long Secular Decline for Stock Picking

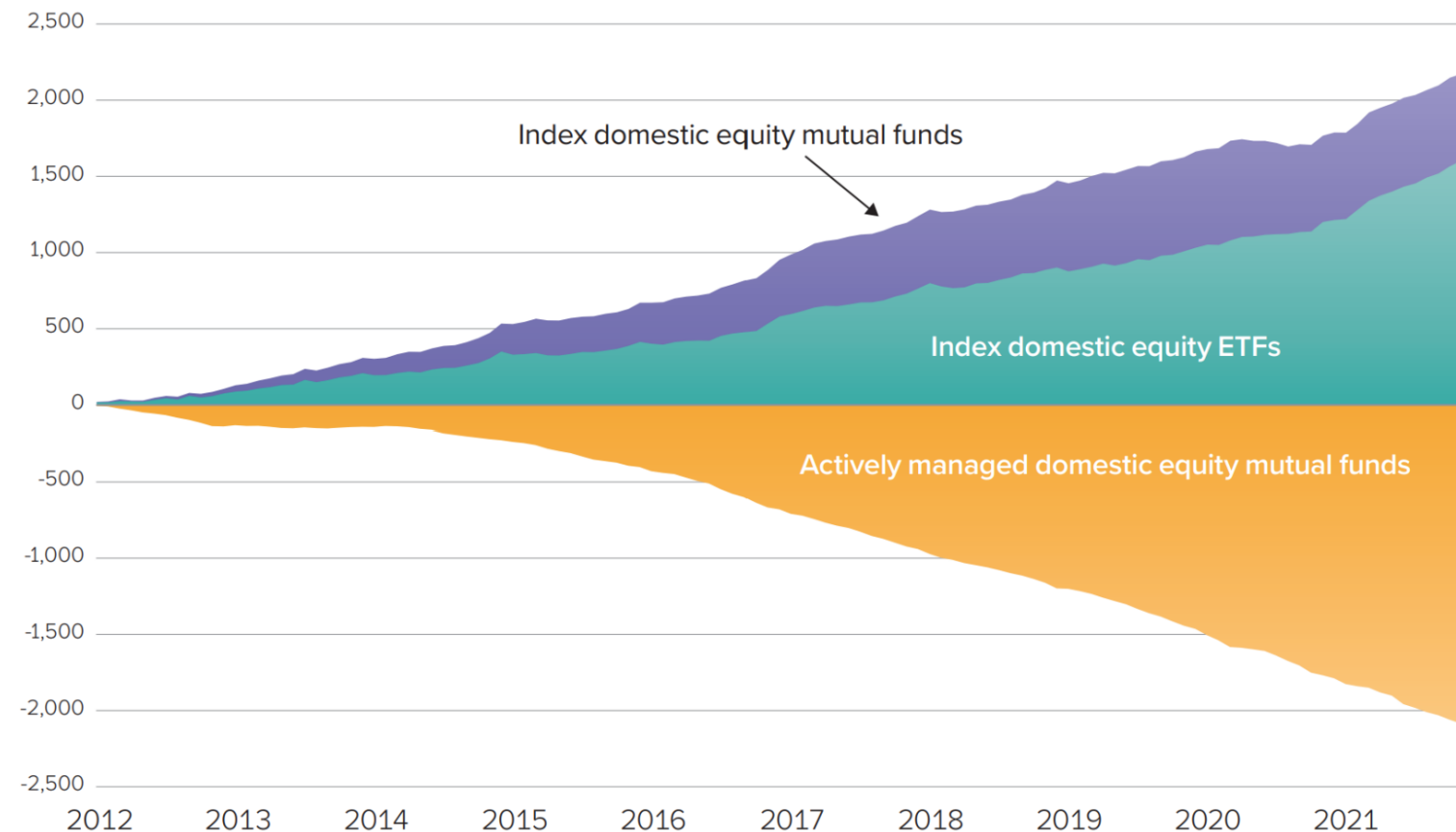
Page 54, ICI 2022 Factbook:

“...Demand for ETFs has been very strong over the past decade. Domestic equity ETFs had net creations in every month of 2021, which resulted in \$520 billion in net share issuance. In contrast, domestic equity mutual funds had net outflows of \$419 billion over the same period.”

FIGURE 3.16

Some of the Outflows from Domestic Equity Mutual Funds Have Gone to ETFs

Cumulative flows to domestic equity mutual funds and net share issuance of index domestic equity ETFs, billions of dollars, monthly



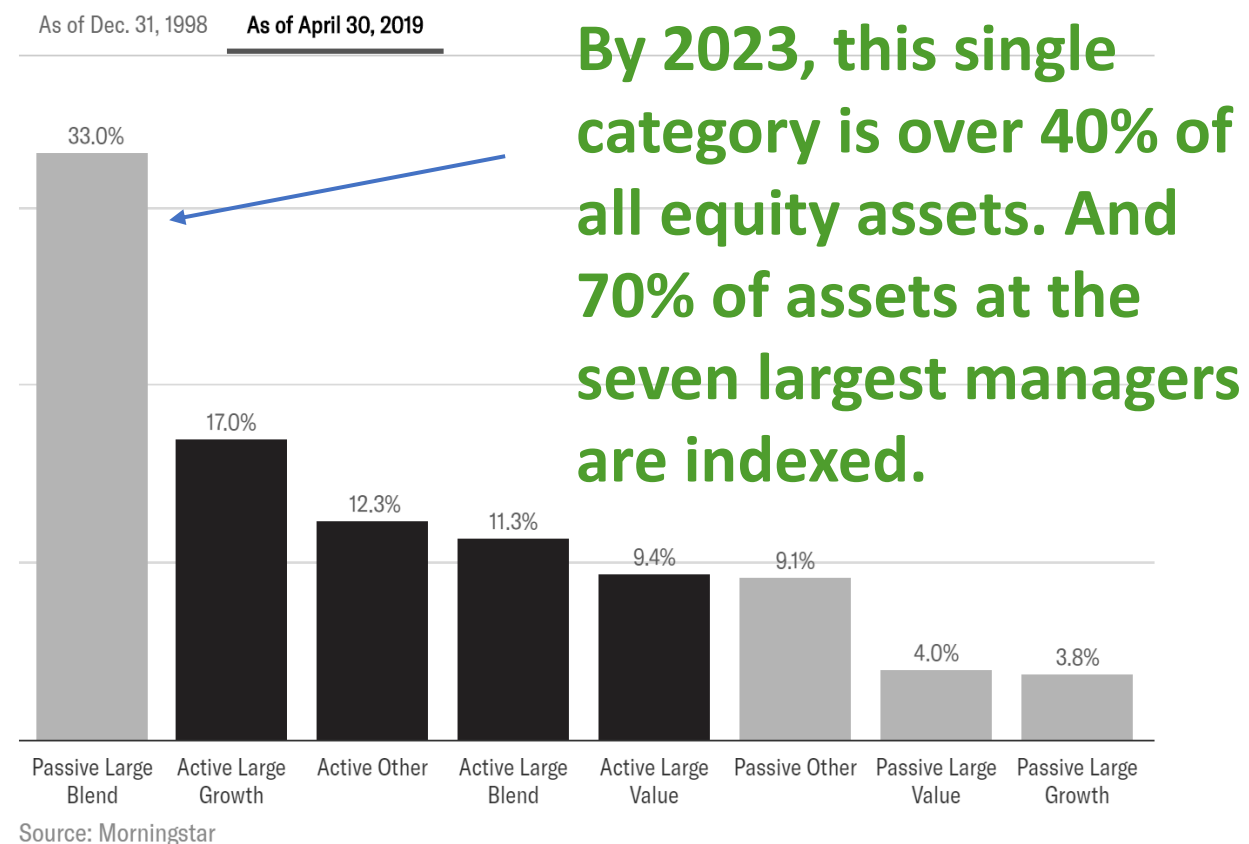
Source: Investment Company Institute 2022 Factbook

Note: Mutual fund data include net new cash flow and reinvested dividends; ETF data for net share issuance include reinvested dividends.

Passive vs Active: Passive leads by 2019

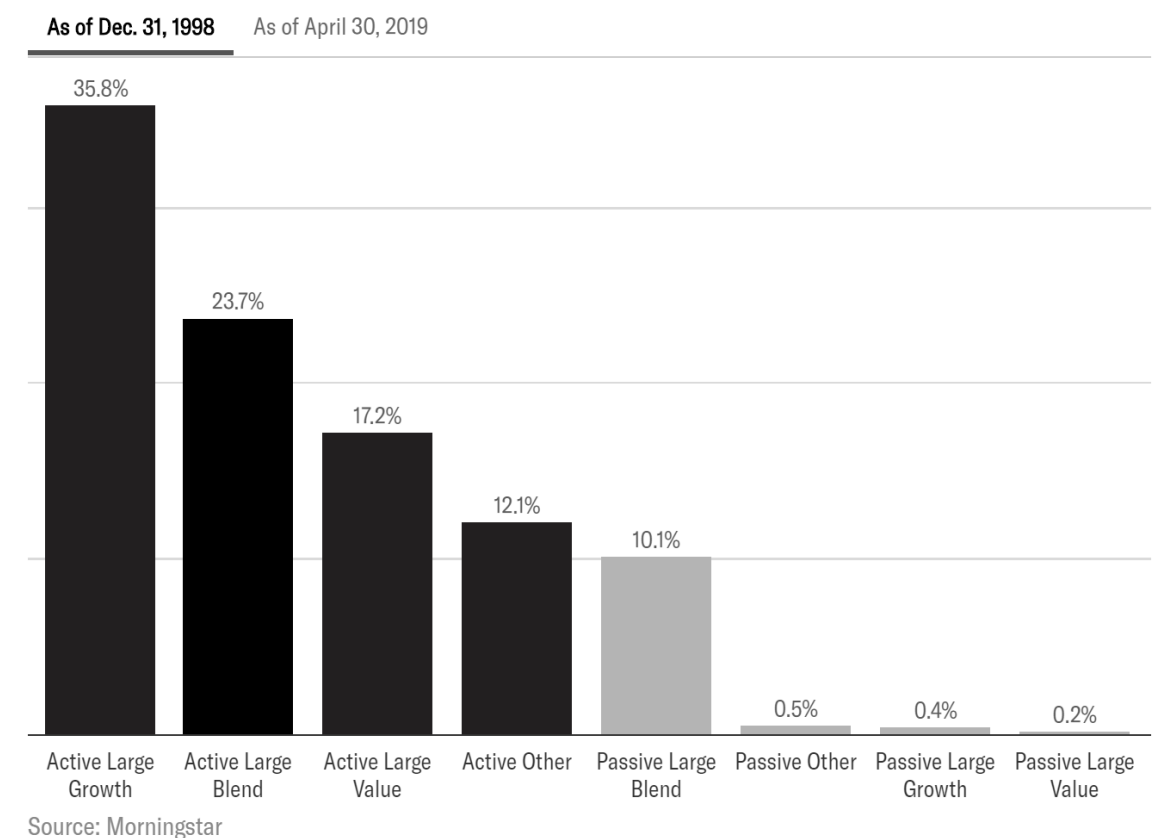
Passive Goes Massive

Percentage of assets in U.S. equity funds by investment type



Passive Goes Massive

Percentage of assets in U.S. equity funds by investment type



Stock Pickers Are Not Winning Assets

Morningstar puts out a [semiannual barometer](#) comparing Passive and Active Investment performance. The most recent is through September 2022. It looks at whether Active funds beat Passive peers and benchmarks over periods.

Excerpt:

*Actively managed U.S. large-cap equity funds' recent woes match a longer trend: They generally succeed less often than active U.S. mid- and small-cap funds over long horizons. **In the decade through June 30, 2022, 10.7% of active large-cap funds lived and outperformed their average passive peer**, compared with success rates of 24.7% and 31.7% among actively managed mid- and small-cap funds, respectively.*

***Active managers in the large-growth category have had a particularly difficult time delivering value for investors.** Nearly 70% of the active funds that existed in this category 20 years ago have died, and just 2.3% managed to both survive and outperform their average passive peer.*

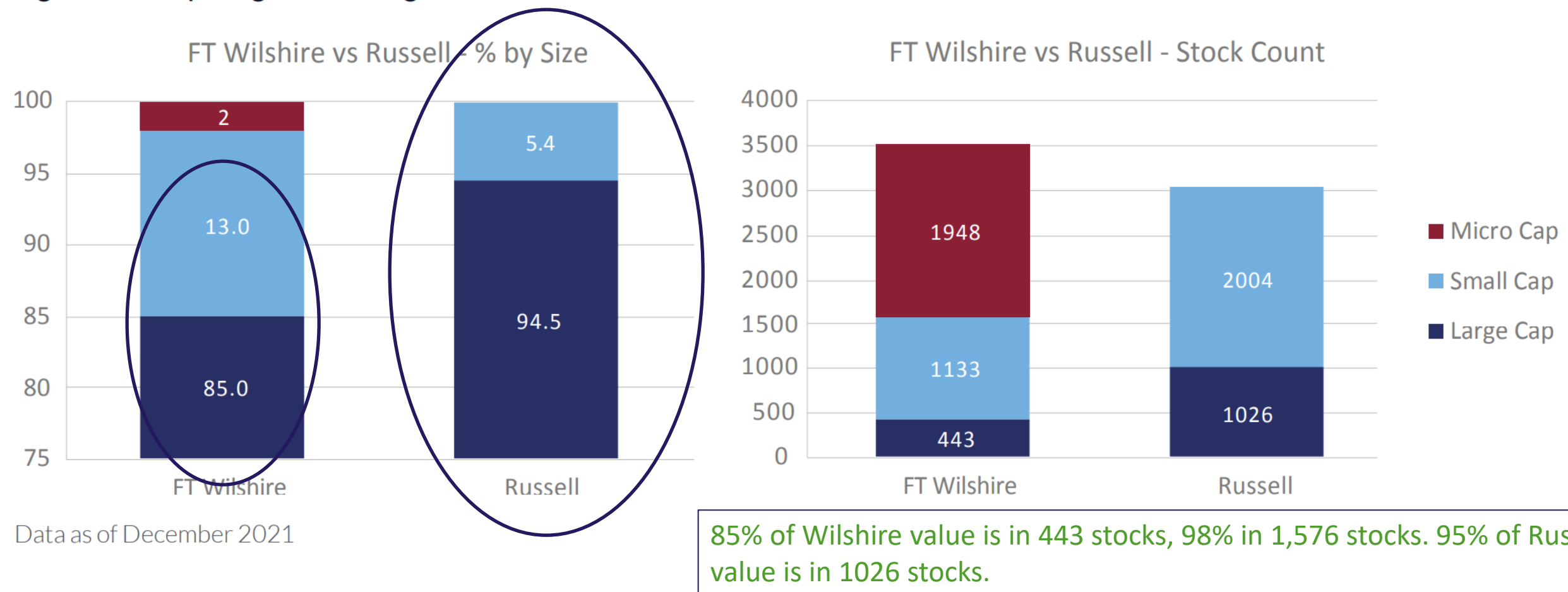
Translation:

Over the last decade, between 11-32% of Actively managed funds likely attracted capital.

The Money is in the Russell 1000

The results of applying the two different segmentation schemes to the US market in December 2021 are displayed graphically in figure 2:

Figure 2: Comparing the Size segments of the FT Wilshire 5000 and the Russell 3000



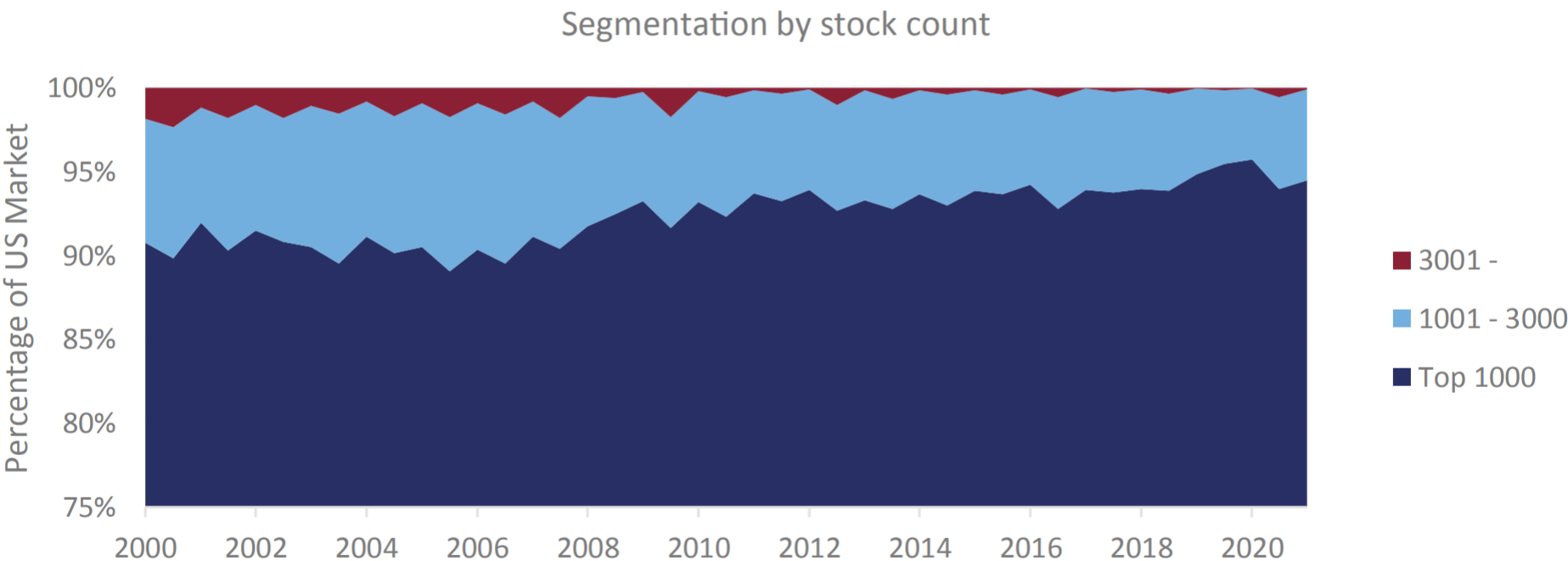
SOURCE: Wilshire Associates. https://assets.website-files.com/60f8038183eb841e628c14df/62ceec895218c176d80032c8_Wilshire-SeeingThroughTheSizeMirageInUSEquities-ResearchNote_June2022%20FINAL.pdf

Wilshire 5000: 90+% in Top 1000

Stability of Size Segments through time

For both schemes one could argue that the breakpoints are somewhat arbitrary, however, the choice of one or the other has dramatic consequences for the stability of what constitutes the Large, Small and Micro Cap universes. Figure 3 shows how the split of the total US market has varied over the last two decades for count-based and cumulative market cap-based schemes:

Figure 3: Segmentation of the US Market by Stock Count and Cumulative Market Capitalization



Index characteristics - Weights

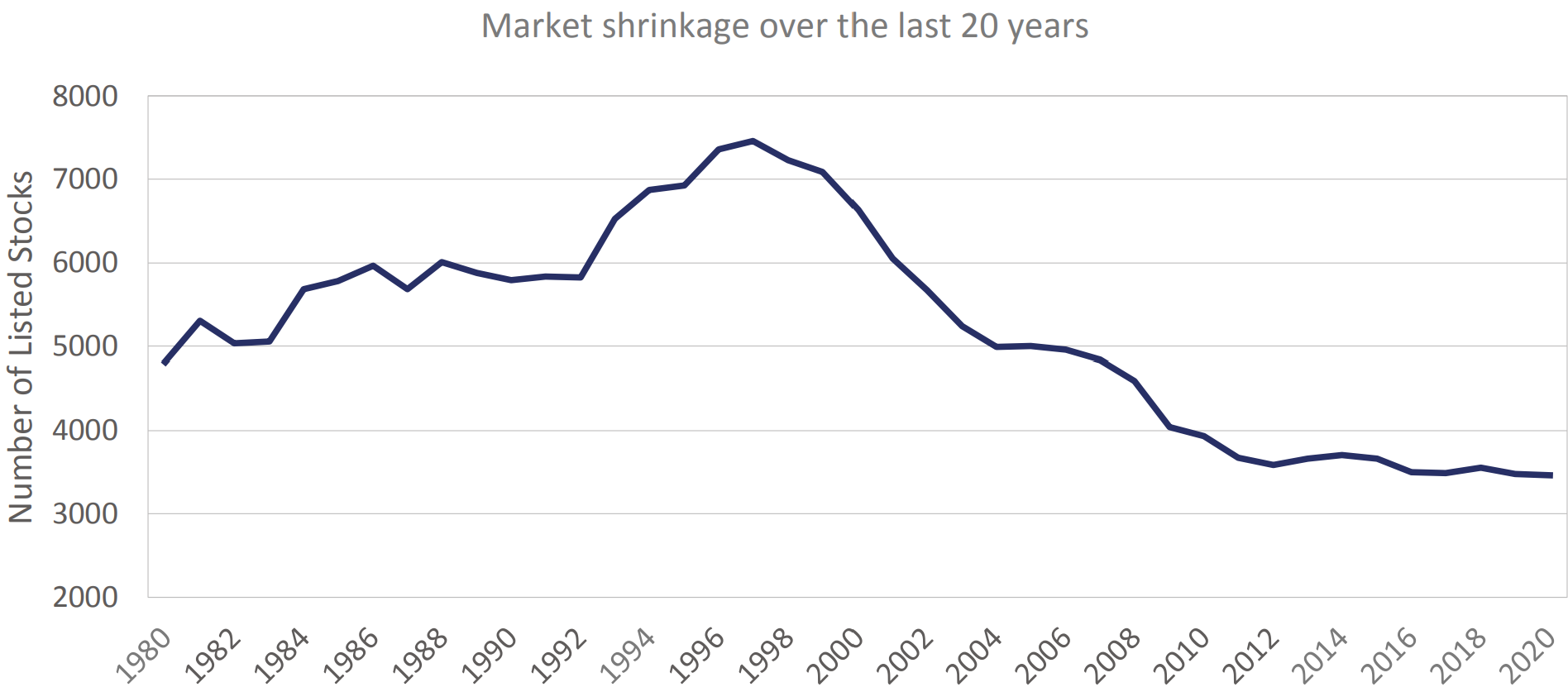
	Number of stocks
FT Wilshire 5000 Index	3525
FT Wilshire US Large Cap	496
FT Wilshire US Mid Cap	289
FT Wilshire US Small Cap	1272
FT Wilshire US Micro Cap	1757

<800 stocks are
MOST of the
market

Wilshire 5000 Components - history

of components of the FT Wilshire 5000 over the last four decades.

Figure 1: Number of Listed Stocks in the US Market has contracted significantly



More money chases fewer goods. The big get bigger, the small die, the market concentrates into the largest stocks (consider AAPL, MSFT).

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SOURCE: Wilshire Associates. https://assets.website-files.com/60f8038183eb841e628c14df/62ceec895218c176d80032c8_Wilshire-SeeingThroughTheSizeMirageInUSEquities-ResearchNote_June2022%20FINAL.pdf



Market Structure Analytics™



Conclusions

- 1. For Investor Relations Officers, expenditures, expectations and resources should conform to what the money is doing.** Telling the Story won't change outcomes at all for large-caps because 89%-98% of category Actives don't beat the benchmark. *Passives drive shareholder-value.* Telling the Story has only a 30% chance of creating shareholder value for the Russell 2000. *Most money today treats stocks as products for asset-allocation.*
- 2. Shareholder capital should be allocated according to Passive Characteristics.** All public companies should understand if they're Passive Large Cap blend (where over 40% of assets are) or not, and if not, each should have a clear plan for reaching the Russell 1000 where 95% of the money is concentrated.
- 3. Investor Relations should be data-driven.** At least 30% of time and resources should focus on helping execs, Boards, understand what drives shareholder value, how to allocate shareholder capital.

For next steps, email timquast@modernir.com

