



## May 2008 – Time for a Growth Tilt?

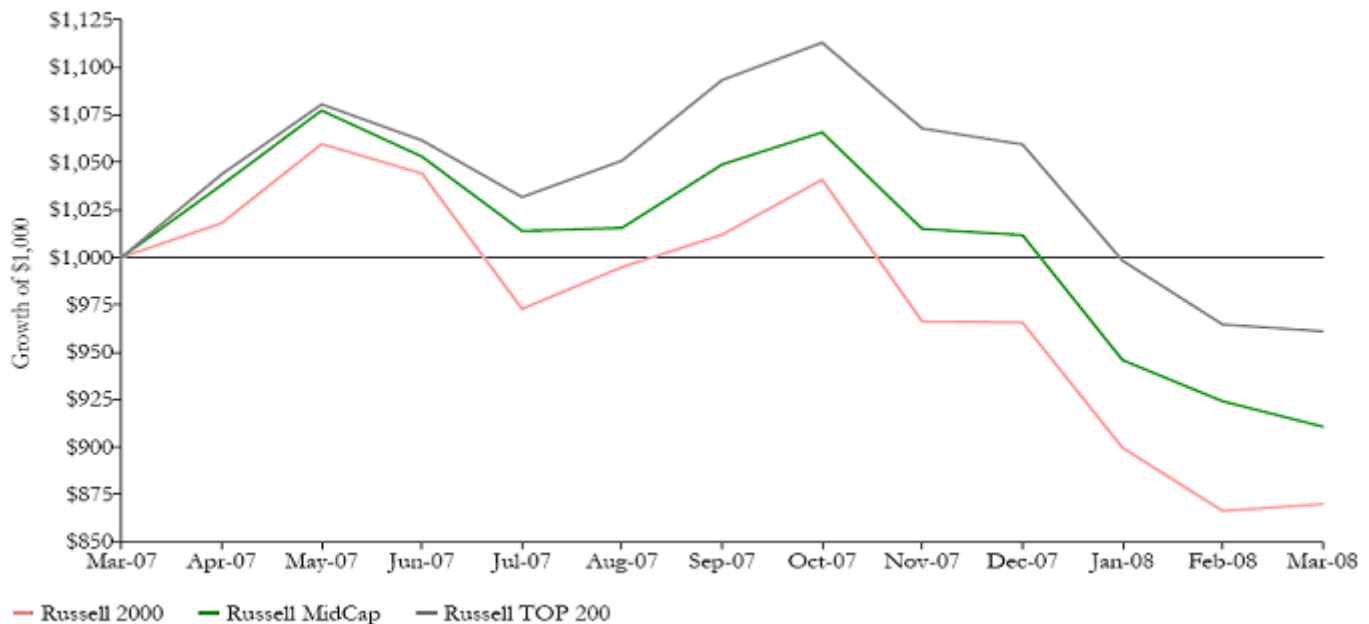
Emerging market leadership suggests growth is coming back in favor. Mean reversion and a trend toward quality supports a portfolio adjustment toward large-cap growth.

A change in equity market performance leadership has been lost in the blizzard of recent negative economic news and declining capital market performance. While this change is only emerging, it has been coming for some time and now is becoming visible.

Despite measly and subhistorical returns from domestic equity markets since the turn of the century, changes in market leadership are now more front and center. With the potential that lower returns may be more likely during a period of slower economic growth, an awareness of where to find better relative domestic equity performance could be of help in achieving a more palatable total return.

As depicted in Figure 1 below, large-cap stocks have outpaced small- and mid-cap stocks over the last 12 months. The reasons: (1) reversion to the mean after years of underperformance and (2) a "flight to quality" as equity investors have been shedding smaller companies in exchange for more seasoned and stable issues. And that is not all.

Figure 1: Large-Cap Growth of \$1,000 Over 12 Months

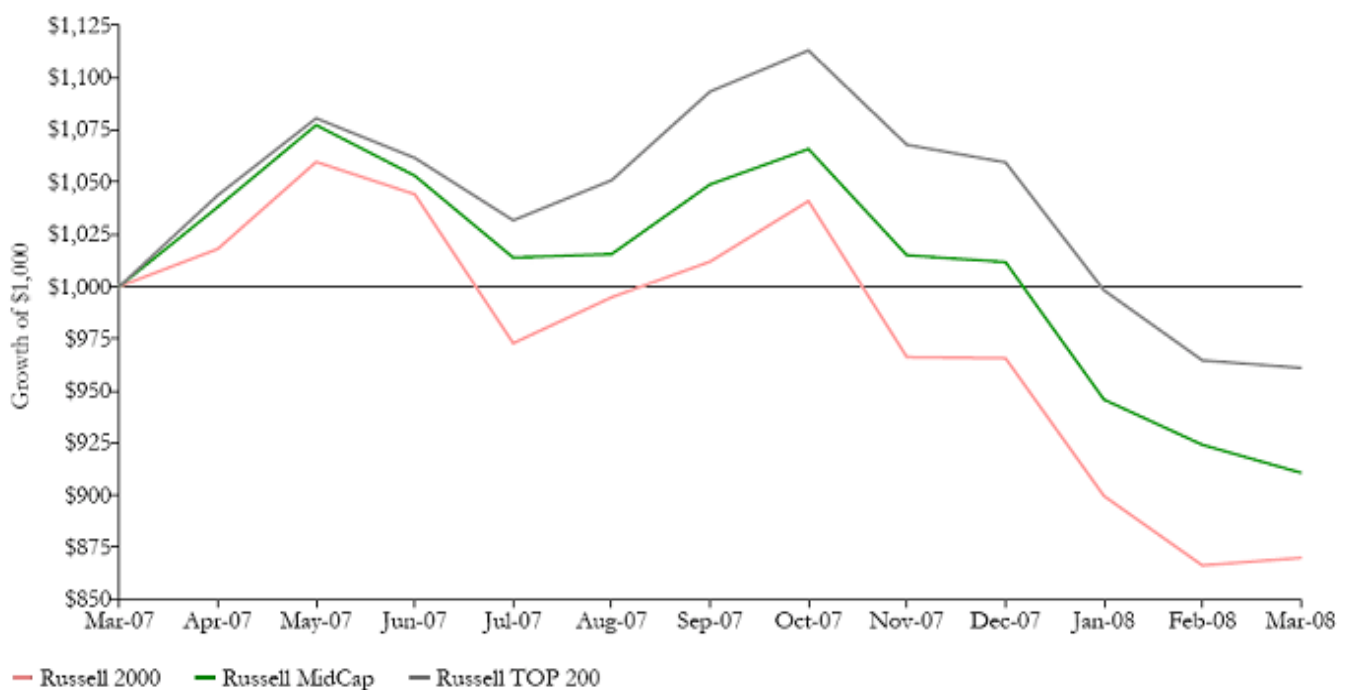


Source: CMC EResearch



Growth appears to be finally turning the corner on value, at least for a while. This turn in style leadership has been a long time in coming this cycle, and this type of change tends to persist for a while. Back in the 1990s, the disparity in performance was extraordinarily pronounced and protracted. The reverse has happened since the turn of the century, but the tables appear to be turning after years of value leadership. The change in style leadership is depicted below for large-cap stocks, but it is somewhat further advanced in small- and mid-cap markets.

Figure 2: Three-Year Rolling Excess Returns



Source: CMC EResearch

So what does this mean? Well, a few things, depending on how you approach portfolio management. First, if you employ a strategic asset allocation strategy and you are still within your minimum and maximum cap and style weights, do nothing or rebalance at the next appropriate interval.

Second, if you wish to style tilt within your target domestic equity allocation ranges, it appears large and growth might be sensible overweights for the time being —the degree of that overweight being a professional judgment on your part.

Third, if your strategic approach is more value-biased (as value has outperformed growth over long time periods), understand performance may lag for a while depending on how strong your value bias has been set.



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