Research & Indexes

S&P/Barra Indexes -- Description
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In 1992, Standard and Poor's and Barra began a collaboration to produce Growth and Value subsets of S&P's industry-leading equity indexes. Academic research pioneered by Nobel Laureate William Sharpe, and continued by Eugene Fama, Kenneth French and others, have confirmed the validity of the growth/value distinction in terms of differential returns over time. The sole criteria for the S&P/Barra Growth/Value split is the book value of a common equity divided by the market capitalization of a firm.

The S&P/Barra Growth and Value indexes are constructed by dividing the stocks in an index according to a single attribute: book-to-price ratio. This splits the index into two mutually exclusive groups designed to track two of the predominant investment styles in the U.S. equity market. The value index contains firms with higher book-to-price ratios; conversely, the growth index has firms with lower book-to-price ratios. Each company in the index is assigned to either the value or growth index so that the two style indexes "add up" to the full index. Like the full S&P indexes, the value and growth indexes are capitalization-weighted, meaning that each stock is weighted in proportion to its market value.

The design of the indexes is an outgrowth of research into investment styles in the U.S. equity market performed by 1990 Nobel Laureate William F. Sharpe. Sharpe found that the value/growth dimension (as represented by price-to-book ratios), along with the large/small dimension, (as represented by market capitalization) appears to explain many of the differences in returns to U.S. equity mutual funds. The importance of the distinction between value and growth stocks was also explored by Eugene Fama and Kenneth French. Fama and French found that the combination of book-to-price ratios and market capitalization explain much of the cross-sectional variability in average stock returns over the period from 1963 to 1990. Furthermore, they found that book-to-price ratios play an even more important role than market capitalization in capturing this return variability.

Clearly, there is no definitive way to characterize a "value" versus a "growth" stock. However, the book-to-price ratio has the advantage of being simple and easy to understand, is mutually exclusive, and captures one of the fundamental differences between companies generally classified as value companies or growth companies. Additionally, book-to-price ratios tend to be more stable over time than alternative measures such as price-to-earnings ratios, historical earnings growth rates, or return on equity. This results in indexes with relatively low turnover.

Part 2 - Index Composition

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Companies in the growth index have higher market capitalizations on average than those in their associated value index. As a result, in each case there are many more companies in the value index than the growth index.

Generally, the companies in the value index also exhibit characteristics associated with "value" stocks: lower price-to-earnings ratios, higher dividend yields, and lower historical and predicted earnings growth. Surprisingly, from September 1993 through January 1994 the Price/Earnings Ratio for the S&P 500/Barra Value Index based on twelve month trailing earnings is higher than that of the S&P 500/Barra Growth Index. This was because several very large companies in the value index (e.g., General Motors) had recently reported large losses. These losses were sufficient to push the P/E ratio of the Value Index temporarily above that of the growth index.

In each case, the value index tends to be more heavily concentrated in the Energy, Utility, and Financial Services sectors than its growth counterpart and the full index. Likewise, the growth index is usually more heavily weighted in the Consumer Non-Cyclicals and Technology sectors than its corresponding value index and the full index.

Similarly, the beta of growth index is generally larger than that of the value index. This implies that the growth indexes will outperform value in periods where the full index has positive excess return (i.e. return net of the return on treasury bills) and underperform when the full index has negative excess return.

There appear to be clear periods when either growth or value style is favored in the equity market. For example, The S&P 500/Barra Value Index clearly dominated over the ten year period between 1975 and 1984.

Part 3 - Construction Methodology

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S&P/Barra Indexes -- Description

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The S&P/Barra Growth and Value indexes were initially constructed at different points in time. In all cases a history of monthly index portfolios was generated back to the inception date of the full index.

Index	Construction Date	History Begins
S&P 500/Barra Growth and Value	May 1992	December 31, 1974
S&P MidCap 400/Barra Growth and Value	October 1993	May 31, 1991
S&P SmallCap 600/Barra Growth and Value	September 1996	December 31, 1993

All S&P/Barra Growth and Value indexes are rebalanced semi-annually on or about January 1 and July 1. The exact rebalance date is selected and announced by Standard & Poor's well in advance. The sole criteria for the S&P/Barra Growth/Value split is the book value divided by the market capitalization of a firm. The values used at the time of rebalancing are the equity's position at the close of trading one month prior (i.e., November 30 and May 31). This one month lag makes it possible to invest in the indexes as of the rebalancing dates because the new constituent lists are known well in advance. Between rebalancings adjustments are made to reflect index changes.

The indexes are designed so that approximately fifty percent of the combined index capitalization is in the value index and fifty percent is in the growth index. During intervening months, of course, the relative weights in the indexes will drift away from 50/50 as a result of capitalization changes in the index constituents. Every six months the indexes are re-adjusted so they are approximately equally split between growth and value.

The indexes are adjusted each month to reflect additions and deletions to the larger index. At each semiannual rebalance, a cutoff value is determined based on the book-to-price ratio of the "last" company in the value index (that is, the company in the value index with the lowest book-to-price ratio). This cutoff value is used to determine whether to place an index addition into the value or growth Index. A company is added to the growth index if its book-to-price ratio is lower than the most recent semi-annual cutoff value; otherwise, it is added to the value index. When companies are deleted from the larger index, they are also dropped from the value and growth indexes.

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