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## Russell Stability Indexes™ FAQs

### Why did Russell introduce the Russell Stability Indexes to the market?

As a leader in the evolution of styles, first with capitalization based indexes and with the introduction of multi-factor growth and value style indexes, Russell is yet again on the leading edge of style investing. Russell's research into markets and managers has resulted in the identification of a third dimension of style™: Stability. The Russell Stability Index series is based on a powerful set of descriptive quality and volatility variables that, in certain market environments, explain money manager performance differently than capitalization and growth and value style measures do.

### Why is Russell expanding the Russell Stability Indexes globally?

Since Russell introduced the Stability indexes concept to the market in December 2010, institutional market participants have been asking for a global set of stability-related indexes that reflect the market volatility in the global equity space. Russell Stability Indexes offer a more nuanced means of tracking investments than traditional indexes, helping investors better position their portfolios for success in volatile global markets by identifying “defensive” and “dynamic” companies in which to invest. The global series of Russell Stability Indexes further offer valuable insights into defensive and dynamic regions, countries, and sectors globally.

### What do the Russell Stability Indexes measure?

According to the Russell Stability Index methodology, companies with greater exposure to certain risks are defined as Dynamic, and companies with less than average exposure to certain risks are defined as Defensive. While Dynamic companies have more risk, historically, their stock prices have tended to increase faster than those of Defensive companies during periods of rapidly rising stock prices. Defensive companies have historically tended to outperform stocks of Dynamic companies during weak market environments.

Russell recognizes that active managers must weigh the tradeoff between the potential benefits of investing in a particular company (in terms of stock price appreciation) against the risks associated with investing in a given company. Managers investing predominantly in more stable companies generally implement defensive or lower risk strategies. Alternatively, managers investing predominantly in less stable companies implement dynamic or higher risk strategies.

### What is unique about the Russell Stability Indexes?

Russell's Stability Indexes incorporate three quality indicators:

1. Earnings variability
2. Leverage
3. Return on assets

Russell is one of the first to combine quality indicators (balance sheet and earnings-related measures) and a stock market indicator, volatility (long- and short-term). As a result, the Russell Stability Indexes are more comprehensive than other indexes that historically focus on single measures such as dividends or volatility.

### **Are the Russell Defensive Indexes low volatility indexes? What is the difference between defensive and low volatility indexes?**

No. Russell considers the Russell Defensive Indexes as more than low volatility indexes. For investment managers who examine changing economic cycles, credit cycles, and market volatility as potential risks to a company, Stability is more comprehensive than a low volatility approach. While defensive companies may experience lower stock total return volatility, Defensive extends beyond volatility. Half of the stability probability is comprised of stock total return volatility, and the remaining half of the stability probability is based on three accounting-based quality variables that indicate a company's sensitivity to economic cycles, strength of a company's business model, and balance sheet leverage, which amplifies business results.

In contrast, low volatility indexes typically focus on stock price volatility only and do not include quality indicators. Price volatility has many explanatory powers for risk stemming from the market's perception of the company's risk; however, it ignores accounting-based indicators, such as leverage. Most low volatility strategies also do not consistently represent the less volatile portion of the market, rather only select stocks, and may represent significantly different portions of the market in different years.

The Russell Stability Indexes are highly diversified in terms of number of holdings and in terms of factor exposures: The indexes are reconstituted annually, and will have relatively low turnover, which makes them uniquely attractive for benchmarks and for large-scale passive investing.

### **Are dynamic stocks aggressive growth and defensive stocks deep value?**

Stability's primary focus is on a company's sensitivity to changing economic or credit cycles and market volatility rather than whether a company has a higher or lower probability for future growth or low valuations. This distinguishes Stability from other asset classes including Growth and Value: The indicators input into the stability non-linear probability algorithm differ from those input into the non-linear probability algorithm to determine Growth or Value probability.

### **Does stability replace Russell's Growth and Value Style Indexes?**

No. Stability expands the Russell Style Index framework, which is why we refer to it as the third dimension of style. Stability complements the existing tools available to investment managers seeking to invest from different style perspectives. Value and growth are valuation-based (price) measures of a company, while Defensive and Dynamic represent non-valuation variables. A money manager who sees the highest potential for payoff by investing in growth stocks, with potentially higher earnings multiples compared to price, may still need to address a client's concern regarding the company's sensitivity to changing business conditions from a risk perspective. Such a manager can now consider both growth and stability probabilities to determine appropriate investments for this client. The same can be said for value: A manager may seek to invest in a company whose price is undervalued compared to its potential valuations, however, those companies may still be volatile in certain cycles.

### **How do the four styles' performance compare to one another?**

The payoff for the four styles (Growth, Value, Defensive, and Dynamic) vary depending on the broader market's performance – in the worst performing markets for the Russell 1000<sup>®</sup> Index, for example, Value stocks have tended to outperform Growth stocks. Although we see a similar pattern with Defensive and Dynamic stocks in amplified form, outside extreme market conditions, a distinct pattern does not emerge.

**For more information about Russell Indexes call us or visit [www.russell.com/indexes](http://www.russell.com/indexes).**

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