

# Global Markets Exploration

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## Comparing small cap stocks to large cap stocks in developed markets

As the global economy continues to expand, global equity markets are an increasingly important part of the investable universe. Today, many index providers define cap size for global indexes according to a country-relative approach. When stocks' respective rankings are determined via a country-relative approach in a global index—by using the same percentages-based market capitalization criteria in different countries—index distortion can occur. For example, a “small cap” stock in France, where the market comprises larger capitalization stocks, could in actuality be much larger than a “large cap” stock in New Zealand, where the market comprises lower capitalization stocks.

In contrast, the Russell Global Index takes a global-relative approach to defining cap size. A small cap stock is a small cap stock regardless of the country in which it is located. This uniform capitalization cut between small and large cap stocks allows for differences in characteristics to become clearer.

What characteristics do small and large cap stocks reveal when compared within the Russell Global Index? In this issue we investigate those specific characteristics, with a focus on developed countries.

### Overview of the results

- The Russell Global Index takes a global-relative approach to differentiating large cap stocks from small cap stocks, and thus the percentages of large cap to small cap stocks within the various countries are not uniform. Percentage differences among the various countries are determined by the markets.
- In looking at the rank order of market capitalization in the countries comprising the Russell Developed Small Cap Index, differences from the rank order of developed large cap stocks are evident. Singapore and Hong Kong have been influential in greatly increasing the proportion of small cap to large cap stocks in the Asia Pacific Basin.
- The percentages of Producer Durables, Consumer Discretionary and Materials & Processing have been higher among small cap stocks than among large cap stocks.

- The returns of the small cap stocks over the past 12 months have been nearly 10 points higher than those of the large cap stocks. Small caps outperformed large caps in 7 of the past 10 years as well.
- Over the past 10 years, there has been a tendency for small cap stocks to outperform large cap stocks when the market was on the rise.
- When comparing the returns of the Russell Developed Small Cap Growth and Russell Developed Small Cap Value Indexes, small cap growth stocks have surpassed small cap value stocks over the past 12 months; but over the past 10 years, small cap value stocks have more often outperformed small cap growth stocks annually.

### Small cap percentages among developed countries

**In the Russell Global Index, the percentage of small cap stocks is determined by the market.**

In a country-relative approach, an index provider establishes the same percentages of large cap stocks and small cap stocks in all countries. In contrast, large cap and small cap stocks within the Russell Global Index are classified in global-relative terms. During Russell's annual reconstitution, all (non-U.S.) companies are ranked by market capitalization. Those that fall below the 90th percentile are classified as small cap stocks and those above the 85th percentile are classified as large cap stocks; and for those companies within the 85th- to 90th- percentile, we maintain their pre-existing classifications. The percentage of large cap to small cap stocks in each country is determined not by the index provider but rather by the dynamics of individual markets relative to each other.

The table below illustrates the percentage allocation ranking of large and small cap stocks included in the Russell Global Index as of May 31, 2010. It is clear from the table that there are countries, even among developed nations, in which the small cap percentage is above the global break point (87.5%.)

**Table 1 / As of May 31, 2010**

<b>Top/Bottom 10 developed countries in the Russell Global Index</b>						
Rank	Top 10 Countries			Bottom 10 Countries		
	Country	Small Cap Percentage	Large Cap Percentage	Country	Small Cap Percentage	Large Cap Percentage
1	Iceland	100.0	0.0	Switzerland	3.9	96.1
2	New Zealand	66.7	33.3	Spain	4.1	95.9
3	Greece	24.3	75.7	France	4.5	95.5
4	Austria	23.6	76.4	Germany	5.0	95.0
5	Norway	21.7	78.3	Portugal	6.6	93.4
6	Singapore	21.5	78.5	Italy	6.6	93.4
7	Hong Kong	20.2	79.8	United Kingdom	7.8	92.2
8	Israel	19.5	80.5	Denmark	8.1	91.9
9	Japan	17.5	82.5	U.S.	8.4	91.6
10	Belgium	16.8	83.2	Ireland	8.9	91.1

## The countries at the top of the small cap index

### Top-weighted countries within the small cap markets differ from those within the large cap markets

The table below arranges the countries with the top 10 market capitalizations among the countries that comprise the Russell Developed Small Cap Index. For comparison purposes, it also illustrates the top 10 countries that comprise the Russell Developed Large Cap Index.

On the whole, countries with large market capitalization tend to rank high for the market capitalization of both large cap and small cap stocks. However, as indicated above, the percentages of large cap and small cap stocks differ substantially by country, and therefore, measurable disparities in the rank order of market capitalization emerge between small cap and large cap stocks.

Hong Kong, Singapore and Sweden are among the 10 top-weighted countries within small cap, but are not among the 10 top-weighted countries within large cap. By contrast, Switzerland, Spain and Italy are not among the top 10 countries for small cap weighting.

**Table 2 / As of May 31, 2010**

Top 10 developed countries in market cap rankings (USD)						
Rank	Russell Developed Small Cap Index			Russell Developed Large Cap Index		
	Country	Market Cap (billions)	Weight %	Country	Market Cap (billions)	Weight %
1	U.S.	994	43.5	U.S.	10,800	51.3
2	Japan	401	17.6	United Kingdom	1,950	9.2
3	Canada	170	7.4	Japan	1,891	8.9
4	United Kingdom	164	7.2	Canada	1,074	5.1
5	Australia	94	4.1	France	890	4.2
6	Hong Kong	65	2.8	Switzerland	819	3.9
7	Singapore	44	1.9	Germany	729	3.4
8	France	42	1.8	Australia	710	3.3
9	Germany	38	1.7	Spain	331	1.6
10	Sweden	36	1.6	Italy	280	1.3

## A comparison of regional structure

### The percentage of the Asia Pacific Basin region is higher in small cap stocks than in large cap stocks, in a trend that has become stronger over the past 5 years.

When comparing the regional structure of small cap stocks and large cap stocks as of the end of May 2010, the percentage of the Asia Pacific Basin was higher in small cap stocks than in large cap stocks. This is the same situation as at the end of May 2005. However, during this 5-year period, the relative growth of the Asia Pacific Basin increased, and in particular, the percentage in small cap stocks increased by 6.2 points.

**Table 3 / As of May 31, 2010**

**Comparison of regional structure (USD, unit %, Excluding Israel)**

Region	May 2010		May 2005	
	Russell Developed Small Cap Index	Russell Developed Large Cap Index	Russell Developed Small Cap Index	Russell Developed Large Cap Index
North America	51.4	56.5	53.7	58.7
Developed Europe	21.4	29.2	25.3	29.9
Developed Asia Pacific Basin	27.2	14.3	21.0	11.4

**A comparison of sector structure**

**Producer Durables, Consumer Discretionary, and Materials and Processing sector weights are higher in small cap stocks.**

When comparing sector weights of small cap stocks with those of large cap stocks, the weights of Producer Durables, Consumer Discretionary and Materials & Processing sectors are higher – and the weights of Energy and Utilities sectors are lower – in small cap stocks than in large cap stocks.

In addition, when comparing sector weights as of the end of May 2010 with those of 5 years ago, the percentages of the Consumer Discretionary and Materials & Processing sectors in small cap stocks have substantially lowered. Such sectors with high percentages in small cap stocks have decreased in weight over the past 5 years — but their weights now are still higher than those in large cap stocks, which means the sector weights of small cap stocks have become more evenly dispersed, and are more closely related to the distribution of large cap stocks.

**Table 4 / As of May 31, 2010**

**Comparison of sector structure (USD, unit %)**

Sector	May 2010		May 2005	
	Russell Developed Small Cap Index	Russell Developed Large Cap Index	Russell Developed Small Cap Index	Russell Developed Large Cap Index
Technology	11.8	11.7	9.9	10.0
Health Care	9.3	9.7	8.0	11.2
Consumer Discretionary	16.4	11.3	21.3	14.1
Consumer Staples	4.6	8.9	3.9	6.7
Energy	5.4	10.4	4.9	8.4
Materials & Processing	12.8	8.2	16.8	7.0
Producer Durables	16.9	11.3	12.5	9.0
Financial Services	19.9	20.9	19.3	24.3
Utilities	3.0	7.5	3.4	9.3

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### Differences in the returns of small and large cap stocks

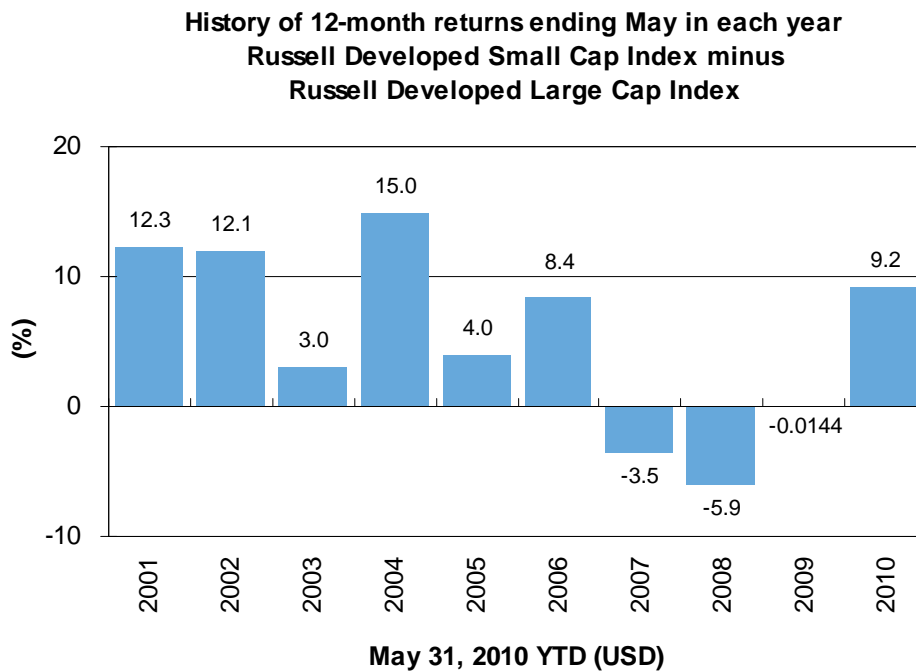
Over the past 12 months, the performance of small cap stocks has been superior to that of large cap stocks.

Over the past 10 years, small cap stocks have outperformed more often than large cap stocks.

The chart below illustrates the extent to which returns of small cap and large cap stocks have differed over the past 10 years. During the 12-month period ending May 31, 2010, returns of small cap stocks included in the Russell Developed Small Cap Index exceeded those of large cap stocks by nearly 10 points. However, in each of the prior 3 years, large cap stocks outperformed small cap stocks.

In a look back over the past decade, small cap stock returns exceeded those of developed large cap stocks 7 times.

Figure 1



Index returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment.

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## Differences in monthly returns

**In months when the market was up, small cap stocks surpassed large cap stocks.**

**In months when the market was down, there was little difference.**

The table below groups monthly returns over the last 10 years according to the level of the returns of large cap stocks; it also shows calculations of the average returns of small cap stocks and large cap stocks, as well as differences within the respective groups. Even in months when the returns of the large cap stocks were greater than 3% and in months when they were greater than 0% but less than 3%, the average returns of small cap stocks exceeded those of large cap stocks. In addition, in months when the returns of large cap stocks were down, the average small cap stock return showed little divergence from that of the large cap stocks.

**Table 5 / As of May 31, 2010**

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### Distribution of monthly returns in the past 10 years (April 2000–May 2010; USD)

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Large Cap returns (monthly)	Number of months	Average returns %		
		Russell Developed Small Cap Index	Russell Developed Large Cap Index	Excess returns
Less than -3%	24	-7.04	-7.29	0.25
Over -3% less than 0%	26	-1.54	-1.51	-0.03
Over 0% less than 3%	38	2.44	1.57	0.87
Over 3%	32	5.96	5.48	0.48

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### Difference between growth and value small cap stocks

Over the past 12 months, small cap growth stocks have experienced greater returns than small cap value stocks.

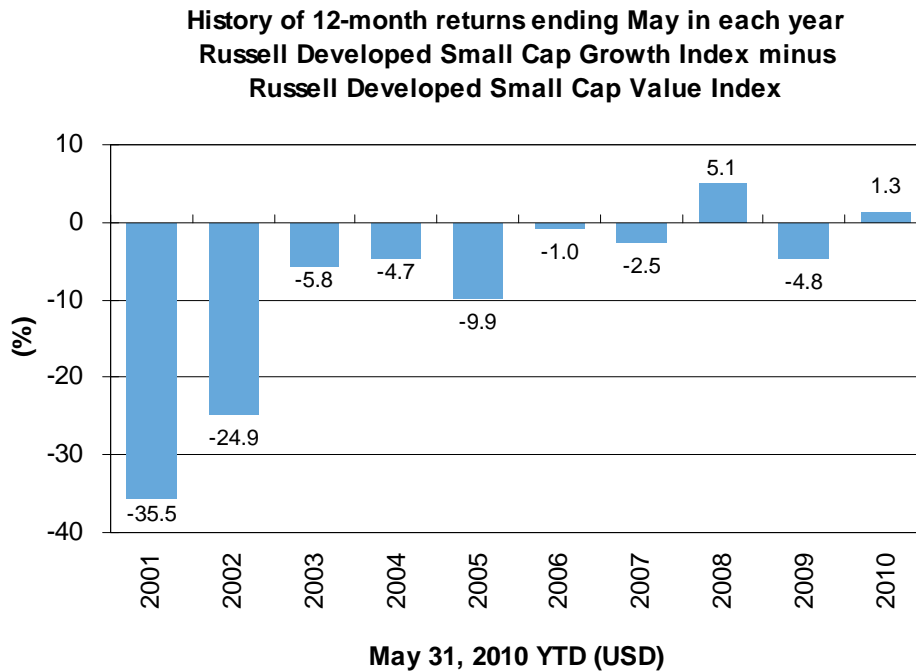
Over the past 10 years, value stocks routinely outperformed growth stocks.

The chart below illustrates the differences between small cap growth and value stock returns over the past 10 years. As in Figure 1, we can see the extent to which there were disparities in the 12-month returns ending May 31 each year.

In the 12 months ending May 31, 2010, the returns of small cap growth stocks exceeded that of the value stocks. However, looking over the past several years, we see that there have been frequent changes in style dominance.

Over the 7-year period from June 1, 2000, to May 31, 2007, in nearly all 12-month periods, small cap value stocks showed superior returns.

Figure 2



## Regional Index data (As of May 31, 2010)

Global market performance in Russell Global Index

### Return rankings by region and large/small caps (USD, in %)

May 2010		Last 3 months		Last 12 months		Last 60 months (Annualized return)	
Region/Size	Return	Region/Size	Return	Region/Size	Return	Region/Size	Return
Global	-9.4	Global	-2.6	Global	17.1	Global	2.8
Emerging Markets LC	-8.8	Emerging Markets SC	0.7	Emerging Markets SC	27.4	Emerging Markets LC	13.6
Developed Markets LC	-9.5	Developed Markets SC	0.5	Developed Markets SC	24.5	Emerging Markets SC	12.5
Developed Markets SC	-9.5	Emerging Markets LC	0.5	Emerging Markets LC	22.8	Developed Markets SC	2.8
Emerging Markets SC	-9.6	Developed Markets LC	-3.4	Developed Markets LC	15.3	Developed Markets LC	1.7
North America LC	-7.8	Emerging Asia LC	1.4	Latin America LC	27.8	Latin America LC	24.0
Emerging Asia LC	-8.4	Emerging EMEA LC	1.2	North America LC	22.1	Emerging Asia LC	12.7
Latin America LC	-8.6	North America LC	-0.2	Emerging Asia LC	21.7	Emerging EMEA LC	8.1
Emerging EMEA LC	-10.1	Latin America LC	-2.1	Emerging EMEA LC	20.3	Developed PB LC	3.1
Developed PB LC	-10.2	Developed PB LC	-4.9	Developed PB LC	11.2	Developed Europe LC	1.6
Developed Europe LC	-12.1	Developed Europe LC	-8.4	Developed Europe LC	6.0	North America LC	1.4

LC = Large Cap; SC = Small Cap; PB = Pacific Basin; EMEA = Europe, Middle East, and Africa

### Return rankings by developed small cap sectors (USD, in %)

May 2010		Last 3 months		Last 12 months		Last 60 months (Annualized return)	
Sector	Return	Sector	Return	Sector	Return	Sector	Return
Consumer Staples	-6.7	Consumer Discretionary	3.0	Consumer Discretionary	32.8	Material & Processing	7.0
Health Care	-7.7	Materials & Processing	2.5	Technology	31.5	Energy	6.8
Utilities	-8.1	Technology	1.2	Materials & Processing	27.9	Consumer Staples	5.4
Technology	-8.3	Health Care	0.7	Health Care	24.9	Health Care	4.3
Consumer Discretionary	-9.5	Producer Durables	0.3	Energy	22.0	Utilities	3.8
Financial Services	-9.8	Utilities	-0.5	Producer Durables	21.3	Producer Durables	2.9
Materials & Processing	-9.8	Financial Services	-0.9	Financial Services	18.4	Technology	2.8
Producer Durables	-10.0	Consumer Staples	-1.4	Consumer Staples	17.4	Consumer Discretionary	1.8
Energy	-13.9	Energy	-5.1	Utilities	17.2	Financial Services	-1.6

### Top/Bottom 5 countries by developed small cap return rankings (Countries with over 10 small cap stocks during the period, USD in%)

May 2010		Last 3 months		Last 12 months		Last 60 months (Annualized return)	
Country	Return	Country	Return	Country	Return	Country	Return
Japan	-6.8	U.S.	5.6	Canada	45.9	Singapore	12.1
U.S.	-7.6	Canada	2.7	Israel	37.5	Canada	9.3
Canada	-8.6	Ireland	1.0	Norway	33.8	Switzerland	9.1
Singapore	-10.0	Singapore	0.6	U.S.	33.6	Australia	8.4
Luxembourg	-10.2	Japan	0.1	Singapore	33.4	Norway	7.5
Australia	-16.7	Italy	-11.0	Denmark	3.7	Japan	-2.1
Denmark	-17.1	Norway	-11.4	Italy	-6.5	Greece	-2.6
Spain	-17.9	Spain	-18.1	Spain	-15.2	Spain	-2.8
Norway	-18.2	Portugal	-18.4	Portugal	-16.0	Italy	-4.6
Austria	-18.4	Greece	-20.5	Greece	-32.3	Portugal	-5.6

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