Confidence must be earned

Amundi Pioneer
ASSET MANAGEMENT

Concentration Risks Continue in the Russell 1000® Growth Index

Market Perspective | November 2020

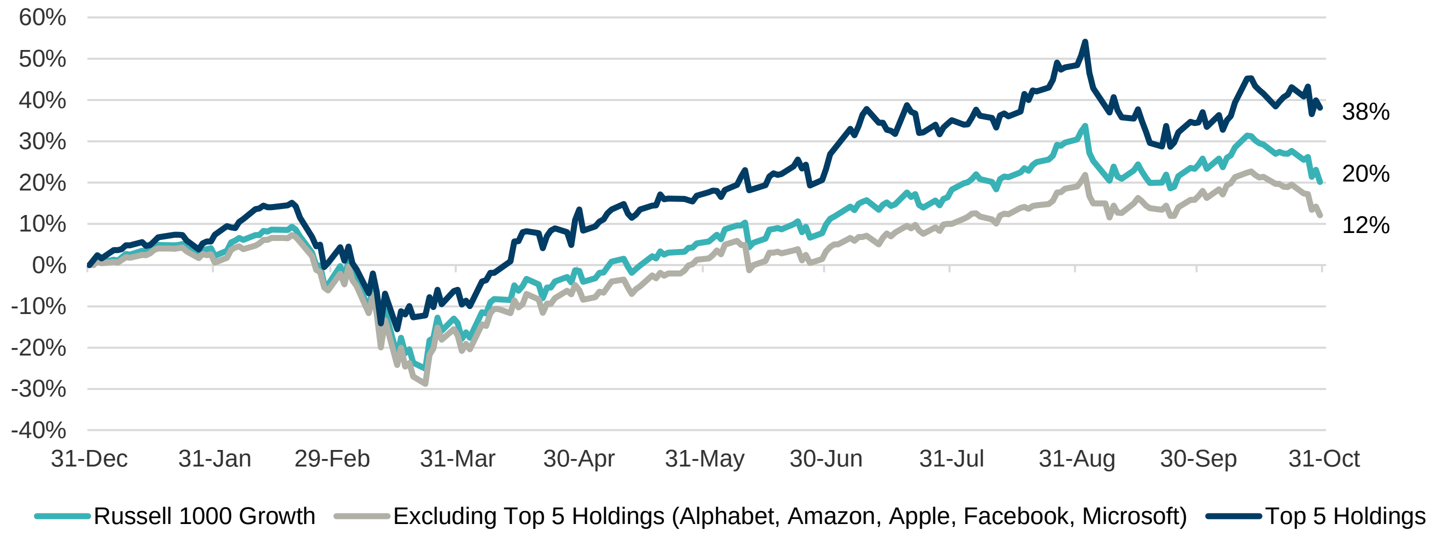
Executive Summary

- The return of the Russell 1000® Growth Index year-to-date through October 31 has been led by the top five stocks in the Index, and more generally by stocks with high valuations; stocks with average or below-average valuations have trailed the benchmark significantly.[1]
- The Index has become highly concentrated at both the stock and sector levels and is no longer a diversified[2] index, based on our view of appropriate portfolio risk management.
- We believe the lack of diversification in the Index elevates its risk profile, making it increasingly vulnerable to even minor corrections in high valuation technology-related stocks.
- Active growth managers with a diversified approach may be able to provide a more balanced risk-return profile, but could likely deviate from the Russell 1000® Growth Index in the process, raising the question of how best to evaluate their results.

A Tale of Two Markets: The Index Returns through October With and Without the Top Five Stocks Were Vastly Different

- The top five stocks in the Russell 1000® Growth Index returned 38% (market cap-weighted) this year through the end of October.
- The remaining stocks in the Index only rose 12% during the same period. This was primarily due to the COVID-19 induced contraction in GDP, which caused earnings for the Russell 1000® Growth Index to contract in the first half of the year. We believe the primary reason the five largest stocks in the Index performed so well is due to their significantly higher earnings growth compared to the Index overall. In part, this was also because they benefitted from secular growth trends, such as cloud computing and subscription movies, that accelerated as people spent more time at home. In our view, the disparity in earnings growth is not likely to continue as the economy recovers and earnings of companies that have been negatively impacted by the pandemic rebound.

Top 5 Stocks Have Driven Returns of the Russell 1000® Growth Index Year-to-Date



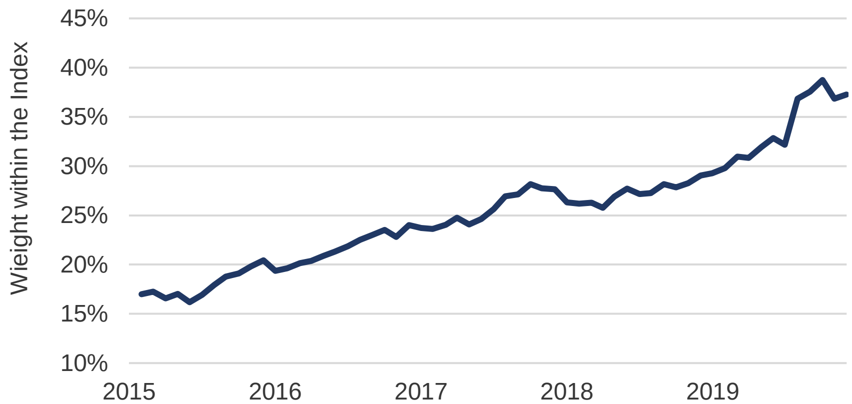
Source: Factset. Data as of October 31, 2020. Securities listed are not meant to represent any current or future holding of an Amundi Pioneer portfolio, and should not be considered recommendations to buy or sell any security.

[1]Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index. [2]Diversification does not assure a profit or protect against loss.

The Russell 1000® Growth Index has Become More Concentrated than Ever

- In our view, the outperformance of the top five stocks in the Russell 1000® Growth Index this year, coupled with a reconstitution of the Index in June 2020, have caused the Index to become extremely concentrated at both the stock and sector levels.
- The aggregate weighting of the top five stocks in the Index over the period rose from 17% as of December 31, 2015 to 38% as of October 31, 2020. This concentration level greatly exceeds the prior peak level of concentration of 26% as of December 31, 2000.

Top Five Issuers as % of Russell 1000® Growth Index



Source: Factset. Data as of October 31, 2020.

Stock	% of Index
Apple	11%
Microsoft	10%
Amazon.com	8%
Alphabet	5%
Facebook	4%
Total	**38%**

Securities listed are not meant to represent any current or future holding of an Amundi Pioneer portfolio, and should not be considered recommendations to buy or sell any security.

- Even before this year, the concentration in the Index had increased as the number of holdings declined. As shown below, the Russell 1000® Growth Index does not include 1000 stocks, but rather a subset of the Russell 1000® Index that has growth attributes. The number of stocks that meet the criteria to be included has declined 36% over the past five years, such that there are currently only 446 stocks in the Index.

Significant Decline in Stocks within the Russell 1000® Growth Index

Date	Number of Holdings
December 31, 2016	606
December 31, 2017	635
December 31, 2018	608
December 31, 2019	550
October 31, 2020	446

Source: Factset. Data as of October 31, 2020.

- Even though the stocks are in three different sectors (consumer discretionary, communication services and information technology), the five largest stocks have tended to move together during certain periods. For example Microsoft (MSFT), the largest-weighted of the top five, had high correlations to the four other largest stocks using weekly returns for the three-year period ending October 31, 2020.

Correlation of Microsoft to Top Four Stocks in the Russell 1000® Growth Index

	Alphabet (GOOGL)	Amazon.com (AMZN)	Apple (APPL)	Facebook (FB)
Microsoft (MSFT)	0.69	0.65	0.65	0.52

Source: Morningstar. Data as of October 31, 2020. **Correlation** is the degree to which assets or asset class prices have moved in relation to one another. Correlation ranges from -1 (always moving in opposite directions) through 0 (absolutely independent) to 1 (always moving together). **Data is based on past performance, which is no guarantee of future results.**

- At the sector level, the information technology sector now accounts for 44% of the Index (as of October 31), which is also a record. Moreover, until two years ago when the communication services sector was created, Alphabet and Facebook were included in the information technology sector. If these stocks were added back to the information technology sector, consistent with how they were categorized previously, the information technology weighting would climb to 56% of the Index. With the new sector classification two years ago, there are now eleven sectors in the Index. The fact that one sector represents more than half the value in the Index is a clear indication to us that the Index is not diversified.

Why High Concentration in the Russell 1000® Growth Index Matters

1. **Risk**: As noted the Russell 1000® Growth Index can no longer be considered diversified. Accordingly, the Index could be vulnerable to significant losses if the information technology sector and/or some or all of the top five stocks falter.
2. **Valuation**: While the fundamentals of technology stocks may appear solid, valuations of these stocks have become elevated as interest rates have collapsed and investors have favored stay-at-home stocks, such as streaming video services. Year-to-date, the top quintile stocks in the Russell 1000® Growth Index in terms of price-to-earnings (34x and higher) have outperformed the rest of the Index by a wide margin.[3] This included some of the top five stocks but also a number of other stocks, such as web-based application software companies, that had much higher valuations than the top five. If valuations compress, either because of a deterioration in fundamentals, a failure to meet lofty expectations or because interest rates rise as the economy rebounds, we believe high valuation stocks could underperform, possibly quite severely as they did after the dotcom stock bubble in 2000. Of course, there is no way to predict how these stocks would perform.

High P/E Stocks in the Russell 1000© Growth Index Have Outperformed Year-to-Date

Quintile	P/E	Year-to-Date Total Return
1st	34x and higher	**53%**
2nd	24x – 34x	**19%**
3rd	19x – 24x	**7%**
4th	14x – 19x	**-4%**
5th	Less than 14x	**-7%**

Source: Factset. Data as of October 31, 2020. **Price-Earnings Ratio (P/E)** is the current price of a stock divided by the estimated 1-year projection of its earnings per share.

3. **Inefficiency**: A basic premise of modern portfolio theory is that if a portfolio is diversified, then the risk of losses can potentially be reduced by decreasing the correlation between the returns of the assets selected for a portfolio. Given that correlations within Russell 1000® Growth Index sectors have tended to be high, investing in an index with 56% of its assets in technology-related stocks does not appear to be efficient from our portfolio construction perspective. Investors who want such significant exposure to information technology might be better off investing in a technology fund that is constructed to optimize the risk and return within that sector.

[3]Excluding Apple, which was removed from the analysis because it inflated the returns of the 19x-24x P/E quintile. Removing Apple illustrated that 19x-24x P/E stocks returned less than half the Index YTD through October 31.

Be Prepared for Higher Benchmark Volatility or Consider Investing with Active Managers Who Diversify

- Information technology stocks outperformed in recent years when the economy was growing, during the 2020 correction and most recently, in the rebound from the correction. From our perspective, there is not much more that can go right for information technology stocks, relative to the opportunities in other sectors that have underperformed during the pandemic. Our job as investors is to assess risk and potential reward. While it may still favorable for a number of technology-related stocks, we believe there are regulatory, valuation and execution risks that at some point could lead the sector, and by extension the Index, to become more volatile.
- Investors with high exposure to the Russell 1000® Growth Index, in our view, can either accept the likely risk of higher volatility or consider investing with active managers who seek to diversify portfolios. If they do the latter, the question is how best to evaluate the performance of these managers as such portfolios are likely to generate a different performance profile than the benchmark.
- Our view is that the high concentration levels in the Index can provide active managers an opportunity to offer more diversified exposure to large-cap growth, and in the process pursue better risk-adjusted returns than the Index over time.

Contributors:

ANDREW ACHESON
Director of Growth, US
Portfolio Manager

PAUL CLOONAN
Portfolio Manager

MATTHEW GORMLEY
Investment Associate

ALEC MURRAY
Client Portfolio Manager, Equities

Average P/E Ratio (Estimated) is the current price of a stock divided by the estimated 1 year projection of its earnings per share. **The Russell 1000® Growth Index** measures the performance of the large-capitalization growth sector of the US equity market. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index.

Important Information

Unless otherwise stated, all information contained in this document is from Amundi Pioneer Asset Management and is as of 31 October 2020.The views expressed regarding market and economic trends are those of Amundi Pioneer Asset Management, and are subject to change at any time based on market and other conditions and there can be no assurances that countries, markets or sectors will perform as expected. These views should not be relied upon as investment advice, as securities recommendations, or as an indication of trading on behalf of any Amundi Pioneer Asset Management product. There is no guarantee that market forecasts discussed will be realized or that these trends will continue. Investments involve certain risks, including political and currency risks. Investment return and principal value may go down as well as up and could result in the loss of all capital invested. This material does not constitute an offer to buy or a solicitation to sell any units of any investment fund or any services. Date of First Use: 17 November 2020.

Amundi Pioneer Asset Management is the US business of the Amundi Asset Management group of companies.