

Equity Research update

Emerging Markets & Global Small Caps

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FOR FINANCIAL ADVISERS ONLY

Agenda

Emerging markets: the 2026 evidence update

1

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2

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Emerging markets

The 2026 evidence update



EM has matched the US and beaten developed markets ex-US

Growth of £1,000, July 1998 to December 2025



Annualised return

(Annualised volatility)

9.68% (15.23%)

US

9.55% (18.91%)

Emerging markets

8.75% (14.31%)

Developed World

7.31% (14.16%)

Developed World ex-US

Source: Growth of £1,000 invested, July 1998 – December 2025. Sources: Developed World Equities: Morningstar Developed World Target Market Exposure Index (GR, GBP), Emerging Markets Equities: Fama/French Emerging Markets 5 Factors dataset, Emerging Markets index (GR, GBP). US Equities: Robert J. Shiller US Stock Market Data (S&P Composite, GR, GBP). Developed World ex-US Equities: Morningstar Developed World ex-US Target Market Exposure Index (GR, GBP). Global Small: Dimensional Global Small Cap Index (GR, GBP). Global Value: Dimensional Global Value Index (GR, GBP). Data period: July 1998 – December 2025.

Past performance is not a reliable indicator of future results.

How often EM out-performed, across all rolling windows

EM out-performed	5-year	10-year	20-year
vs Developed World	43.3%	42.9%	72.2%
vs Developed World ex-US	57.8%	60.0%	100%
vs US	40.0%	40.0%	57.8%

~2/3

of a Developed World index is now the US

So comparing EM with Developed World is partly comparing it with the US. Strip the US out and EM looks much stronger.

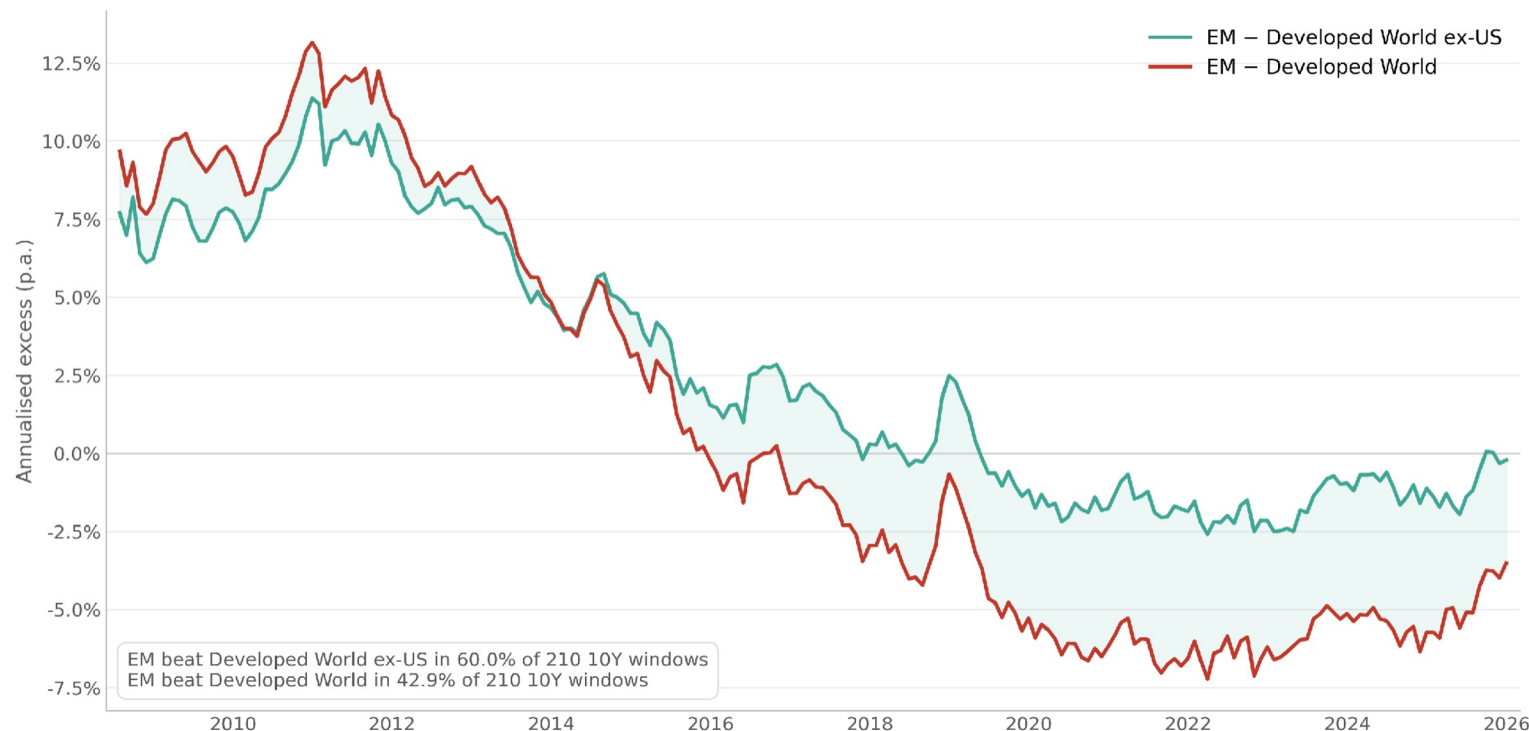
270 five-year, 210 ten-year and 90 twenty-year windows. They overlap, so there are far fewer truly independent market cycles than the counts suggest.

Source: Timeline analysis. Developed World: Morningstar Developed World Target Market Exposure Index. Developed World ex-US: Morningstar Developed World ex-US Target Market Exposure Index. US: Robert J. Shiller US Stock Market Data (S&P Composite). Emerging Markets: Fama/French Emerging Markets 5 Factors dataset, Emerging Markets index. All gross returns in GBP, July 1998 to December 2025. Rolling windows measured monthly.

Past performance is not a reliable indicator of future results.

The EM premium has narrowed sharply over the last decade

Rolling 10-year annualised excess return of EM versus Developed World and Developed World ex-US



10-year

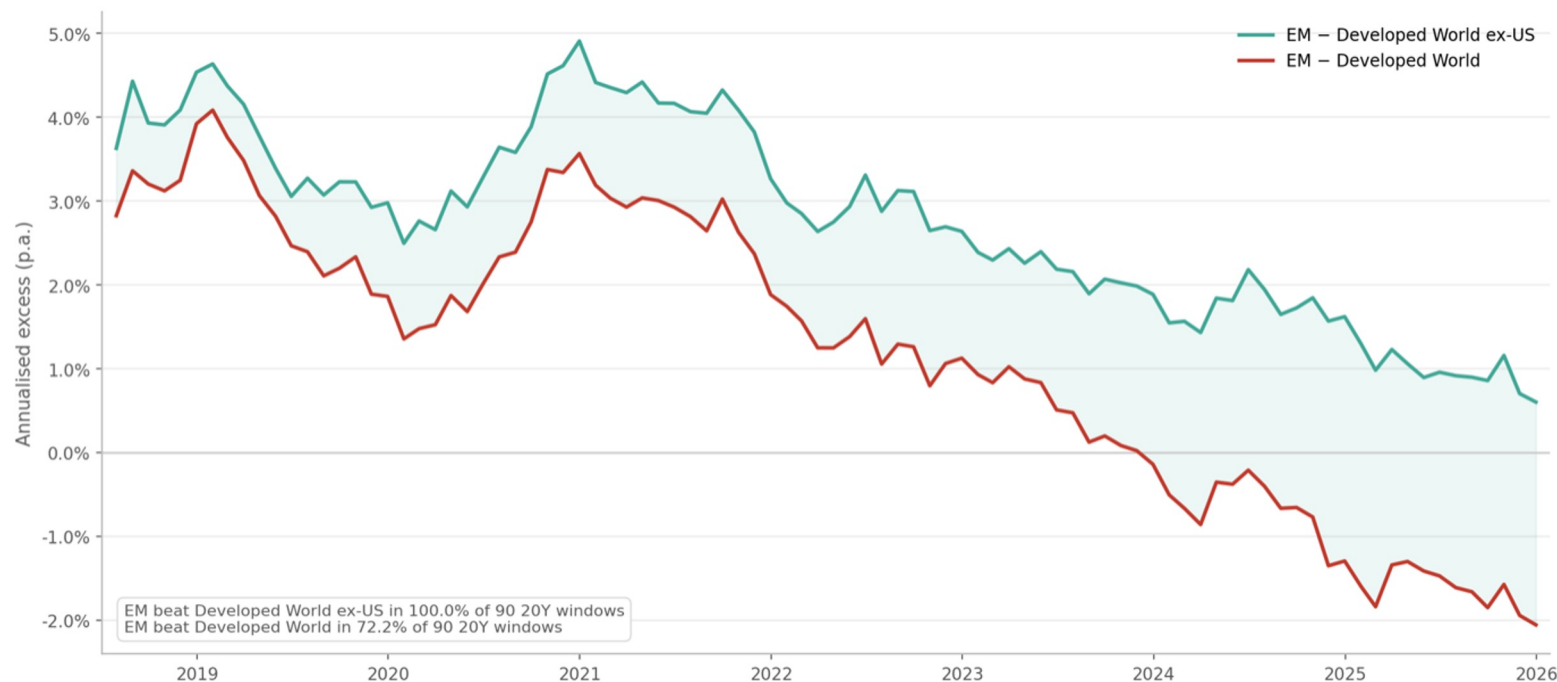
EM led by up to 12% a year after the early 2000s, but has trailed Developed World since around 2017.

Source: Timeline analysis. Developed World: Morningstar Developed World Target Market Exposure Index. Developed World ex-US: Morningstar Developed World ex-US Target Market Exposure Index. Emerging Markets: Fama/French Emerging Markets 5 Factors dataset, Emerging Markets index. All gross returns in GBP. Underlying data: July 1998 to December 2025. Rolling 10-year windows measured monthly and plotted at each window's end date, so the first point (June 2008) covers July 1998 to June 2008.

Past performance is not a reliable indicator of future results.

The EM premium has narrowed sharply over the last decade

Rolling 20-year annualised excess return of EM versus Developed World and Developed World ex-US



20-year

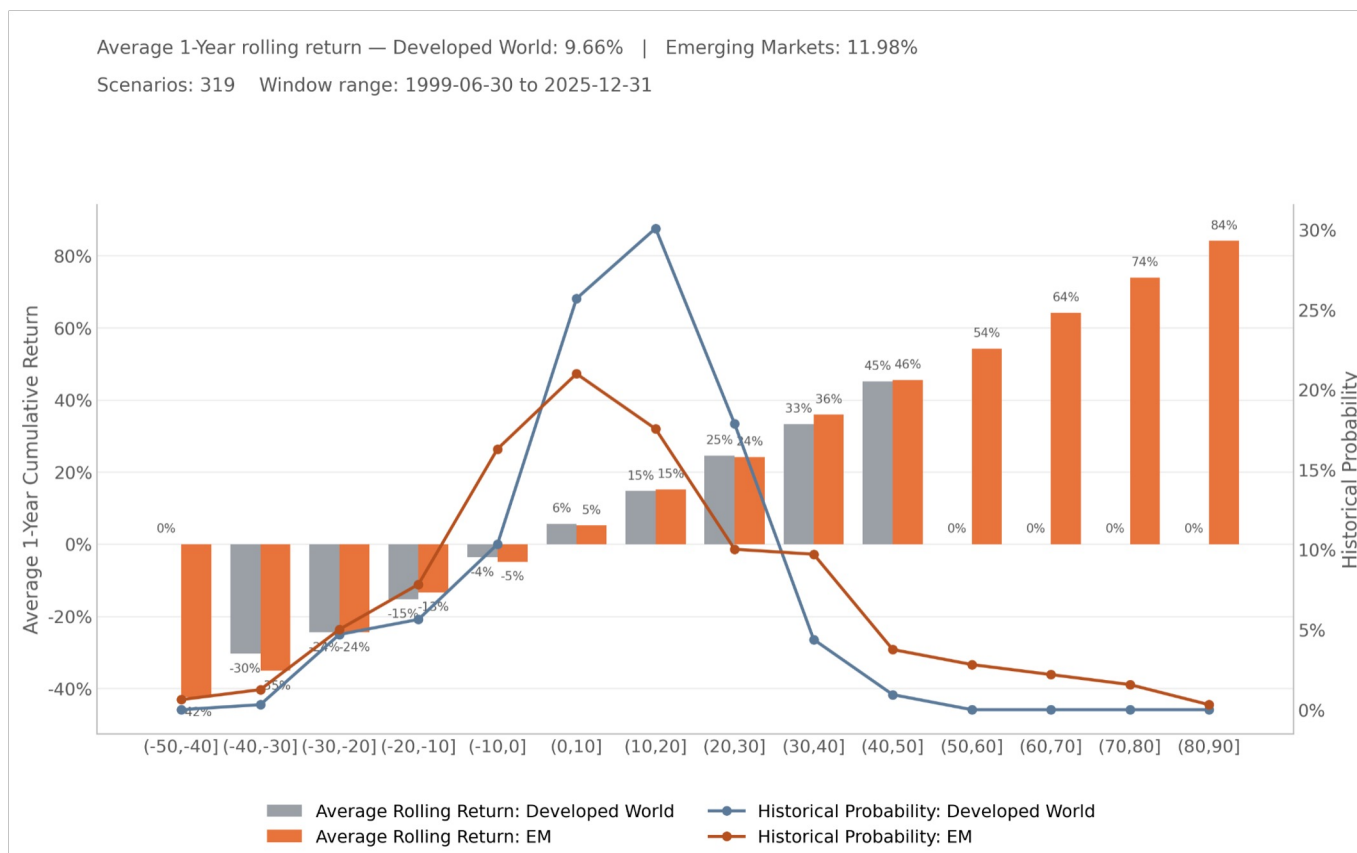
still ahead of Developed World ex-US, but the margin is now below 1% a year.

Source: Timeline analysis. Developed World: Morningstar Developed World Target Market Exposure Index. Developed World ex-US: Morningstar Developed World ex-US Target Market Exposure Index. Emerging Markets: Fama/French Emerging Markets 5 Factors dataset, Emerging Markets index. All gross returns in GBP. Underlying data: July 1998 to December 2025. Rolling 20-year windows measured monthly and plotted at each window's end date, so the first point (June 2018) covers July 1998 to June 2018.

Past performance is not a reliable indicator of future results.

EM's extra risk shows up mostly over shorter horizons

Distribution of 1-year rolling returns, Developed World (grey) versus EM (orange)



1 year

EM lost money in 31% of periods, versus 21% for Developed World.

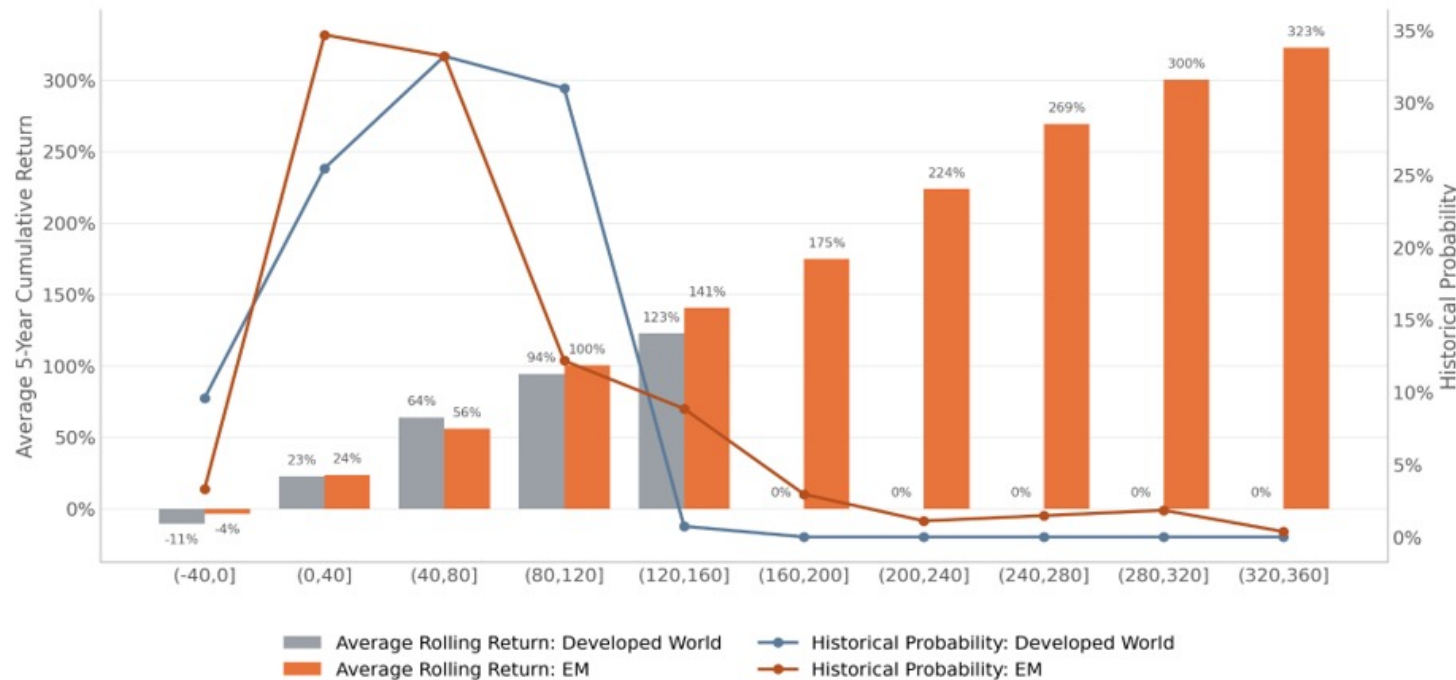
Source: Timeline analysis. Developed World: Morningstar Developed World Target Market Exposure Index. Emerging Markets: Fama/French Emerging Markets 5 Factors dataset, Emerging Markets index. All gross returns in GBP. Underlying data: July 1998 to December 2025; 319 rolling 1-year windows measured monthly, the first covering July 1998 to June 1999.

Past performance is not a reliable indicator of future results.

At five years, EM loses money less often

Distribution of 5-year rolling returns, Developed World (grey) versus EM (orange)

Average 5-Year rolling return — Developed World: 56.14% | Emerging Markets: 69.66%
Scenarios: 271 Window range: 2003-06-30 to 2025-12-31



5 years

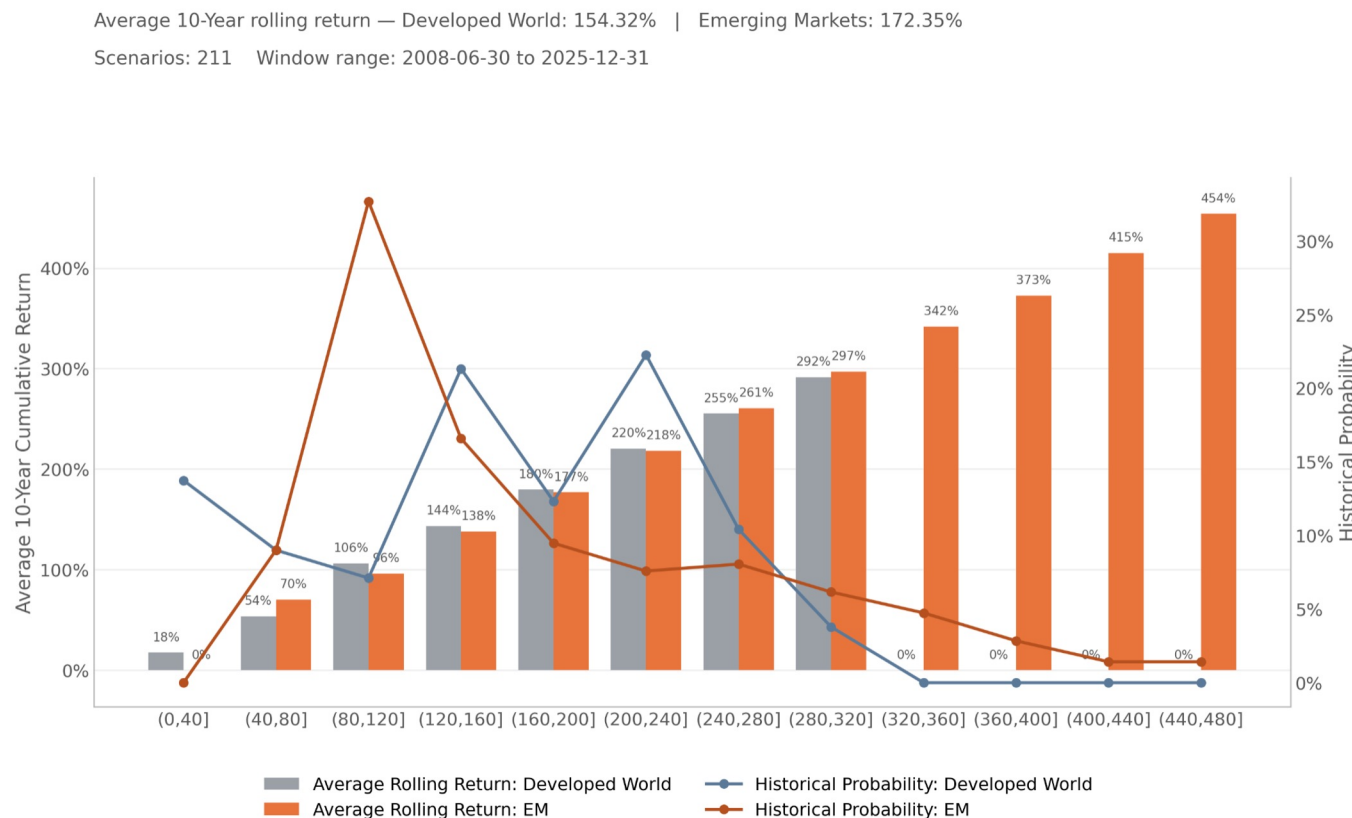
EM lost money in 3% of periods, versus 10% for Developed World, but its outcomes spread much wider.

Source: Timeline analysis. Developed World: Morningstar Developed World Target Market Exposure Index. Emerging Markets: Fama/French Emerging Markets 5 Factors dataset, Emerging Markets index. All gross returns in GBP. Underlying data: July 1998 to December 2025; 271 rolling 5-year windows measured monthly, the first covering July 1998 to June 2003.

Past performance is not a reliable indicator of future results.

EM's extra risk shows up mostly over shorter horizons

Distribution of 10-year rolling returns, Developed World (grey) versus EM (orange)



10 years

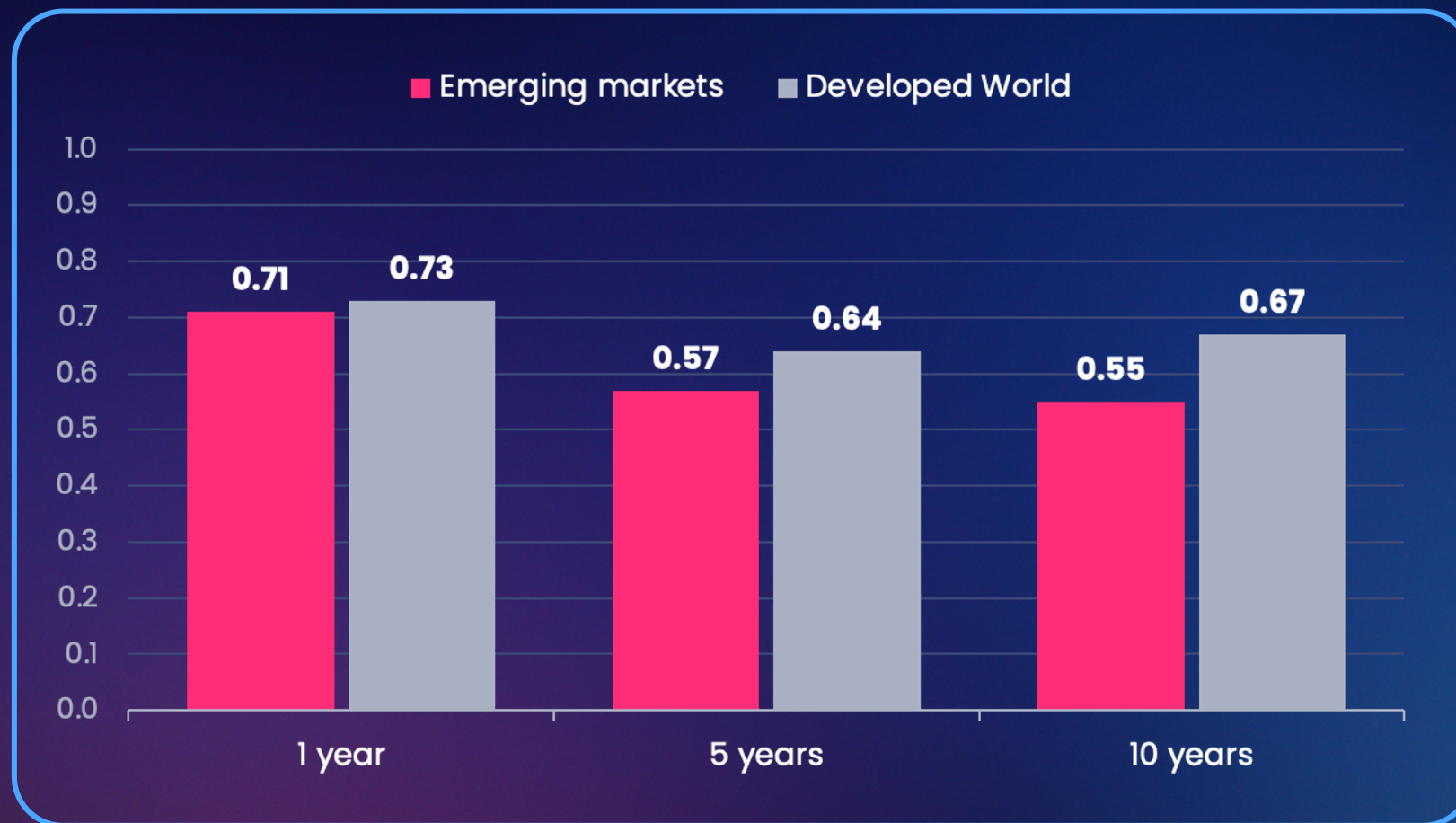
no losing periods for either, and EM's outcomes still sit further to the right.

Source: Timeline analysis. Developed World: Morningstar Developed World Target Market Exposure Index. Emerging Markets: Fama/French Emerging Markets 5 Factors dataset, Emerging Markets index. All gross returns in GBP. Underlying data: July 1998 to December 2025; 211 rolling 10-year windows measured monthly, the first covering July 1998 to June 2008.

Past performance is not a reliable indicator of future results.

Higher return, but no better return for the risk

Sharpe ratio by holding period (0% risk-free rate)



18.9% vs 14.3%

annualised volatility, EM versus Developed World

-45.1% vs -45.7%

maximum drawdown, broadly similar

Same story

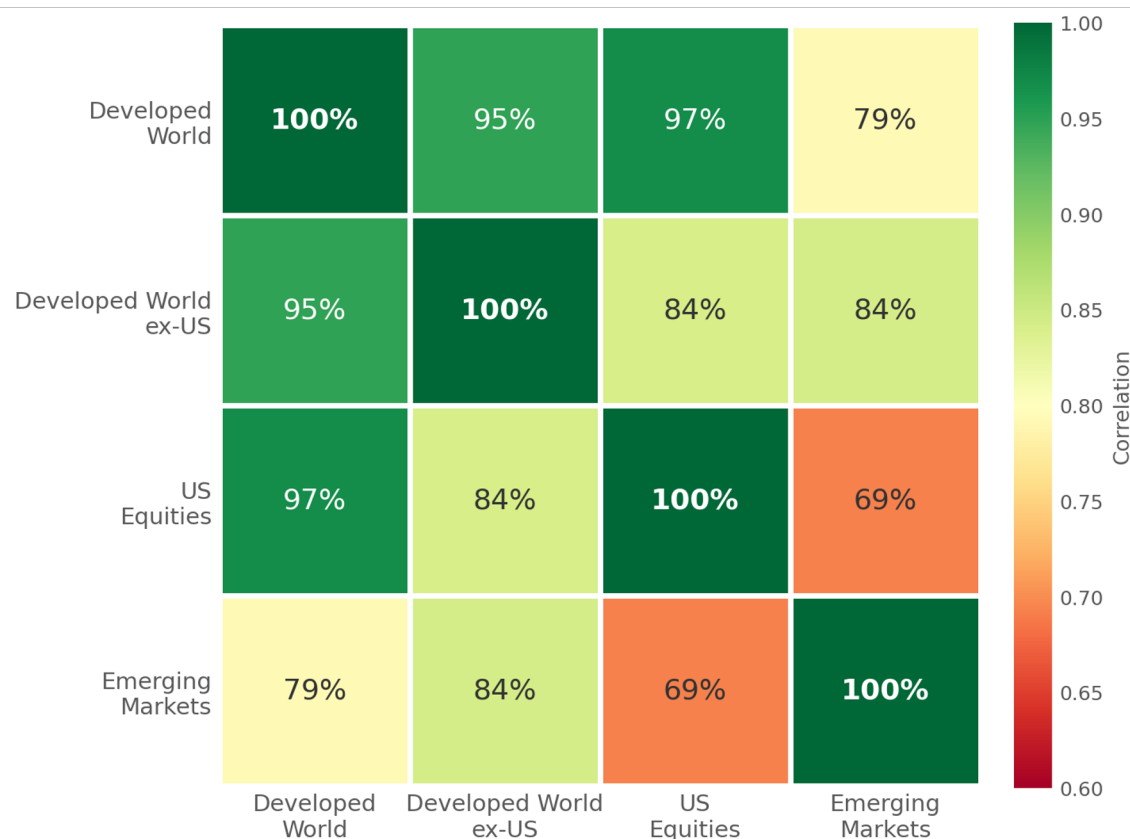
on a Sortino basis, at every horizon

Source: Timeline analysis. Developed World: Morningstar Developed World Target Market Exposure Index. Emerging Markets: Fama/French Emerging Markets 5 Factors dataset, Emerging Markets index. Gross returns in GBP, July 1998 to December 2025. Sharpe ratios average rolling windows (0% risk-free rate); volatility and drawdown are full-period.

Past performance is not a reliable indicator of future results.

EM diversifies, but modestly and mostly against the US

Average within-window correlation over 20-year horizons



69%

EM with US equities

79%

EM with Developed World

84%

EM with Developed World ex-US

EM moves largely in line with developed markets over the long run.

Source: Timeline analysis. Developed World: Morningstar Developed World Target Market Exposure Index. Developed World ex-US: Morningstar Developed World ex-US Target Market Exposure Index. US: Robert J. Shiller US Stock Market Data (S&P Composite). Emerging Markets: Fama/French Emerging Markets 5 Factors dataset, Emerging Markets index. GBP, gross, July 1998 to December 2025; rolling 20-year windows, the first ending June 2018.

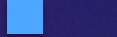
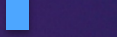
Past performance is not a reliable indicator of future results.

EM is more top-heavy than the developed world

Top 10 holdings of each index fund, % of fund

Developed World

Top 10: 27.5%

	NVIDIA		5.50%
	Apple		5.04%
	Microsoft		3.88%
	Alphabet		3.85%
	Amazon		2.72%
	Broadcom		1.81%
	Meta Platforms		1.36%
	Micron Technology		1.17%
	Tesla		1.14%
	JPMorgan Chase		1.03%

Emerging Markets

Top 10: 38.2%

	TSMC		15.12%
	Samsung Electronics		8.08%
	SK hynix		5.47%
	Tencent		2.88%
	Alibaba		1.97%
	MediaTek		1.45%
	Delta Electronics		0.91%
	China Construction Bank		0.83%
	Hon Hai Precision		0.78%
	HDFC Bank		0.69%

TSMC alone (15.1%) outweighs NVIDIA, Apple and Microsoft combined (14.4%)

Source: Northern Trust World and EM Equity Index Funds (Class X GBP Dist), latest top 10 holdings. As at 30 September 2026. Companies are shown for illustration only and are not a recommendation to buy or sell any security.

Where the evidence leaves emerging markets

1

The premium is real

EM beat Developed World ex-US in every 20-year window and roughly matched the US.

2

So is the risk

Higher volatility, more frequent short-term losses and no better Sharpe ratio at any horizon.

3

Diversification is modest

Long-run correlations of 69% to 84%, with Tech correlation to the US continually higher.

For portfolio construction, the question is how much risk is worth taking to collect the EM premium, and whether there's a more efficient way to earn it within EM itself.

Risk factors within EM

Value, Quality and Momentum

Why factor premia could be larger in EM

Both main explanations for factor premia point the same way

Risk explanation

Investors are paid for bearing more risk

- Macroeconomic and currency instability
- Political risk and weaker creditor protection
- More cyclical company earnings

Mispricing explanation

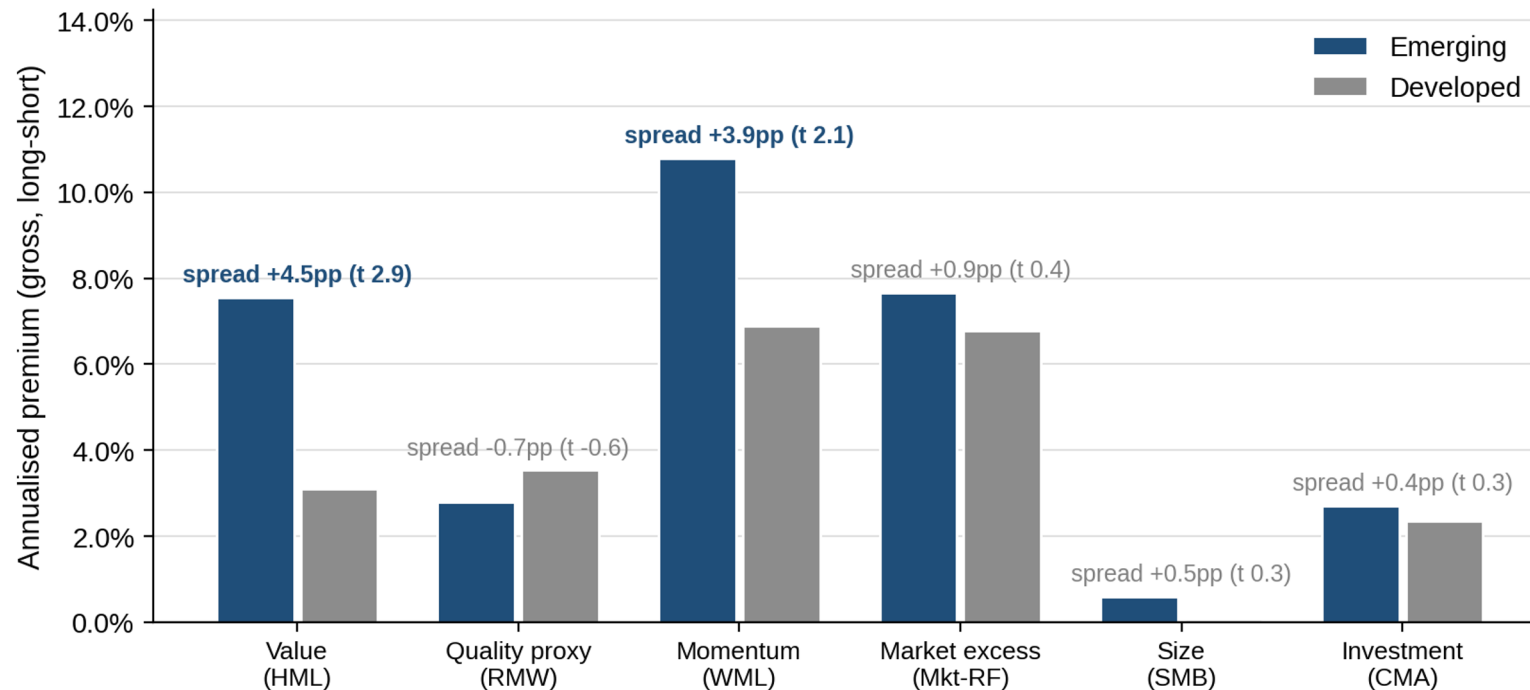
Prices adjust to news more slowly

- Thinner analyst coverage and weaker disclosure
- More retail, less institutional ownership
- Tighter short-selling constraints

The catch: the same frictions that create bigger premia also make them more expensive to capture. Higher trading costs, lower liquidity, less capacity.

Value and momentum premia have been larger in EM

Annualised long-short factor premia, EM versus Developed, common samples to May 2026



7.6% vs 3.1%

Value, spread t-stat 2.9

10.8% vs 6.9%

Momentum, spread t-stat 2.1

2.8% vs 3.5%

Quality proxy, no EM advantage

Source: Timeline analysis of Kenneth French Data Library Emerging Markets and Developed factor returns, May 2026 vintage. Monthly long-short factor returns in USD, gross of costs and fees; annualised arithmetic means. Common EM and DM samples to May 2026, starting July 1990 (HML, Mkt-RF, SMB), July 1991 (RMW), November 1990 (WML) and July 1992 (CMA).

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Value and momentum premia have been larger in EM

Table 1. Annualised long-short factor premia, EM versus Developed, common samples to May 2026

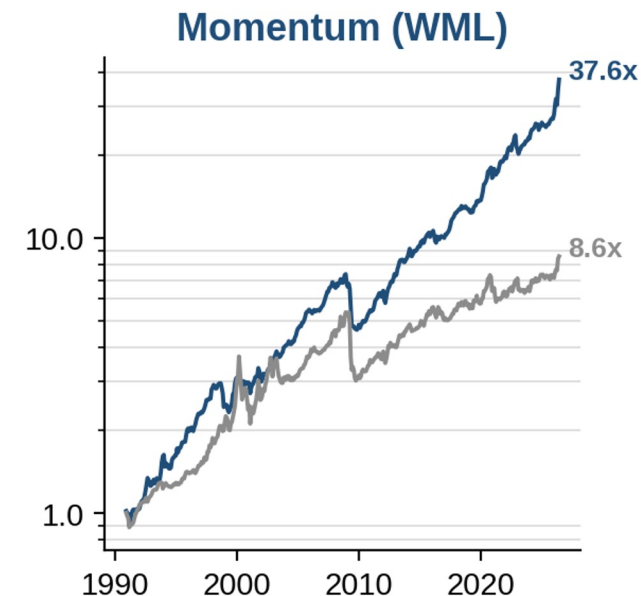
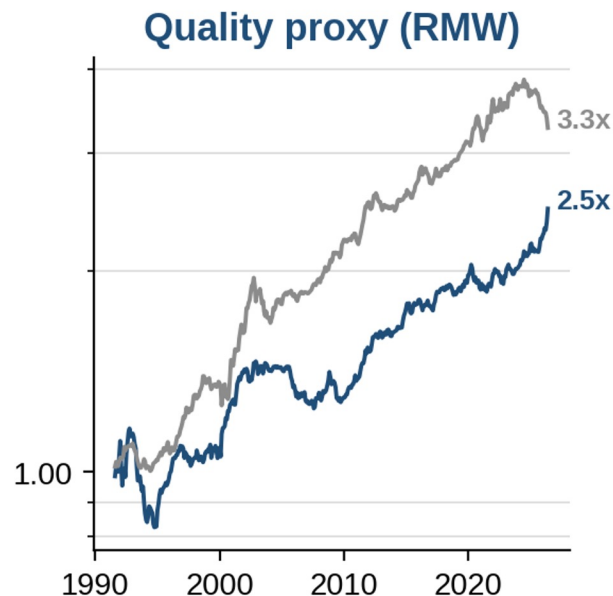
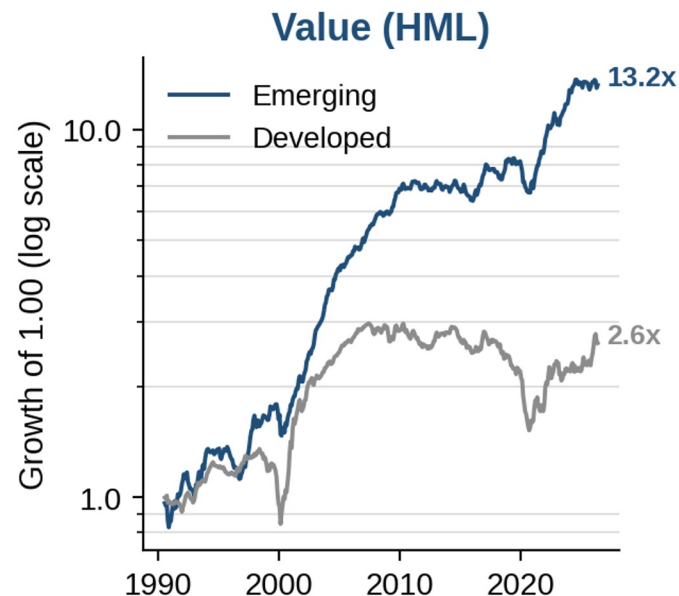
Factor	Common sample	EM premium pa	DM premium pa	EM-DM spread pa	Spread t-stat	Corr (EM, DM)
Value (HML)	Jul 1990–May 2026	7.56%	3.09%	+4.47%	2.94	0.45
Quality proxy (RMW)	Jul 1991–May 2026	2.79%	3.53%	-0.74%	-0.57	0.08
Momentum (WML)	Nov 1990–May 2026	10.79%	6.89%	+3.90%	2.14	0.58
Market excess (Mkt-RF)	Jul 1990–May 2026	7.66%	6.79%	+0.87%	0.41	0.78
Size (SMB)	Jul 1990–May 2026	0.59%	0.05%	+0.54%	0.34	0.15
Investment (CMA)	Jul 1992–May 2026	2.70%	2.34%	+0.36%	0.27	0.36

Source: Timeline analysis of Kenneth French Data Library Emerging Markets and Developed factor returns, May 2026 vintage. Monthly long-short factor returns in USD, gross of costs and fees; annualised arithmetic means. Common EM and DM samples to May 2026, starting July 1990 (HML, Mkt-RF, SMB), July 1991 (RMW), November 1990 (WML) and July 1992 (CMA).

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Persistence of Emerging Market factor premia

Cumulative long-short factor return, EM versus Developed, log scale



13.2x vs 2.6x

cumulative growth of value, EM versus Developed

98%

of rolling 10-year periods with a positive EM value premium

+6.6% a year

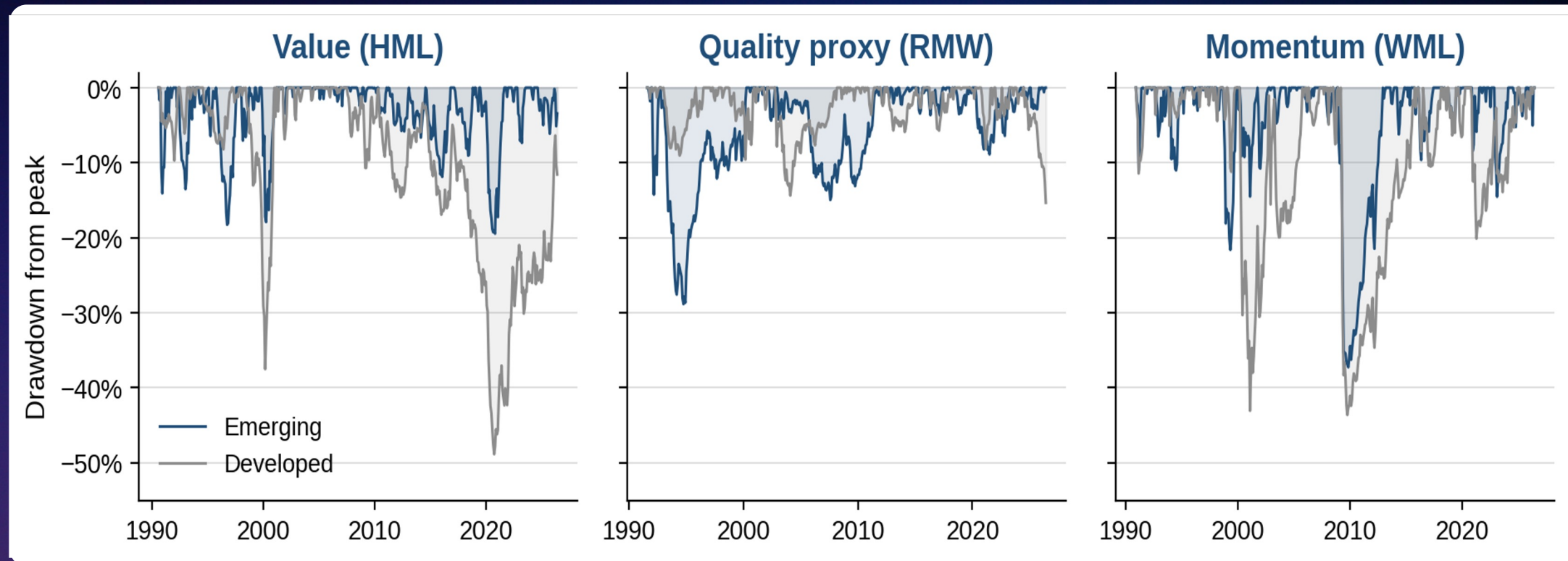
momentum spread over Developed since 2013, its strongest period

Source: Timeline analysis of Kenneth French Data Library Emerging Markets and Developed factor returns, May 2026 vintage. Monthly long-short returns in USD, gross of costs and fees; log scale. Common samples to May 2026, starting July 1990 (value), July 1991 (quality proxy) and November 1990 (momentum); spread since 2013 from January 2013.

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A distinct source of return, without much more risk

EM factors regressed on their developed-market equivalents, and long-short drawdowns



19% vs 49%

Value max drawdown, EM vs DM

29% vs 15%

Quality max drawdown, the exception

37% vs 44%

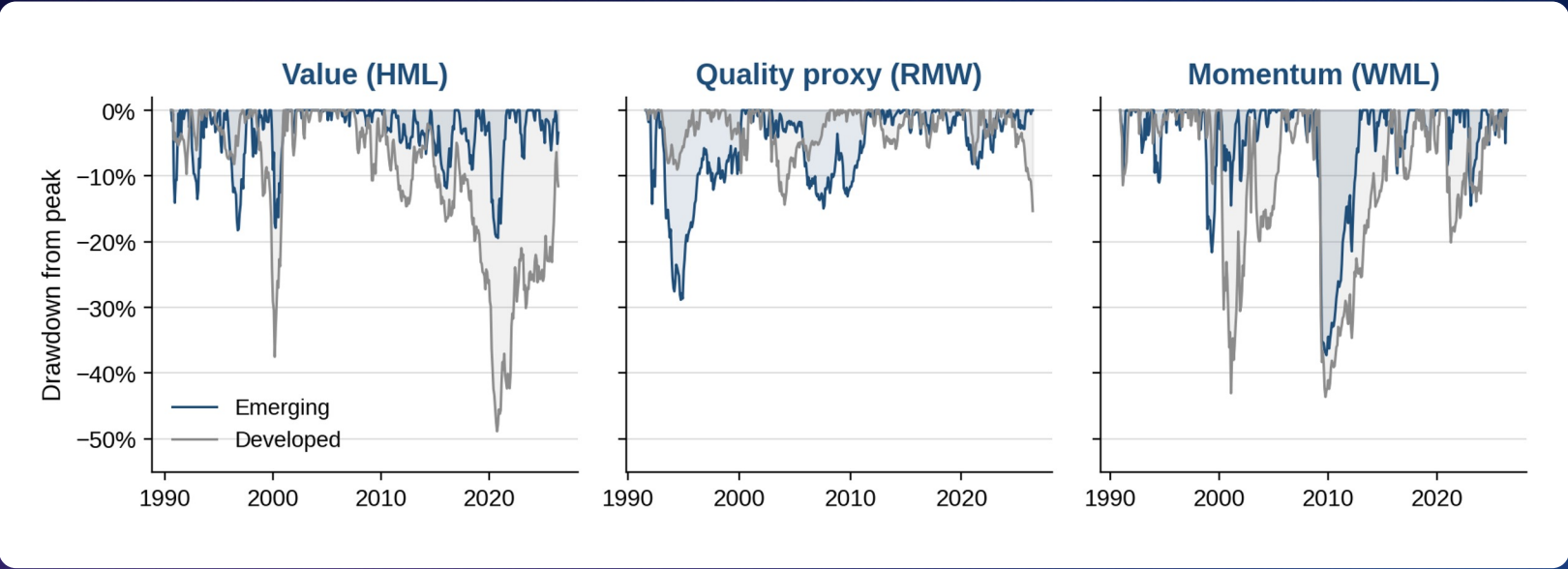
Momentum max drawdown, EM vs DM

Source: Timeline analysis of Kenneth French Data Library Emerging Markets and Developed factor returns, May 2026 vintage. Monthly long-short factor returns in USD, gross of costs and fees. Common EM and DM samples to May 2026, starting July 1990 (value), July 1991 (quality proxy) and November 1990 (momentum). Monthly OLS regressions of each EM factor on its developed-market equivalent; alpha annualised. Drawdowns are of cumulative factor returns.

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A distinct source of return, without much more risk

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37% vs 44%

Momentum max drawdown, EM vs DM

EM factor	Beta on DM factor	R ²	Alpha pa
Value	0.42	0.21	6.3%
Quality	0.10	0.01	2.4%
Momentum	0.47	0.34	7.5%

Low betas and R² mean most of the variation in EM factor returns is independent of developed markets. The value and momentum alphas are highly significant (t-stats above 4.9).

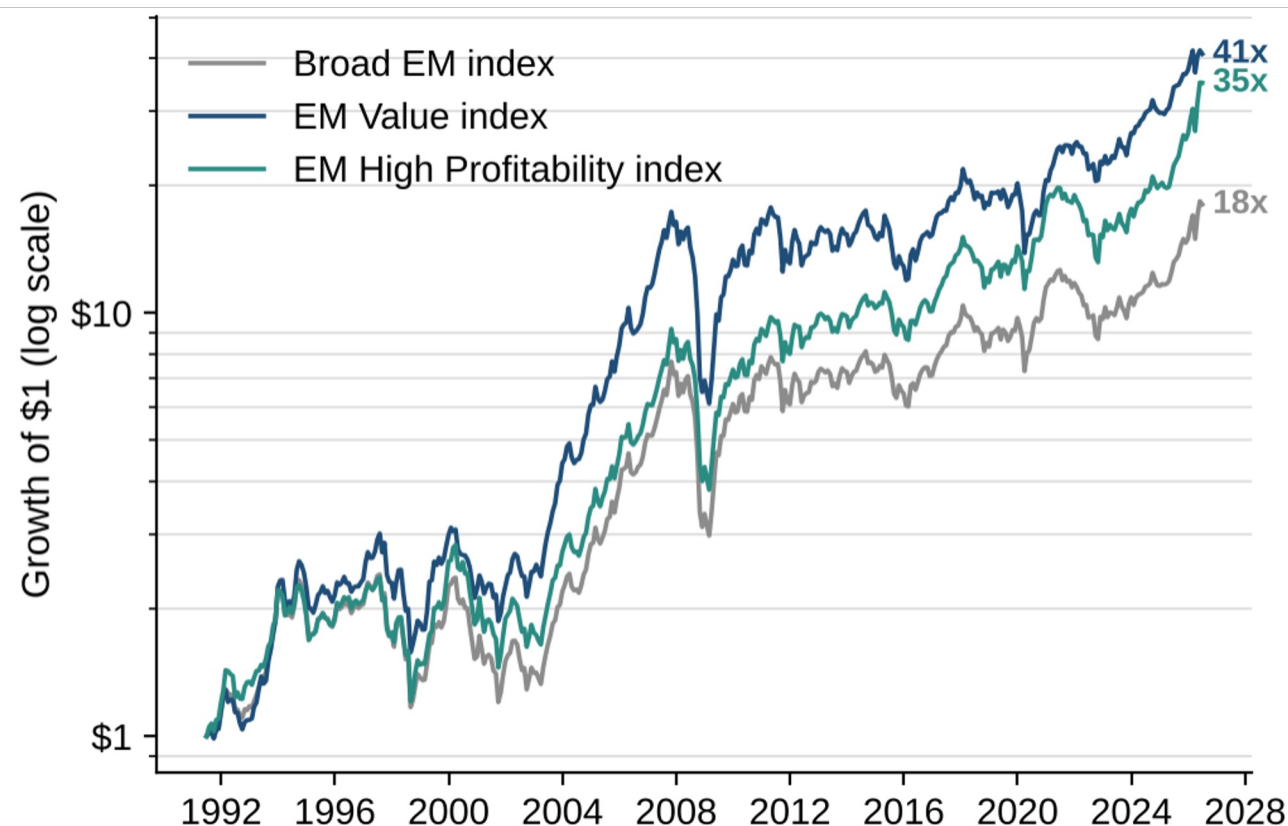
Source: Timeline analysis of Kenneth French Data Library Emerging Markets and Developed factor returns, May 2026 vintage. Monthly long-short factor returns in USD, gross of costs and fees. Common EM and DM samples to May 2026, starting July 1990 (value), July 1991 (quality proxy) and November 1990 (momentum). Monthly OLS regressions of each EM factor on its developed-market equivalent; alpha annualised. Drawdowns are of cumulative factor returns.

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What about long-only Portfolios?

Long-only, value and profitability added 2.6% and 2.1% a year

Growth of \$1, long-only EM factor portfolios versus the broad EM index, July 1991 to June 2026, log scale



+2.6% pa

EM Value over broad EM (t 2.6)

+2.1% pa

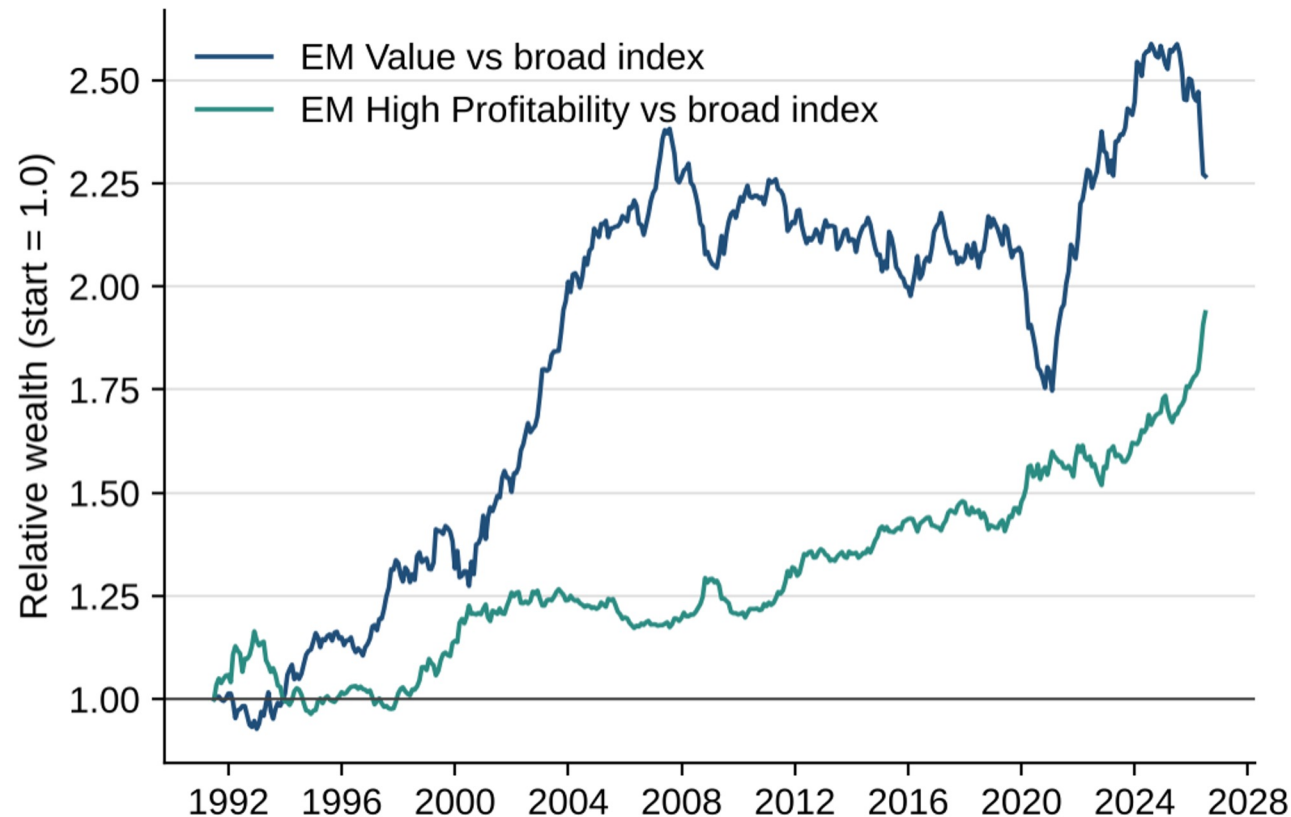
EM High Profitability (t 2.8)

Source: Timeline analysis of Fama/French Emerging Markets index series via Dimensional (broad EM, EM Value and EM High Profitability indices), monthly USD returns, July 1991 to June 2026, gross of fees and trading costs. Log scale. Compound annual growth rates; t-statistics computed on monthly excess returns.

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Long-only keeps about a third of the value premium

Cumulative return of long-only EM factor portfolios relative to the broad EM index, July 1991 to June 2026



- **Value:** 7.6% long-short to 2.6% long-only per year
- **Profitability:** 2.8% long-short to 2.1% long-only

Long-only keeps about a third of the value premium and about two-thirds of profitability.

Source: Timeline analysis of Fama/French Emerging Markets index series via Dimensional: broad EM index, EM Value index and EM High Profitability index. Monthly USD returns, July 1991 to June 2026, gross of fees and trading costs. Chart shows cumulative return relative to the broad EM index, so a rising line means the tilt is outperforming.

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Value pays more, profitability is more dependable

Consistency over time: Long-only excess returns by subperiod

Long-only index	Jul 1991–Dec 1999	Jan 2000–Dec 2012	Jan 2013–Jun 2026	Rolling 5y / 10y hit rate
EM Value	+3.4% (t 1.5)	+4.0% (t 2.7)	+0.6% (t 0.4)	77% / 80%
EM High Profitability	+1.6% (t 0.8)	+1.2% (t 1.3)	+2.8% (t 2.7)	78% / 97%

Annualised excess return a year over the broad EM index, t-statistic in brackets. Hit rate is the share of rolling five- and ten-year windows in which the index beat the broad EM index.

Source: Timeline analysis of Fama/French Emerging Markets index series via Dimensional (broad EM, EM Value and EM High Profitability indices), monthly USD returns, July 1991 to June 2026, gross of fees and trading costs. Rolling 10-year windows, the first ending June 2001. Subperiods: Jul 1991–Dec 1999, Jan 2000–Dec 2012, Jan 2013–Jun 2026.

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Value pays more, profitability is more dependable

Rolling 10-year excess return of long-only EM factor portfolios over the broad EM market



Source: Timeline analysis of Fama/French Emerging Markets index series via Dimensional (broad EM, EM Value and EM High Profitability indices), monthly USD returns, July 1991 to June 2026, gross of fees and trading costs. Rolling 10-year windows, the first ending June 2001. Subperiods: Jul 1991–Dec 1999, Jan 2000–Dec 2012, Jan 2013–Jun 2026.

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Where the evidence leaves factors within EM

Value

The strongest premium in EM, but it has arrived in bursts and lagged for long stretches.

Profitability

A smaller premium, but it has been more dependable and easier to hold.

Momentum

Powerful on paper and costly to trade. Best used selectively alongside other factors.

Long-only results

Long-only value and profitability beat the broad EM index by 2.6% and 2.1% a year gross, against a 7.6% long-short value premium.

Next: the same question for small caps. Is the raw size premium enough, or do quality and value do the heavy lifting?

Small caps

Quality, value and the size premium

Small caps have earned their place in evidence-based portfolios

Banz (1981)

Small US companies earned more than their market risk alone would predict.

Fama and French (1993)

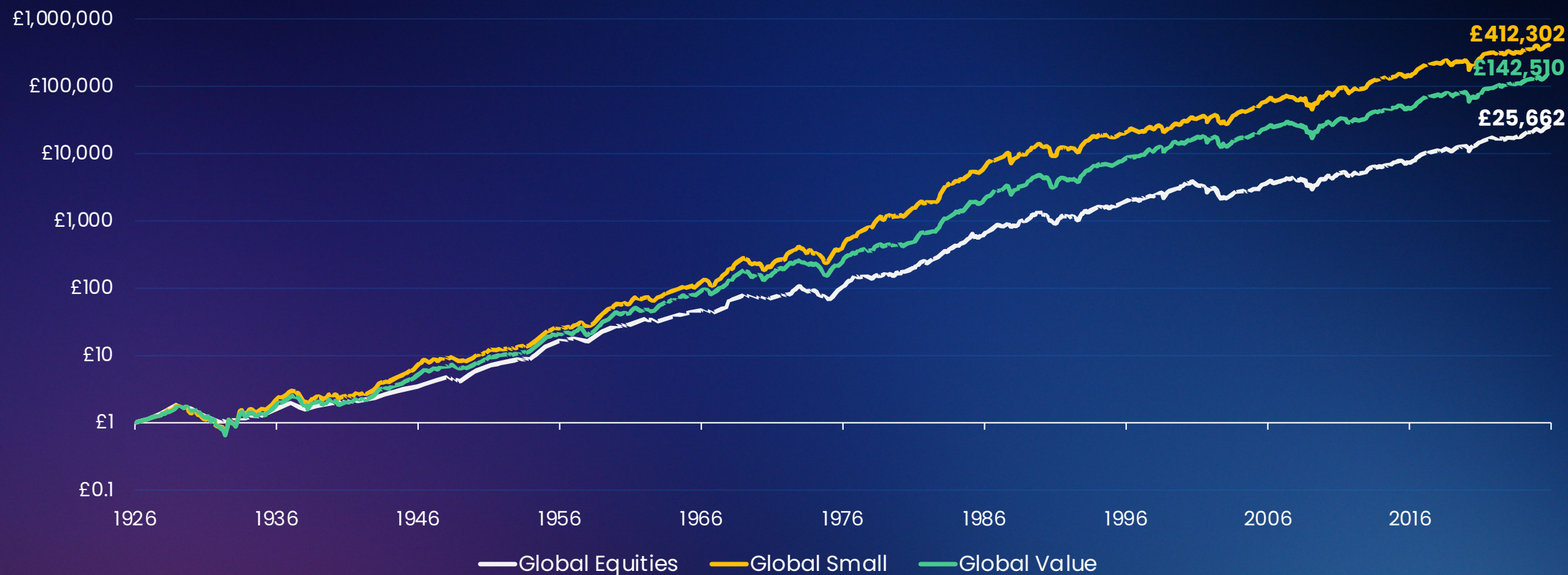
Size became a core factor in the three-factor model that reshaped asset management.

Why it should exist

Smaller firms are less liquid, more fragile and more exposed to the economy, so investors demand a higher return to hold them.

The question in this paper is narrower: given what we now know, how should we own small caps?

Historical factor returns



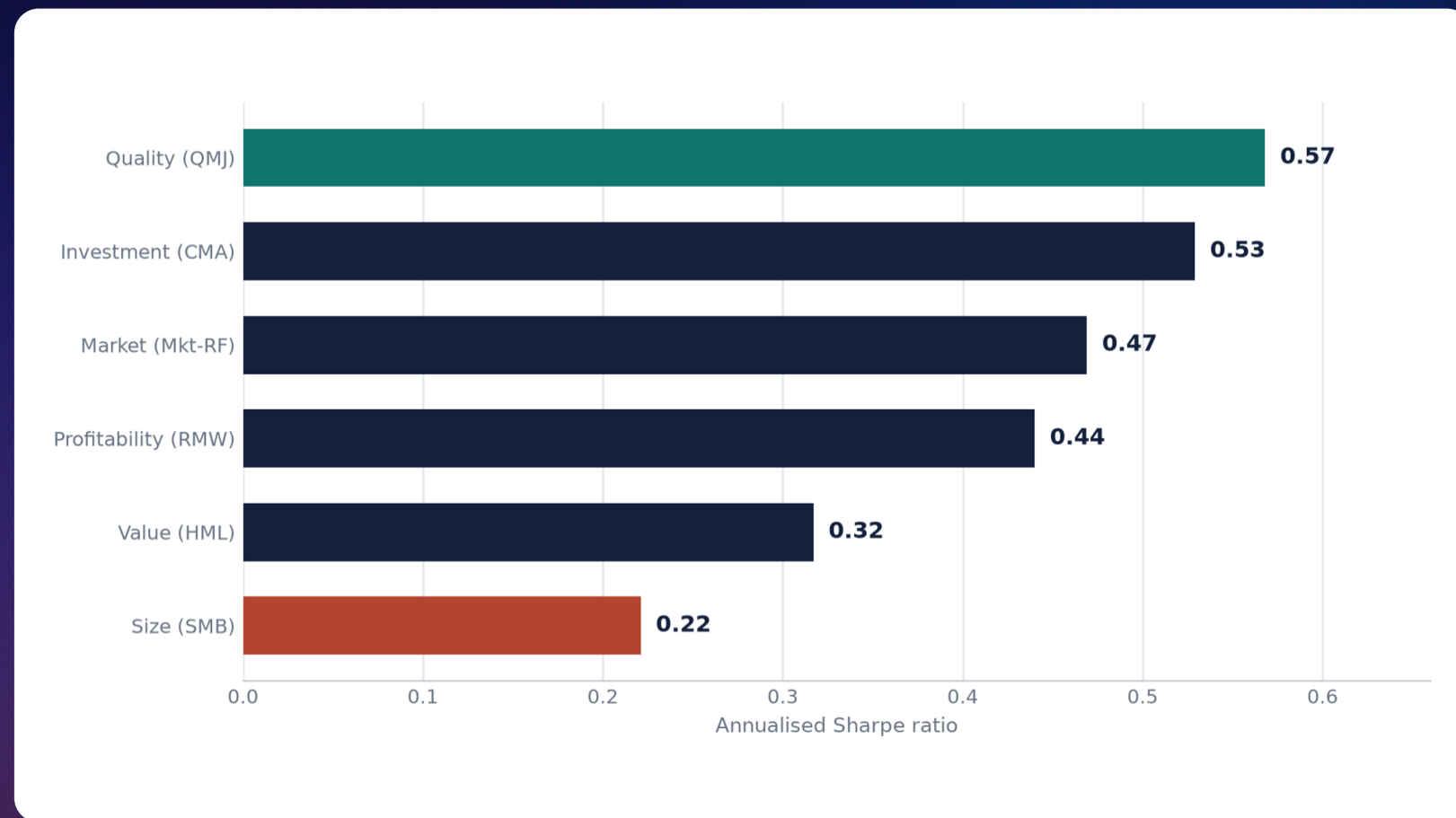
Source: Timeline analysis. Global Equities: DMS World Equity TR (Jan 1915 to June 1998), Morningstar Global All Cap Target Market Exposure (July 1998 onwards). Global Value: Global Equities (Jan 1915 to May 1927), UK value 50% + US value 50% (June 1927 to May 1969), DFA Dimensional Global Value (Jan 1975 onwards). Global Small: Global Equities (Jan 1915 to May 1927), UK small 50% + US small 50% (June 1927 to May 1969), DFA Dimensional Global Small (Jan 1970 onwards). All gross returns in GBP. Data from Morningstar, Dimensional and the Ken French Library.

Past performance is not a reliable indicator of future results.

Limitations of the standalone size premium

On its own, size is the weakest of the major premia

Annualised Sharpe ratios of US long-short factor portfolios, 1973 to 2021 – Feng, Lan, Wang and Zhang (2026)



0.22

Sharpe ratio for size, against 0.57 for quality

1.89 vs 3.42

t-stat for size versus value, 1963 to 1993

Decayed

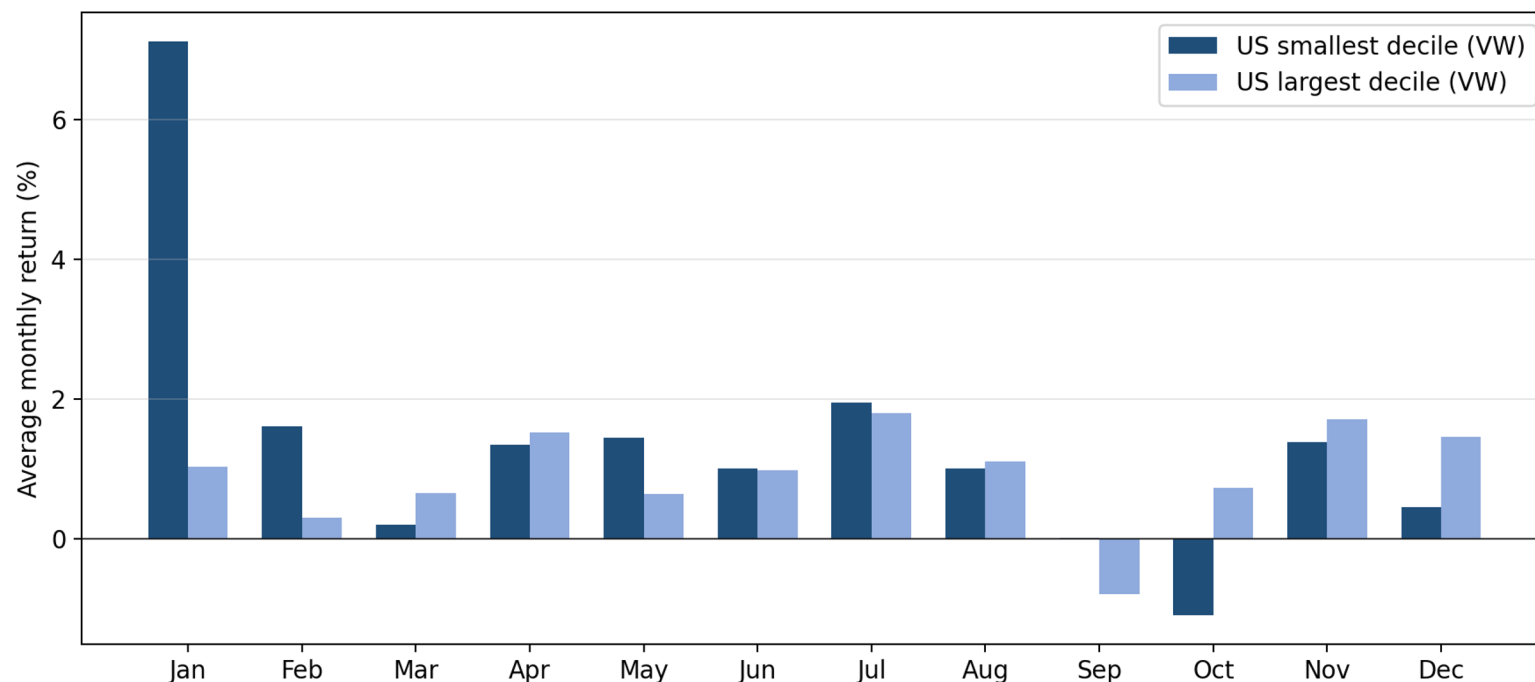
more than most anomalies once published (McLean and Pontiff, 2016)

Source: Reproduced from published values in Feng, Lan, Wang and Zhang (2026), Table A.1. Annualised Sharpe ratios of US long/short factors, January 1973 to December 2021. Factor data originally from the Ken French Data Library (Mkt-RF, SMB, HML, RMW, CMA) and AQR (QMJ). Returns are USD, gross of transaction costs, fees and taxes. Live fund returns would be lower after fees. A GBP investor's returns would differ by USD/GBP movements.

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The smallest companies earn most of their return in January

Average monthly return of the smallest and largest US size deciles, by calendar month, 1926 to 2026



7.13% vs 0.85%

smallest decile, January
against the average other
month

1.03% vs 0.92%

largest decile: no real January
effect

56%

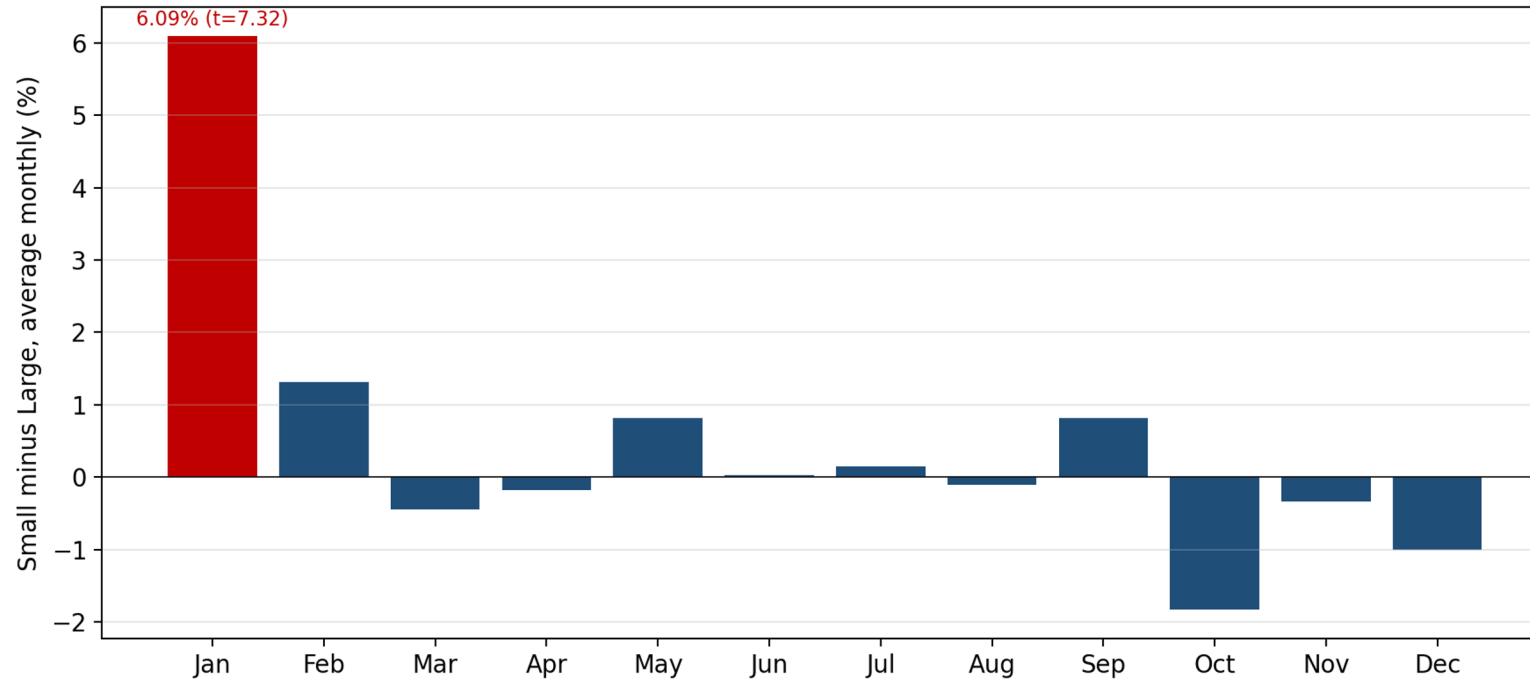
of the smallest decile's
cumulative return came in
January, 8% of the calendar

Source: Timeline analysis of Ken French Data Library, Portfolios Formed on Size [Daily]: value-weighted US size-decile returns (smallest and largest deciles), July 1926 to June 2026. Daily returns compounded to monthly returns and averaged by calendar month.

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The size premium is a January effect, and January is fading

US size premium (smallest minus largest decile, value-weighted) by calendar month, 1926 to 2026



6.09% vs -0.07%

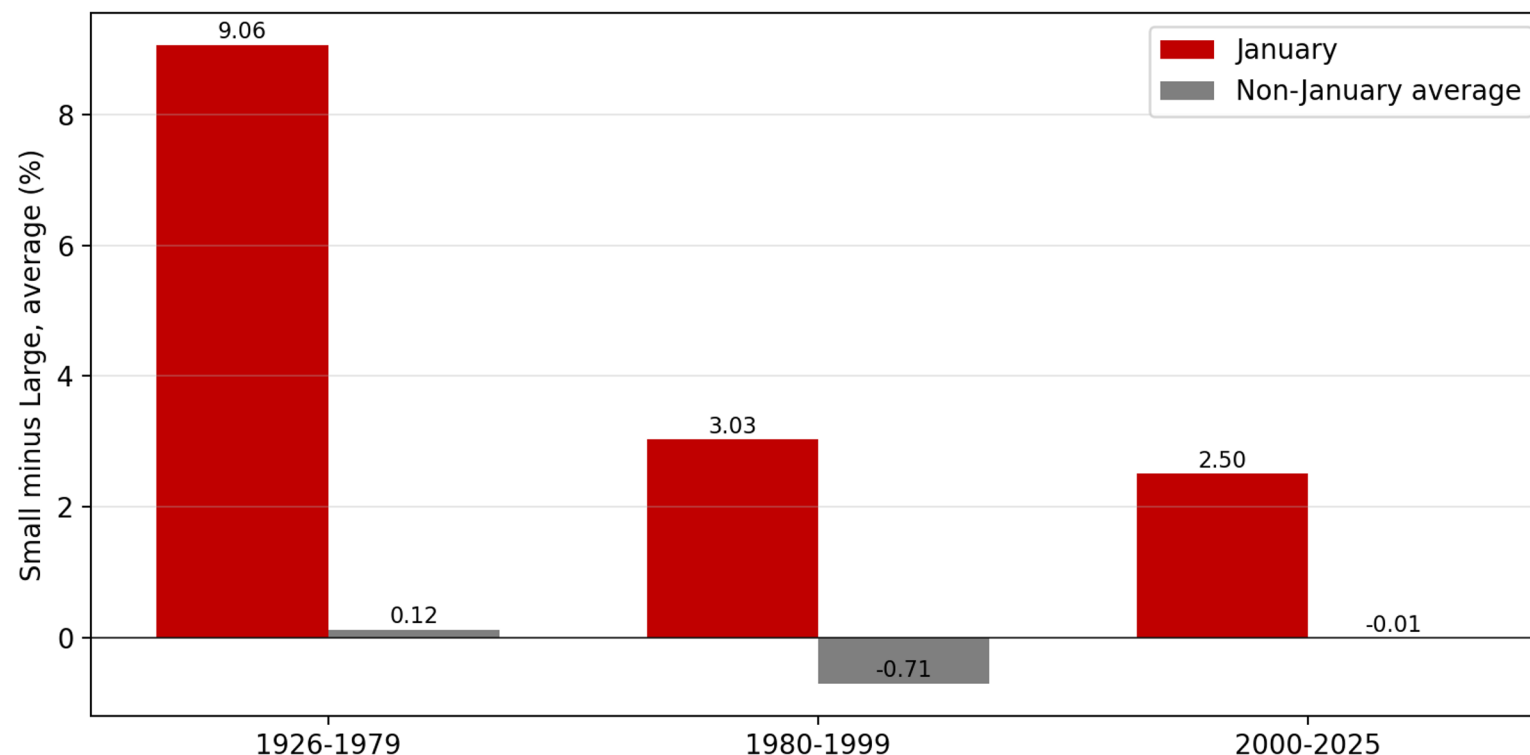
average monthly size premium in January against the other eleven months (t 7.32).

Source: Timeline analysis of Ken French Data Library, Portfolios Formed on Size [Daily]: value-weighted US size-decile returns, July 1926 to June 2026. Size premium is the smallest decile's return less the largest decile's, with daily returns compounded to monthly returns and averaged by calendar month.

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The size premium is a January effect, and January is fading

US size premium in January versus the average of the other months, by era



Smaller each era

since 2000 the January gap for the smallest decile is no longer significant (t 1.13).

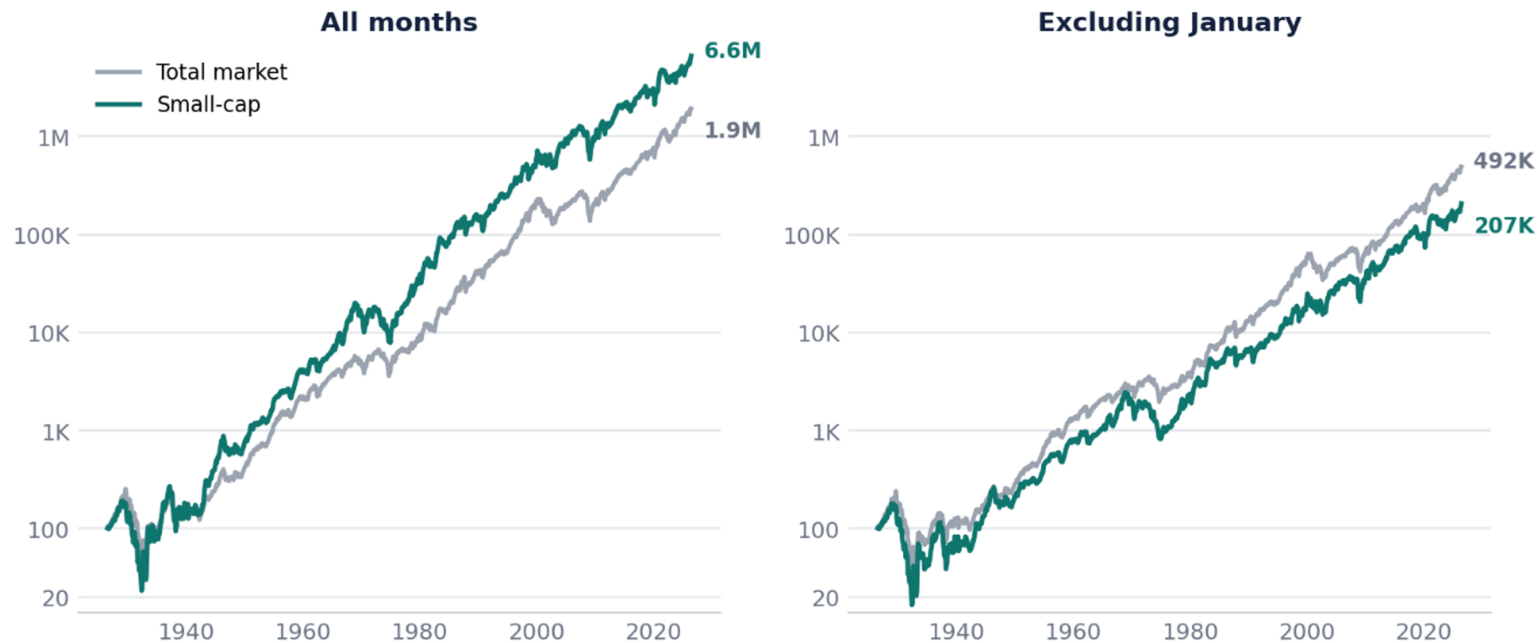
Source: Timeline analysis of Ken French Data Library, Portfolios Formed on Size [Daily]: value-weighted US size-decile returns, July 1926 to December 2025. Eras: 1926 to 1979, 1980 to 1999 and 2000 to 2025. January and non-January means compared using a two-sample t-test.

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What about long-only Portfolios?

Remove January and long-only small caps lose their edge

Growth of \$100, US small caps versus the market, all months and excluding January, log scale



US since 1926

\$6.6m against \$1.9m for the market. Without January, \$207k against \$492k.

Source: Timeline calculations using Fama-French US market and small-cap research indices, July 1926 to June 2026. Growth of 100 in USD total returns. The excluding-January series removes January returns from both the small-cap and total-market series before compounding.

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Remove January and long-only small caps lose their edge

Growth of \$100, developed ex-US small caps versus the market, all months and excluding January, log scale



Ex-US since 1990

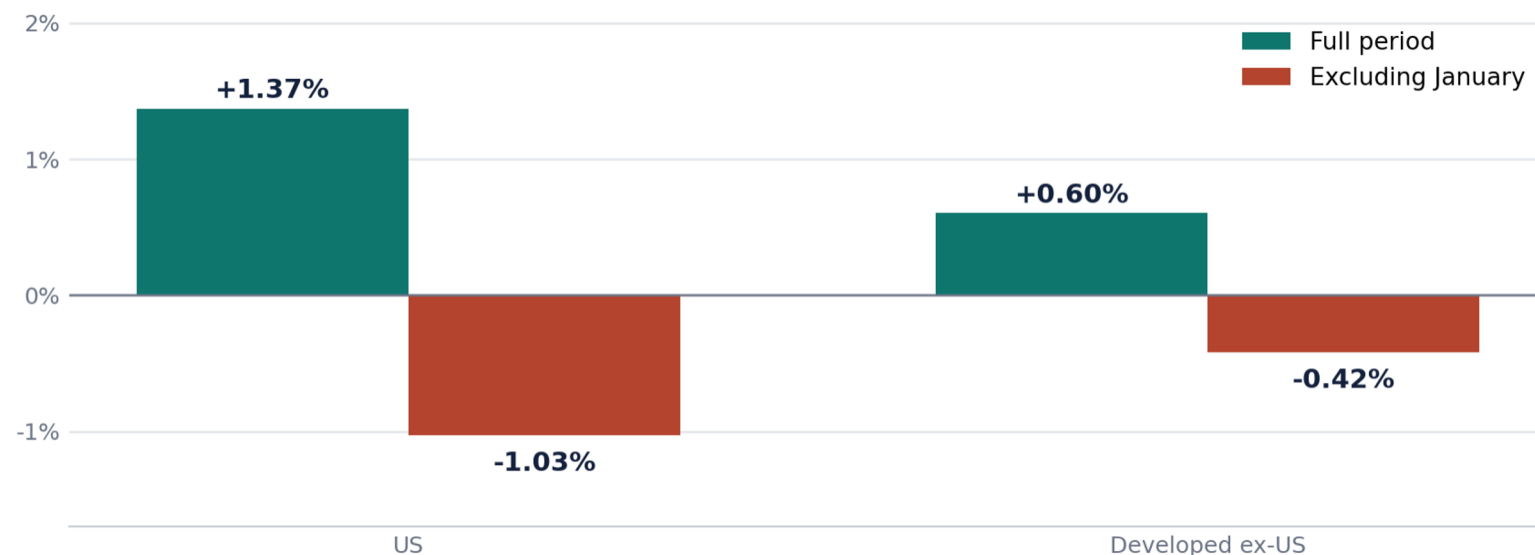
\$1,100 against \$895 for the market. Without January, \$753 against \$857.

Source: Timeline calculations using Ken French Data Library: Fama/French Developed ex US 5 Factors (market) and 6 Developed ex US Portfolios Formed on Size and Book-to-Market (2x3), July 1990 to June 2026. Small caps combine the value-weighted small-value, small-neutral and small-growth portfolios. Growth of 100 in USD total returns; the excluding-January series removes January returns from both series before compounding.

Past performance is not a reliable indicator of future results. Returns are shown in US dollars and may increase or decrease as a result of currency fluctuations.

Remove January and long-only small caps lose their edge

Annualised excess return of a small-cap index over the market, all months versus excluding January



+1.37% to -1.03%

US small caps over the market,
with and without January

+0.60% to -0.42%

developed ex-US, with and
without January

2.28% (t 5.86)

average US January excess
return

Source: Timeline calculations, USD total returns; excess return is small-cap less market. US: Fama-French US market and small-cap research indices, July 1926 to June 2026. Developed ex-US: Ken French Data Library, Fama/French Developed ex US 5 Factors and 6 Developed ex US Portfolios Formed on Size and Book-to-Market (2x3), July 1990 to June 2026.

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FROM OUR LATEST RESEARCH



None of this is an argument against investing in small companies. It is an argument against **relying on raw size alone.**

From Small-Cap Indexing to Small-Cap Quality and Value

Timeline Research, October 2026

Size matters, if you control your junk

Asness et al. (2018)

Small firms are, on average, lower quality. Control for quality and the size premium becomes larger, steadier and robust across seasons and markets.

Asness, Frazzini and Pedersen (2019)

Quality minus junk earned positive returns in 23 of 24 countries, with a negative market beta. It has tended to hold up in crises.

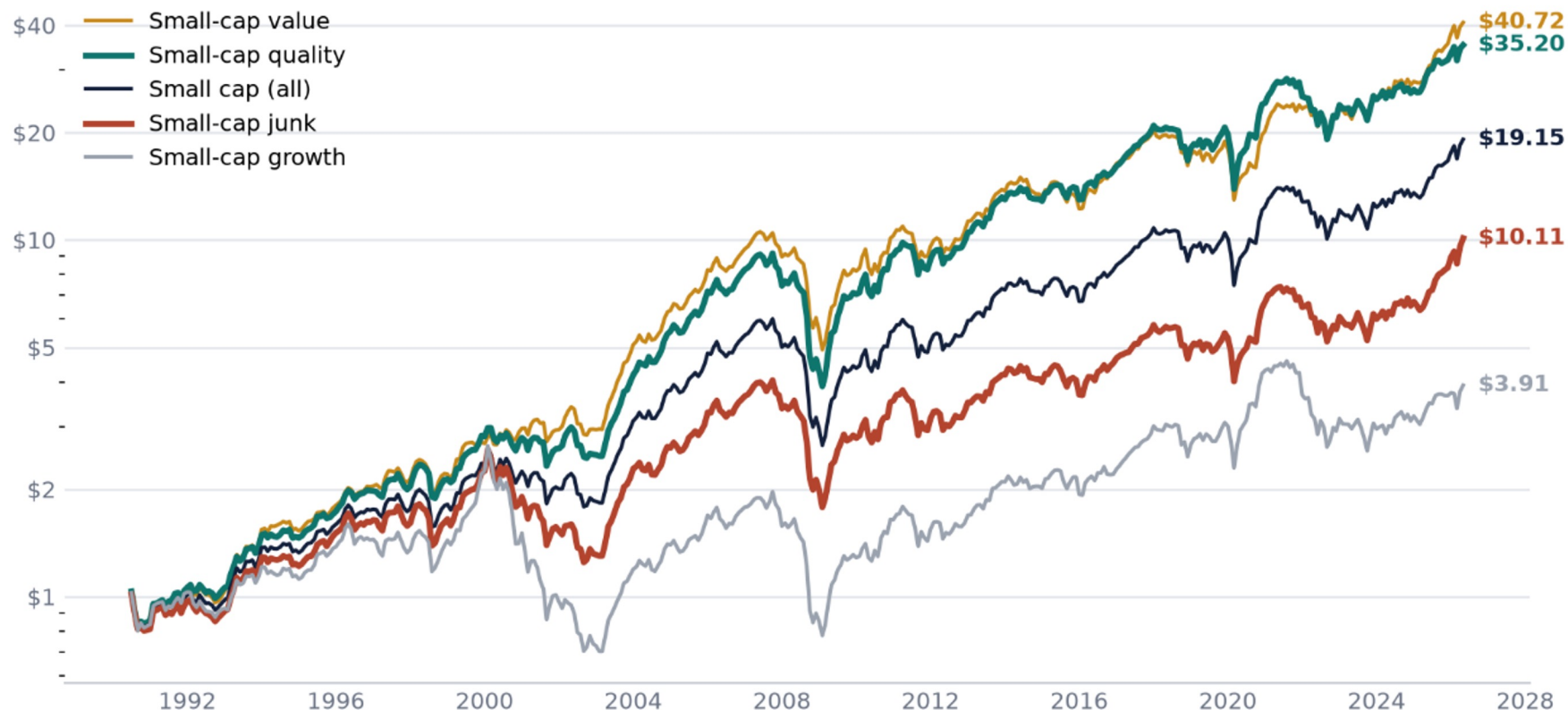
Fama and French (2015)

The five-factor model's biggest blind spot: small firms that invest aggressively despite weak profitability.

Novy-Marx (2013): profitability predicts returns about as strongly as value, and the effect is particularly strong among small companies.

Quality and value beat junk and growth by a wide margin

Growth of \$1, developed-market small caps, July 1990 to May 2026, log scale. Quality = high operating profitability

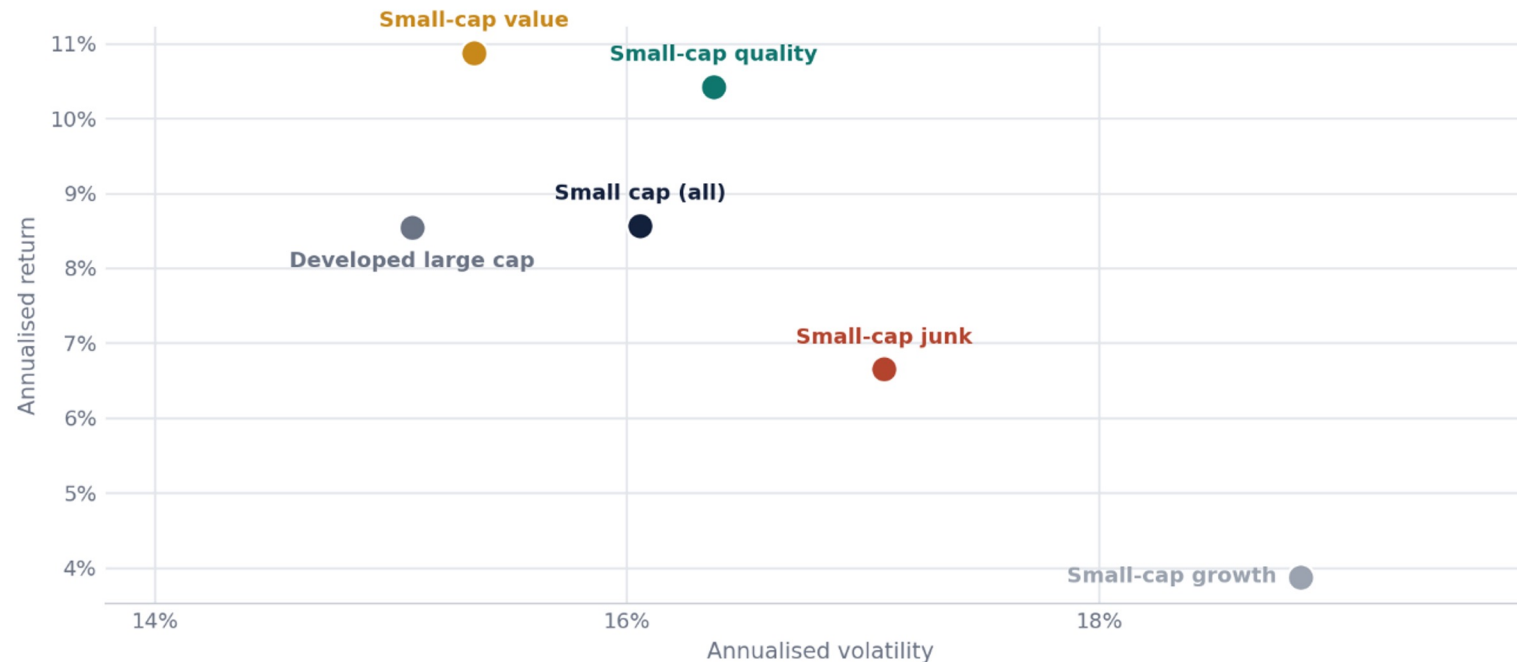


Source: Timeline calculations using Ken French Data Library: 6 Developed Portfolios Formed on Size and Operating Profitability (2x3) and on Size and Book-to-Market (2x3), July 1990 to May 2026, value-weighted USD total returns. Quality/junk: high/low-profitability small caps; value/growth: high/low book-to-market small caps.

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Quality's extra return didn't come from extra risk

Annualised return against volatility, developed-market small caps, July 1990 to May 2026



Quality

higher return than the small-cap universe, at similar volatility

Junk

lower return and higher volatility than quality

Value

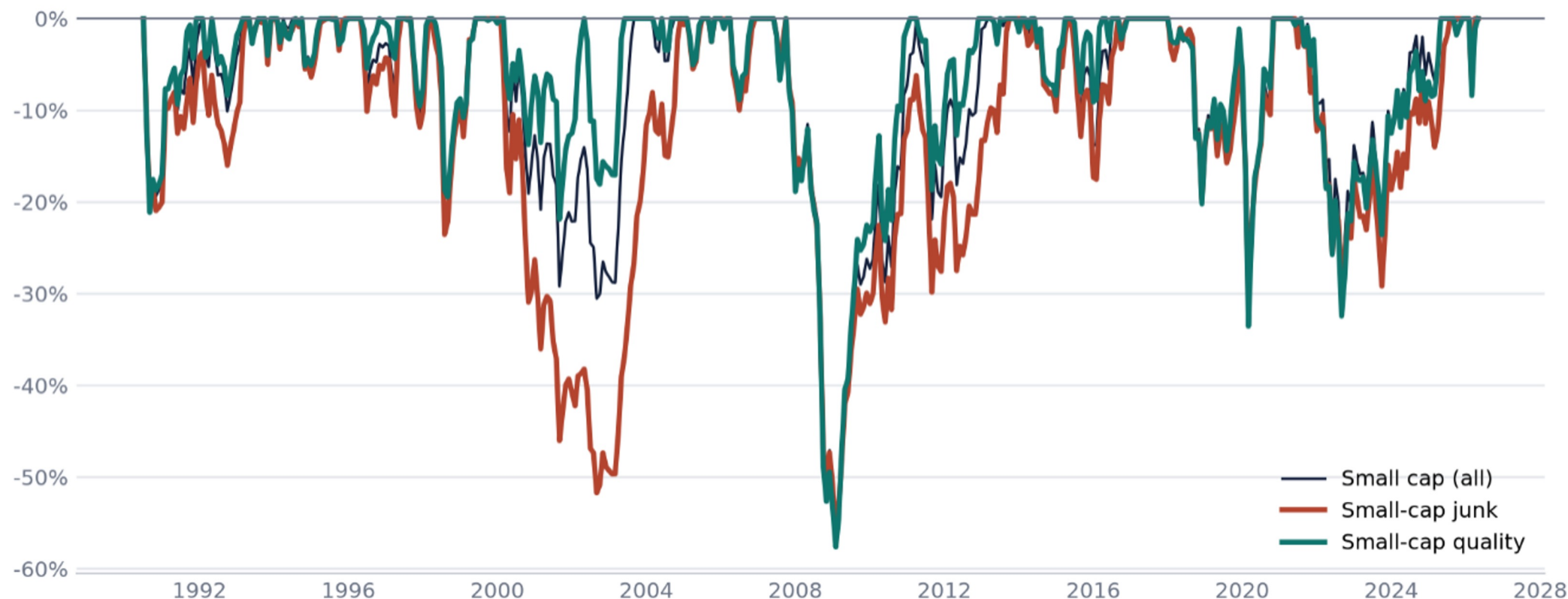
the highest return, with lower volatility than the universe

Source: Timeline calculations using Ken French Data Library: 6 Developed Portfolios Formed on Size and Operating Profitability (2x3) and on Size and Book-to-Market (2x3), July 1990 to May 2026, value-weighted USD total returns. Annualised return and volatility from monthly returns.

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Junk fell much further in the dot-com bust

Drawdown from prior peak, developed-market small-cap portfolios, July 1990 to May 2026

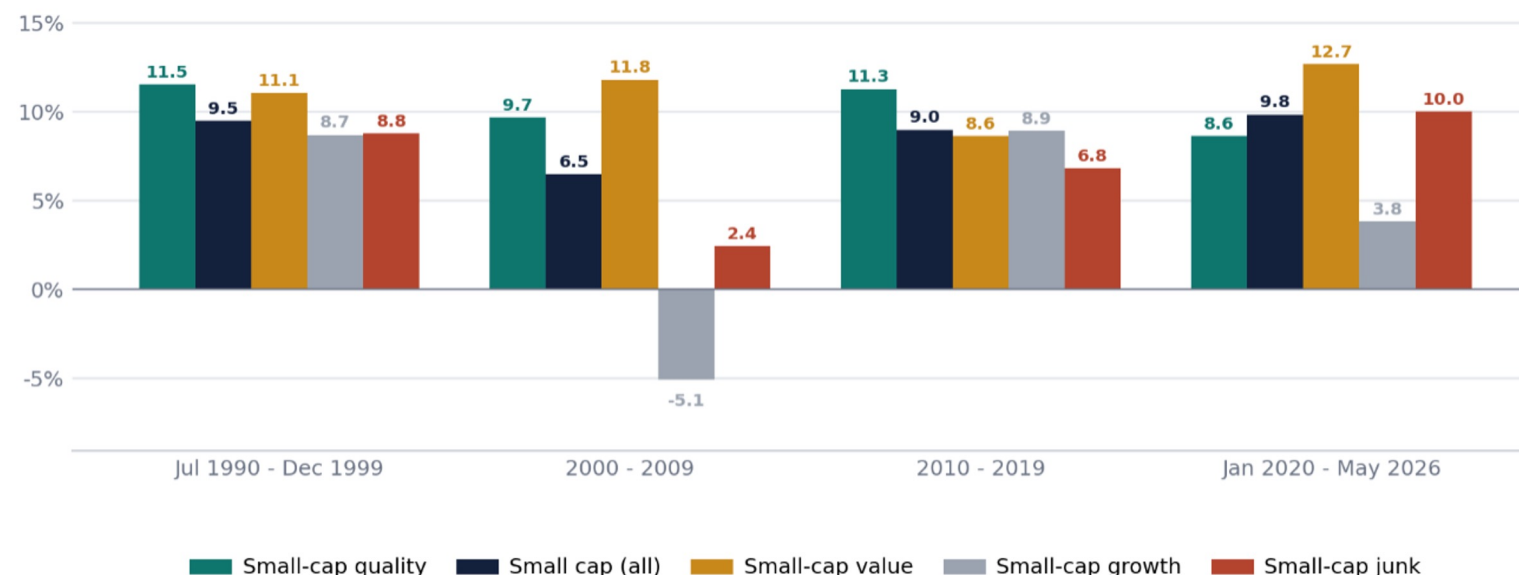


Source: Timeline calculations using Ken French Data Library: 6 Developed Portfolios Formed on Size and Operating Profitability (2x3), July 1990 to May 2026. Value-weighted USD total returns. Quality and junk are the high- and low-profitability small-cap portfolios. Drawdowns are measured from each portfolio's prior peak.

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Quality or value led in every sub-period

Annualised total return by sub-period, developed-market small-cap portfolios, % a year



1990s

quality led at 11.5% a year

2000s

value led at 11.8%, growth lost 5.1%

2010s

quality led at 11.3%

Since 2020

value led at 12.7%, though junk beat quality

Source: Timeline calculations using Ken French Data Library: 6 Developed Portfolios Formed on Size and Operating Profitability (2x3) and on Size and Book-to-Market (2x3), July 1990 to May 2026, value-weighted USD total returns. Sub-period returns annualised from monthly data.

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The market has already run this experiment

S&P SmallCap 600 (positive-earnings screen) versus Russell 2000 (no screen), USD, Dec 1994 to Aug 2020



11.77% vs 10.49%

annualised return, S&P 600
versus Russell 2000

18.96% vs 19.70%

volatility, slightly lower with the
screen

Not a clean test

the indices differ in other ways
too

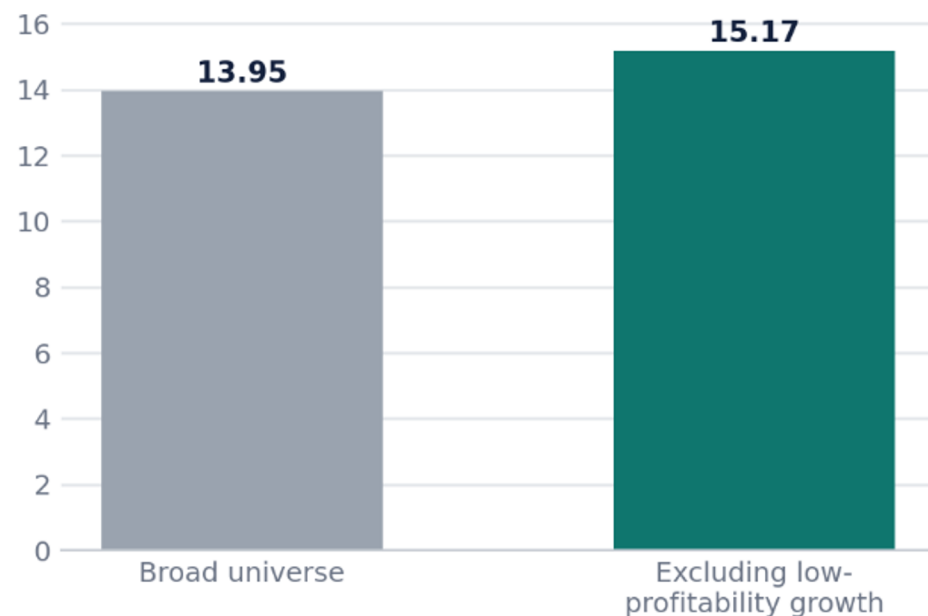
Source: Reproduced published values from S&P Dow Jones Indices (2020), 31 Dec 1994 to 30 Aug 2020.

Past performance is not a reliable indicator of future results. Returns are shown in US dollars and may increase or decrease as a result of currency fluctuations.

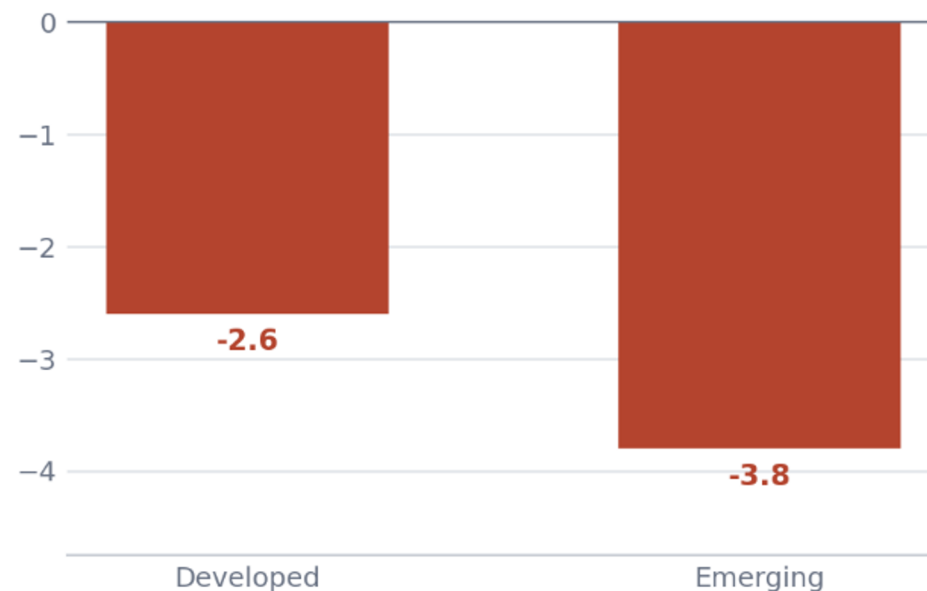
Dimensional has spent decades screening out small-cap junk

US small-cap returns with and without low-profitability growth, and the drag from that segment

US small-cap return since 1975 (% a year)



Drag from low-profitability small-cap growth (pp a year)



Source: Reproduced from published values in Dimensional Fund Advisors research. US small-cap annualised returns since 1975 compare the broad small-cap universe with a universe excluding low-profitability small-cap growth stocks. Developed and emerging market figures show the annual return drag from low-profitability small-cap growth stocks.

Past performance is not a reliable indicator of future results.

What this means in practice

Index or screened fund: what you're choosing between

	Market-cap small-cap index	Quality or value screened small caps
Size exposure	Broad small-cap exposure	Broad small-cap exposure retained
Return drivers	The raw size premium	Size plus quality, profitability or value
Seasonality	Excess return concentrated in January	Less reliant on the January effect
Downside	More exposed to unprofitable, weaker firms	Quality has been more resilient in downturns
Cost	Simple, transparent and very low cost	Typically, higher fees, turnover and trading costs

The evidence favours screened exposure, but the fund still has to earn its extra cost through the strength of its tilts, its diversification and how well it trades.

What the research tells us

Emerging markets

The premium is real but lumpy. It comes with more volatility, more concentration and no better risk-adjusted return.

Factors within EM

Value and momentum premia have been larger in EM than in developed markets. Profitability has translated more consistently into long-only returns.

Small caps

Raw size has weakened and is mostly a January effect. Small caps work much better combined with quality or value.

What happens next: The research will inform asset allocation decisions and feed into our regular review of the Classic and other Evidence-based models.

Upcoming webinars: 3 November, Fixed income research | 11 November, Classic review

Any Questions?

Thank You!



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