S&P Dow Jones Indices

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Market Commentary

Navigating the Narrow Path

Contributors

Shaun Le Messurier
Client Director
ARC Research
shaun.le.messurier@spglobal.com

Daniel Hurdley
Managing Director
ARC Research
daniel.hurdley@spglobal.com

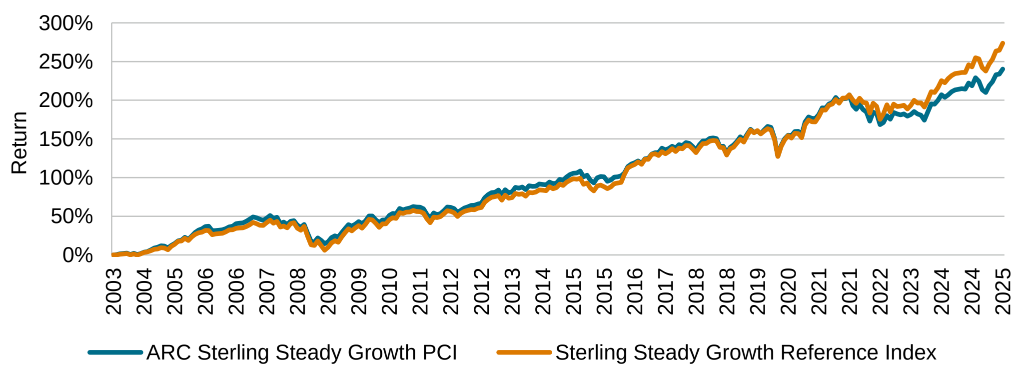
"The essence of investment management is the management of risks, not the management of returns." – Benjamin Graham

Investors have enjoyed a strong run since the inflation-induced sell-off that occurred in 2022. The ARC Sterling Steady Growth PCI (Steady Growth PCI), which comprises portfolios with a risk relative to global equities of between 60% and 80%, has demonstrated a cumulative gain of 23.3% since that point, equivalent to 7.91% annualized to the end of Q3 2025—comfortably ahead of the long-term average performance of 5.8%.

Yet, despite these strong absolute returns, markets have offered more.

The Sterling Steady Growth Reference Index (Reference Index), which represents a typical strategic asset allocation for a steady growth investor, has outperformed the Steady Growth PCI since the beginning of 2023. This marks a clear divergence from the historical pattern: from the launch of the ARC Wealth Indices in 2003 up until 2022, performance between the Steady Growth PCI and the Reference Index was broadly in line.

Exhibit 1: Cumulative Returns since 2003



Source: ARC Research, now a part of S&P Dow Jones Indices LLC. Data as of Sept. 30, 2025. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Exhibit 2: Sterling Steady Growth Reference Index

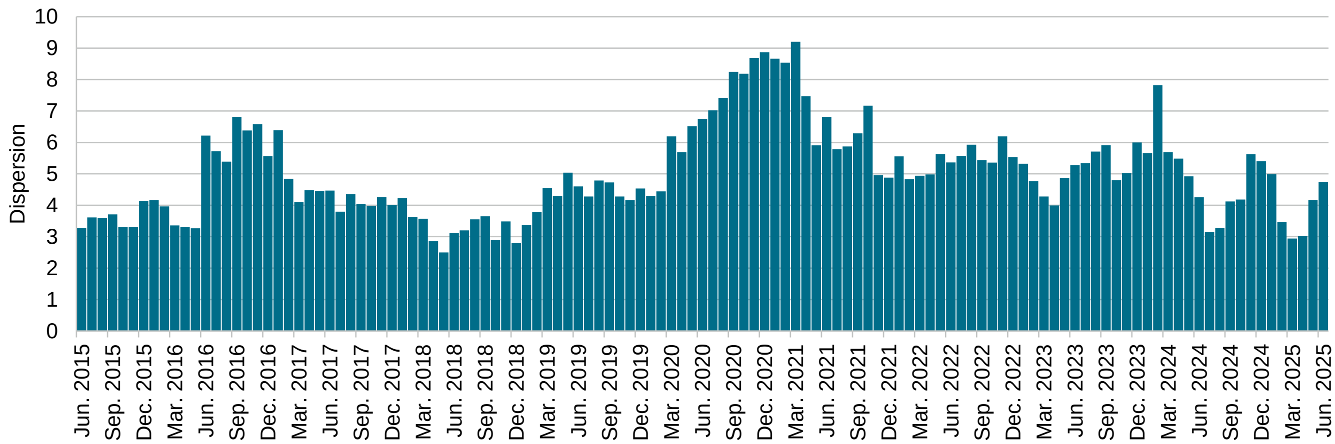
Sector	Weight (%)
U.K. Equities	20
Global Equities	35
Emerging Market Equities	5
U.K. Gilts	10
U.K. Corporate Bonds	10
Diversified Commodities	5
Absolute Return	10
Cash	5
Total	100

Source: ARC Research, now a part of S&P Dow Jones Indices LLC. Data as of Sept. 30, 2025. Table is provided for illustrative purposes.

What Has Changed?

As shown in Exhibit 3, dispersion among Discretionary Fund Managers (DFMs) contributing to the ARC Sterling Steady Growth Index has been falling steadily since the COVID-19 pandemic. Lower dispersion suggests that, in general, tactical positioning has converged and, as a result, managers are facing similar challenges. In short, it's not that some DFMs have been struggling, dragging down the index average—it's that the environment has been difficult for most.

Exhibit 3: Rolling 12-Month 10th – 90th Percentile Return Dispersion

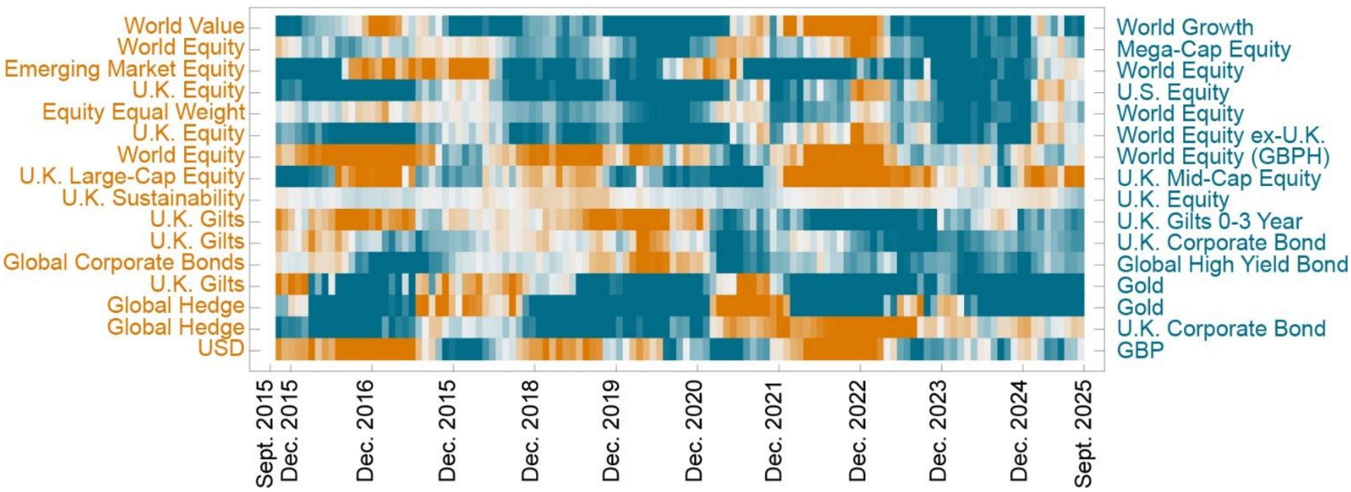


Source: ARC Research, now a part of S&P Dow Jones Indices LLC. Data as of Sept. 30. 2025. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

What Might Be the Common Headwinds That the Peer Group Are Facing?

To help answer this question, Exhibit 4 shows excess 12-month rolling returns for a number of the more significant asset class pairs.

Exhibit 4: Rolling 12-Month Returns of Asset Class Pairs



Source: ARC Research, now a part of S&P Dow Jones Indices LLC. Data as of Sept. 30, 2025. Past performance is no guarantee of future performance. Chart is provided for illustrative purposes.

Several persistent market trends over the past two to three years help explain the challenges that DFMs have been grappling with:

- Mega-cap stocks have significantly outperformed;
- Market-cap weighted indices have outpaced equally weighted benchmarks;
- U.S. equities have outperformed global ex-U.S. markets; and
- Growth stocks have outperformed value (but on further examination, only in the U.S.)

These trends present a structural challenge for active DFMs, not helped by the fact that they are inextricably linked.

Global equity returns have been largely driven by a small number of U.S.-listed mega-cap growth stocks. This has led to an increase in concentration risk. The following statistics relate to the S&P World Index as of Sept. 30, 2025:

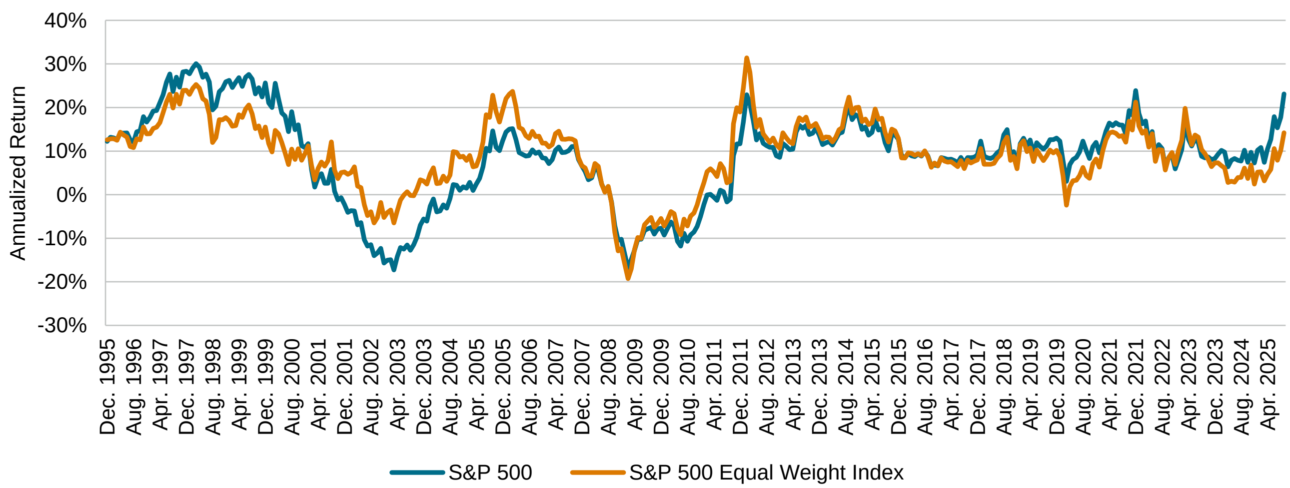
- U.S. equities represent 70.7% of global equity market capitalization.
- Information Technology is the largest sector at 27.9%.
- NVIDIA has a weight of 5.8% in the index, not far behind Japan, which is the second-largest country at 6.7%.
- The top-5 stocks make up 20.2% of the index.

– The top-10 stocks make up 28.2% of the index.[1]

The role of the DFM is to meet their investors' investment objectives while managing risk to acceptable levels. The traditional way of managing risk is to construct portfolios that are well diversified at the asset class, country, sector and stock level. Many DFMs would argue that the global equity market indices no longer provide a sufficient level of diversification. Just because concentration risk is yet to manifest itself does not mean that it should be ignored or accepted.

The dominance of a select few stocks is evidenced by the performance of market-capitalization-based indices versus equally weighted indices. Exhibit 5 shows the rolling 36-month returns of the S&P 500® and the S&P 500 Equal Weight Index over the past 30 years. We can see that relative performance has tended to be cyclical, but that the equally weighted index has lagged the market-cap-weighted index since the COVID-19 epidemic.

Exhibit 5: Rolling 36-Month Returns



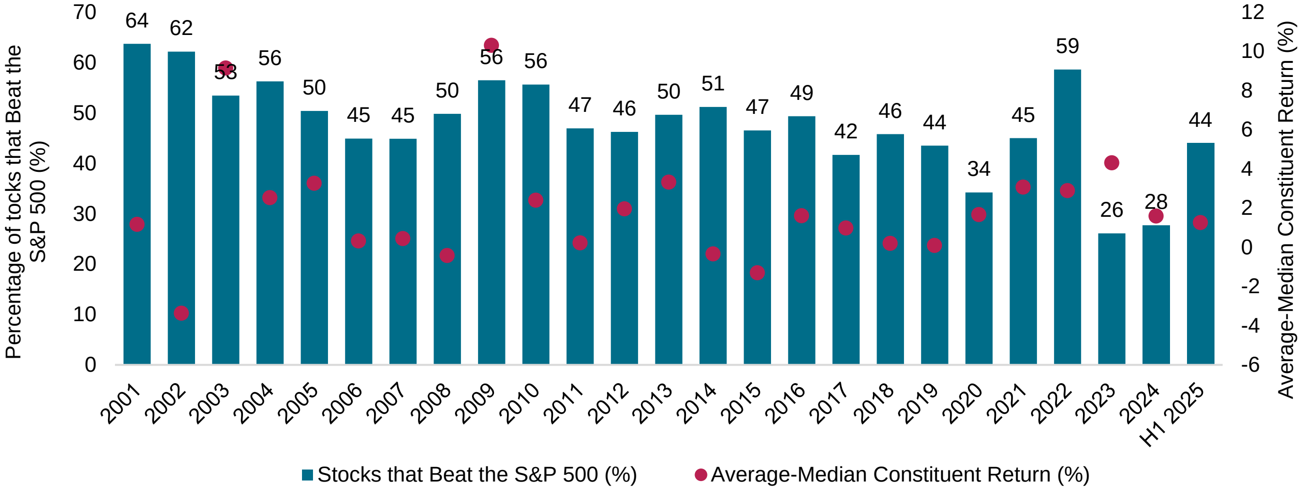
Source: S&P Dow Jones Indices LLC. Data from December 1995 through September 2025. Index performance based on total return in USD. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Another way of thinking about market breadth is to determine the percentage of stocks that outperformed the index over a given period—how likely is it that a randomly selected portfolio of stocks would have performed in line with, or ahead of, the overall market? Exhibit 6[2] shows the percentage of stocks that beat the S&P 500 on an annual basis since 2001, along with the difference between the average return and the median return.

[1] Source: S&P Dow Jones Indices LLC. Data as of Sept. 30, 2025.

[2] See Ganti, A., "Skewing Success." S&P Dow Jones Indices, 2025.

Exhibit 6: Market Breadth



Source: S&P Dow Jones Indices LLC, FactSet. Data as of June 30, 2025. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

From Exhibit 6, we can see that 2023 and 2024 were particularly challenging years for active managers with only 26% and 28% of stocks outperforming the overall index, respectively. The chart also highlights the difference between the average return and the median return (over 4% in 2023, around 2% in 2024). Identifying the winners has been statistically tricky over the past few years, and the cost of not doing so relatively high.

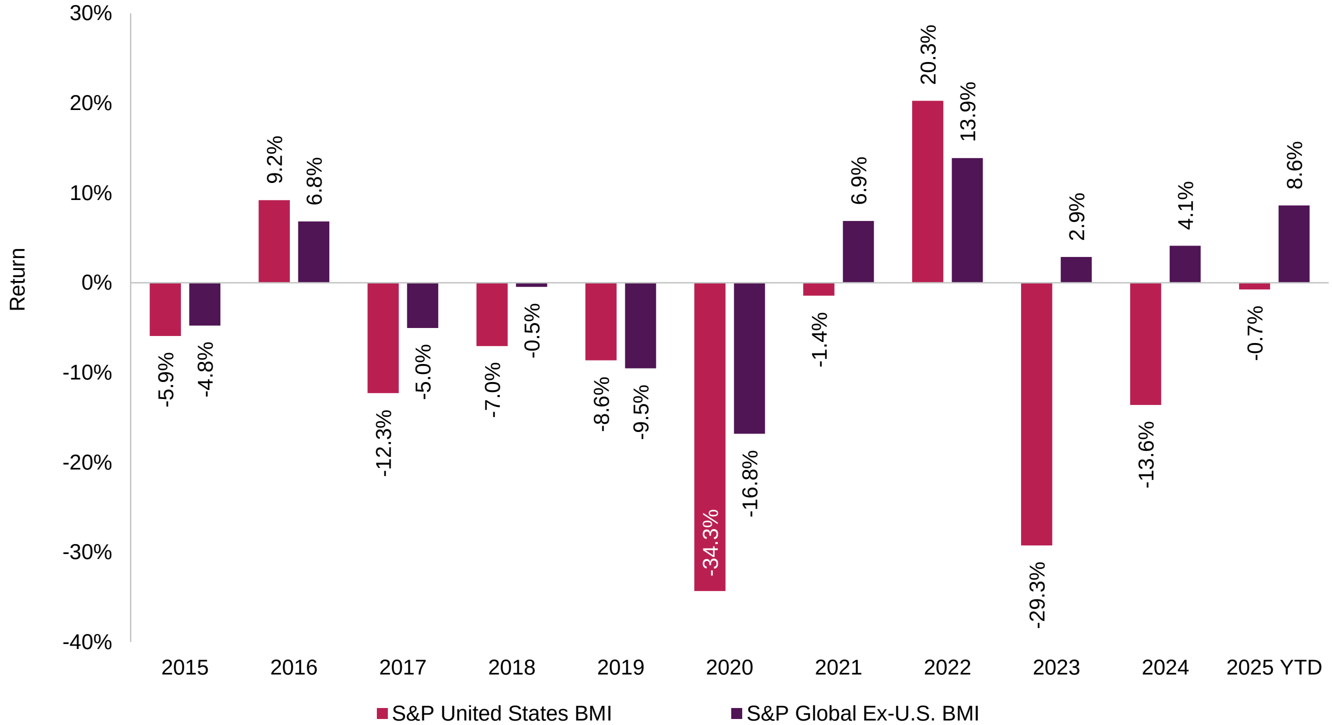
While market breadth and concentration risk are important considerations, another factor that has been at play is the domination of stocks that, at least using traditional valuation techniques, might have been deemed over-valued or “too risky.”

The majority of DFMs will employ investment strategies that involve some consideration of valuation. Even those seeking companies with above-average growth prospects may screen for stocks that offer growth at a reasonable price (GARP) characteristics. Such screens would have excluded many of the top-performing stocks of recent years on the basis that they are too “expensive,” “volatile” or lack “quality” attributes.

Adding to the challenge, the characteristics of the U.S. market and the rest of the world have diverged. Historically, growth stocks have tended to underperform during periods of high or rising interest rates. The logic here is that the increased rates at which future earnings must be discounted back results in lower present values. This rule of thumb has held true in Europe and Asia, but as we can see from the following chart, U.S. growth stocks have outperformed despite the higher interest rate environment since the end of 2022.[3]

[3] See Zurita, D., “We Never Go out of Style.” S&P Dow Jones Indices, 2025

Exhibit 7: Excess Return of Value over Growth Indices Since 2015



Source: S&P Dow Jones Indices LLC. Data as of Sept. 30, 2025. Excess return calculated as the difference in total return of each index in USD. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

This divergence in the factor-driven performance of U.S. stocks compared to those traded elsewhere has meant that any attempt to reduce geographic concentration by substituting U.S. growth stocks with proxies domiciled outside of the U.S. (often at a compelling valuation discount) has generally resulted in unsatisfactory outcomes.

This combination of outperforming mega-cap stocks, the domination of the U.S. equity market and the recent underperformance of “cheaper” stocks has resulted in an extremely challenging environment for active managers, especially those targeting higher levels of diversification than that offered by the headline indices.

Conclusion

As Benjamin Graham wisely observed, “The essence of investment management is the management of risks, not the management of returns.” This principle is especially relevant in today’s environment, where market gains have been driven by a narrow group of stocks and traditional diversification has faced headwinds.

It is clear that the recent market environment has not rewarded traditional active investment and risk management approaches. However, this does not imply that DFMs should abandon their tried and tested style of investing, or chase returns at the expense of prudent risk management.

The role of the DFM is not to outperform in every market condition, nor to mirror the returns of concentrated indices if doing so would be at odds with their stated investment style. Their primary responsibility is to manage risk in alignment with their clients' investment objectives. This possibly means constructing portfolios that are more diversified across asset classes, geographies, sectors and individual securities than indices may dictate—even when such diversification runs the risk of temporarily lagging the performance of those more concentrated benchmarks.

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