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A Tale of Two Indexes

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Investors have a couple of index options to gain exposure to the small-cap equity universe. Understanding index specifics, and importantly their differences, enables investors to make more informed decisions around which index would best meet their investing needs.

There has been a healthy debate within the investment community around which small-cap index universe is optimal to invest in: the S&P 600 or the Russell 2000. In this paper we will define these indexes, explore the similarities and differences, and provide pertinent information in order to help investors make an informed decision when deciding which index is more suitable for their portfolio.

Defining the Indexes: Construction and Methodology

S&P 600

The S&P SmallCap600 Index is the small-cap series of the S&P Dow Jones U.S. equity indexes, representing almost 3% of the U.S. equity market. The S&P 400 (mid-cap) Index combined with the S&P 600 constitute the S&P 1000, and the S&P 1000 plus the S&P 500 (large-cap) comprise the S&P 1500. While the S&P 600 is constructed of small-sized companies that are typically less liquid and stable than large-cap names, these small-cap names must meet specific criteria based on investability and financial viability in order to be included. The S&P SmallCap 600 Index implements changes on an as-needed basis. Constituent deletions may occur due to bankruptcy, mergers, acquisitions, significant restructuring, or substantial violation of one or more of the eligibility measures. Constituents removed from the index are replaced by an addition at the time of the deletion. To be eligible for inclusion in the index, a company should be a U.S. company, have a market capitalization between \$750 million to \$3.3 billion, maintain a public float of at least 10% of its shares outstanding, and have its most recent quarter's earnings and the sum of its trailing four consecutive quarters' earnings be positive.

The S&P 600 is maintained by the U.S. Index Committee. The Index Committee meets monthly and reviews pending corporate actions that may affect index constituents, statistics comparing the composition of the indexes to the market, companies that are being considered as candidates for addition to an index, and any significant market events. Companies are not removed from or added to the S&P 600 because of anticipated future stock price performance. Rather, the informed approach of the Index Committee keeps turnover low and allows quick adjustments when a company's financial status or overall market conditions change. The index also rebalances quarterly in March, June, September, and December.

Russell 2000

The Russell 2000 Index is the small-cap segment of the Russell US equity universe. This index is a subset of the Russell 3000 Index, representing approximately 7% of the total market capitalization of that index. Unlike the S&P 600, there is no financial viability criteria and no Index Committee to make decisions about inclusion. This index is made up of approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. It is constructed to provide a comprehensive and unbiased small-cap component, and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set. Once the market capitalization for each security is determined by use of total shares and price, each security is placed in the appropriate Russell market capitalization-based index. The Russell 2000 Index includes companies #1,001–3,000, based on descending total market. There has to be a minimum company total market cap of \$30 million on rank day, which occurs annually in May. Then the index has its annual reconstitution in June. This index also has smaller quarterly rebalances, which occur annually in March, September, and December.

Refer to Figure 1 for a detailed comparison between the two indexes.

Figure 1
Comparison across Indexes

	S&P SmallCap600 Index	Russell 2000 Index
Universe	All constituents must be US companies.	US companies as defined by the Russell US ground rules, based on country of incorporation, headquarters and most liquid US exchange.
Eligibility	To be included, companies must have an unadjusted market cap of \$850 million to \$3.7 billion, and must have a float-adjusted market cap that is at least 50% of unadjusted minimum market cap threshold.	Once the market capitalization for each security is determined by use of total shares and price, each security is placed in the appropriate Russell market capitalization — based index. The Russell 2000 Index includes companies #1,001–3,000 based on descending total market capitalization (there is a +/-2.5% band based on cumulative market cap above and below the breakpoint at the 1000th stock to mitigate turnover). Minimum company total market cap of \$30 million on rank day.
Public Float	Must have greater than 10% of shares available in the marketplace.	Must have greater than 5% of shares available in the marketplace.
Financial Viability	Companies must have positive as-reported earnings over the most recent quarter, as well as over the most recent four quarters (summed together).	No specific rule for financial viability.
Liquidity	Using composite pricing and volume, the ratio of annual dollar value traded (defined as average closing price over the period multiplied by historical volume) to float-adjusted market capitalization should be at least 1.00, and the stock should trade a minimum of 250,000 shares in each of the six months leading up to the evaluation date.	Average Daily Dollar Trading Value (ADDTV) must exceed that of the global median, which is determined each reconstitution rank day by ranking all securities in investable countries by ADDTV. As of the reconstitution 2021 rank date, the global median ADDTV was USD 255,000.
Sector Representation	Global Industry Classification Standard (GICS)	Proprietary sector classification framework
Company Type	All eligible US common equities listed on eligible US exchanges can be included. REITs are also eligible for inclusion. Closed-end funds, ETFs, ADRs, ADS, and certain other types of securities are ineligible for inclusion.	Companies structured in the following ways are excluded from inclusion in the Russell 2000 Index: royalty trusts, U.S. limited liability companies, closed-end investment companies (as a point of clarification: Companies that are required to report Acquired Fund Fees and Expenses [as defined by the SEC], including Business Development Companies, are not eligible for inclusion), blank-check companies, special purpose acquisition companies (SPACs), and limited partnerships. Exchange Traded Funds (ETFs) and mutual funds are also excluded. Companies that have historically generated UBTI and not taken steps to block UBTI to equity holders are also excluded. ADRs and ADSs are not eligible.
Reconstitution	There is no annual Reconstitution. Names are added and deleted as corporate actions arise.	Once a year in June (IPOs are the exception).
IPOs	6–12 months required before inclusion.	Eligible IPOs are added quarterly.

Source: S&P Dow Jones Indices and FTSE Russell.

Figure 2
Summary of Characteristics Across the Indexes

	S&P SmallCap 600 Index	Russell 2000 Index
# Constituents	601	1950
Index Market Cap (USD millions)	872,829	2,266,155
Largest Market Cap (USD millions)	6,282	7,516
Smallest Market Cap (USD millions)	203	4
Average Market Cap (USD millions)	1,574	1,162
Median Market Cap (USD millions)	1,333	706

Source: S&P Dow Jones Indices and FTSE Russell, as of December 31, 2022.

Figure 3
Top 5 Holdings Comparison

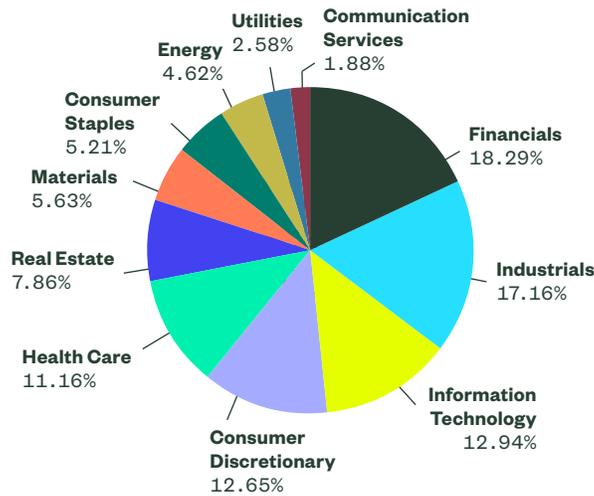
Top 5 Holdings S&P 600	Weight (%)
AGREE REALTY CORP	0.72
ENSIGN GROUP INC/THE	0.60
HELMERICH & PAYNE	0.60
EXPONENT INC	0.57
UFP INDUSTRIES INC	0.56
Total Weight of Top 5	3.05

Top 5 Holdings Russell 2000	Weight (%)
HALOZYME THERAPEUTICS INC	0.32
SHOCKWAVE MEDICAL INC	0.31
INSPIRE MEDICAL SYSTEMS INC	0.31
EMCOR GROUP INC	0.30
CROCS INC	0.29
Total Weight of Top 5	1.53

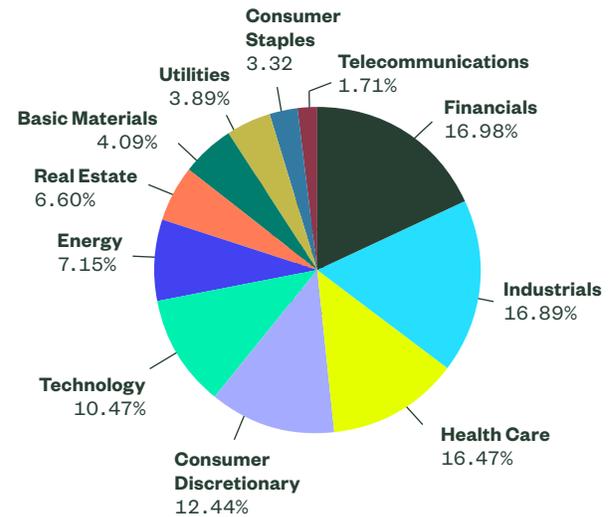
Source: State Street Global Advisors, S&P Dow Jones Indices and FTSE Russell, as of December 31, 2022.

Figure 4
Sector Breakdown of the Indexes

S&P SmallCap 600 Index



Russell 2000 Index



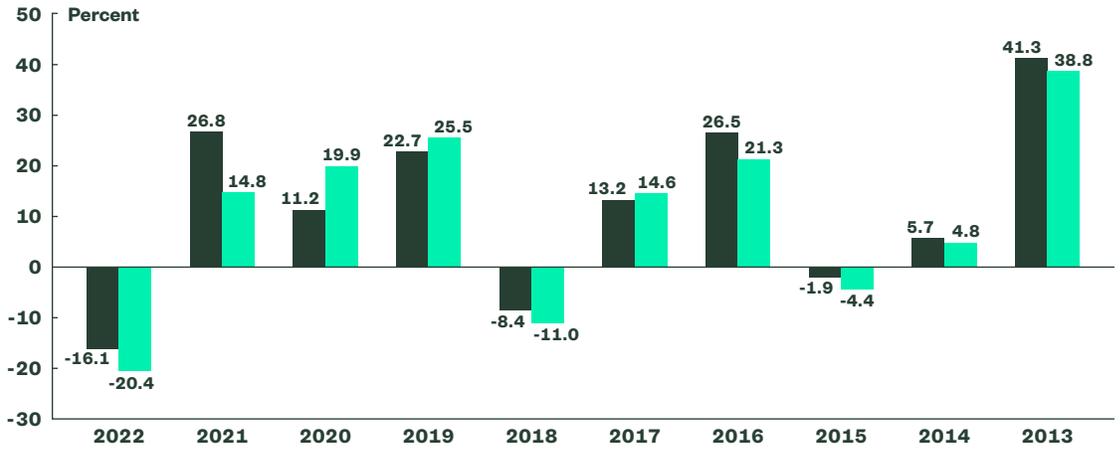
Source: State Street Global Advisors, S&P Dow Jones Indices, and FTSE Russell. Data as of December 31, 2022.

Figure 5

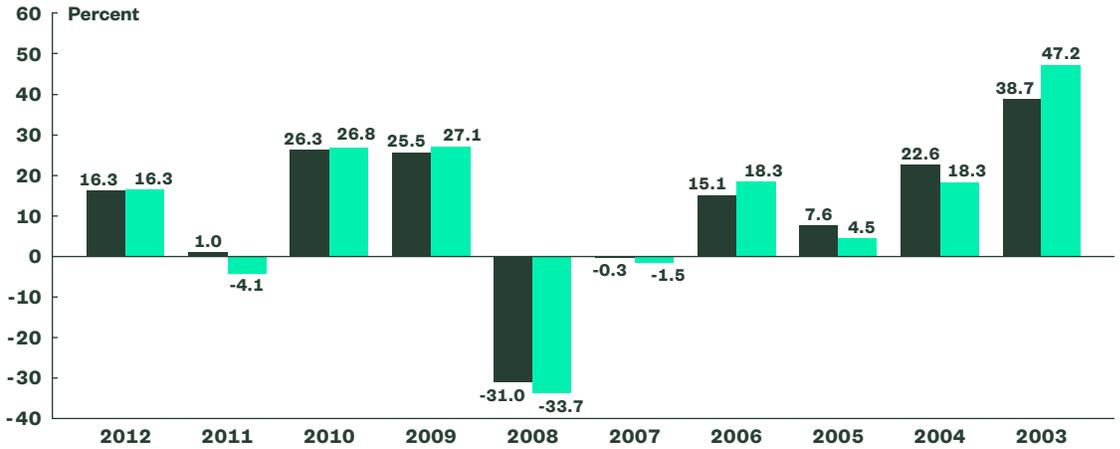
Comparative Performance Across the Indexes

Annualized Performance						
Index	1 year (%)	3 year (%)	5 year (%)	10 year (%)	20 year (%)	25 year (%)
S&P 600	-16.10	5.80	5.88	10.82	10.64	8.95
Russell 2000	-20.44	3.10	4.13	9.01	7.16	7.13

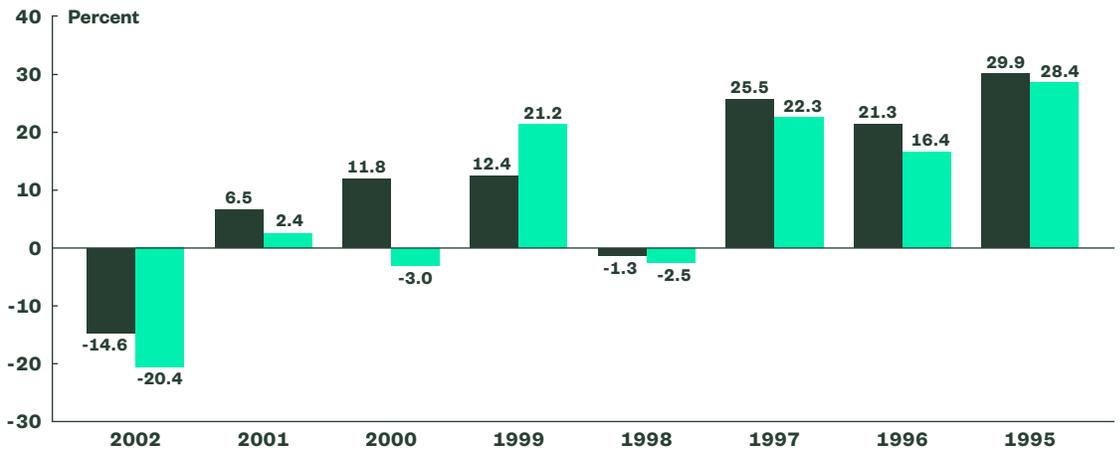
■ S&P 600
■ Russell 2000



■ S&P 600
■ Russell 2000



■ S&P 600
■ Russell 2000



Source: State Street Global Advisors, S&P Dow Jones Indices and FTSE Russell, as of December 31, 2022. Past performance is not a reliable indicator of future performance.

Analyzing the index performance over the past ten years does not give any guarantees as to how either index will perform in the future; however, it is helpful to compare historical returns to see if there are any trends. One may want to consider that the S&P 600 has a financial viability requirement for companies, whereas the Russell 2000 does not. This can potentially result in a higher percentage of unprofitable companies being included in the Russell Index, for example. On the other hand, there could be a greater potential for growth, given the smaller size of the average Russell 2000 company. The Russell 2000 also tends to be larger and more diverse than other popular small-cap indexes, something that arguably makes it more representative of the “real” economy.

Cost of Trading

When choosing a benchmark, another critical factor to consider is the cost of trading. Below are comparisons of cost when buying a slice of each index in three different amounts (\$100 million, \$250 million and \$1 billion). In all three cases it is more costly to buy an S&P 600 slice. The drivers of these costs are the impact costs, which are a reflection of the percentage of the average daily volume (ADV). The cost differential between the two indexes becomes greater as the dollar value increases.

Figure 6
A Comparative Look
at Trading Costs

Estimated Cost of Trading \$100 Million

Index	% ADV	Impact Cost	Commissions	Ticket Charges	Estimated Total Cost (bps)
S&P 600	1.8	16.3	2.7	0.3	19.3
Russell 2000	0.6	13.5	3.7	1.0	18.2

Estimated Cost of Trading \$250 Million

Index	% ADV	Impact Cost	Commissions	Ticket Charges	Estimated Total Cost (bps)
S&P 600	4.5	23.6	2.7	0.1	26.4
Russell 2000	1.6	16.7	3.7	0.4	20.8

Estimated Cost of Trading \$1 Billion

Index	% ADV	Impact Cost	Commissions	Ticket Charges	Estimated Total Cost (bps)
S&P 600	17.9	50.4	2.7	0.0	53.1
Russell 2000	6.2	28.5	3.7	0.1	32.3

Source: State Street Global Advisors analysis. ADV refers to average daily volume.

In addition to these estimated costs for trading flows, investors should also consider turnover. Average two-way turnover for the S&P 600 Index over the past 10 years is 41.33%, whereas the Russell 2000 Index’s average two-way turnover is only 27.07% over this same time period. The additional trading in S&P 600 means more transaction costs.

Conclusion

There are many differences among indexes that investors should consider when choosing an index for investing. The optimal approach, in our view, is to not only weigh the pros and cons, but also factor in any existing holdings to ensure the entire asset allocation is being considered. For example, if an investor has exposure to the S&P 500, he/she may want to consider the S&P 600 for small-cap exposure, in addition to the S&P 400, which covers the mid-cap market. Further, if an investor has exposure to the Russell 1000, then the Russell 2000 may be a better fit to round out the investor's holdings. Staying within the same benchmark family can help ensure no overlaps or gaps. For example, adding the S&P 600 to the Russell 1000 could, in theory, provide a small-cap component, yet this is typically not considered a preferred option, given the overlap. Rebalancing also becomes more difficult without clear-cut market cap bands. Similarly, holding the S&P 500 and adding the Russell 2000 would leave a hole in the mid-cap exposure.

Investors should also determine the best way to access these indexes. This can be done by investing in pooled funds (i.e. mutual funds, commingled funds, or ETFs) or by setting up a separately managed account (SMA). SMAs allow investors to customize indexes as needed, but these vehicles are more expensive, more complex, and are often time-consuming to set up. All strategies and investment vehicles are feasible, though, and each investor should examine the full picture before deciding what is the best approach given their investment objectives.

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* Pensions & Investments Research Center, as of December 31, 2021.

[†] This figure is presented as of December 31, 2022 and includes approximately \$58.60 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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