

A Moving Yardstick: Dynamic Risk Profiles of the Indexes

Benchmark index construction rules generally do not account for fundamentals, underlying quality, or risk management

We've written at length about the rules that determine the composition of the style indexes against which many active managers are benchmarked. An index's composition is a function of mechanical rules, not a stable definition of "value" or "growth." Those rules cause companies to shuffle in and out of the Growth and Value indexes, and cause weightings to evolve dramatically over short periods, based on market sentiment. As a result, the Russell 1000 Value Index carries a risk profile that can change (and has changed) meaningfully within a single year and could shift again at each style reconstitution in June.

We don't expect clients to monitor every nuance of index construction methodology. But we do think it is important for advisors to understand just how dynamic a style index's risk profile really is, particularly since most clients have risk profiles that remain stable from year to year.

To illustrate this point, consider the 10 largest holdings in the index as a concentrated value portfolio managed for a client. The average P/E multiple is 20x, and the average yield is 2.4%.

The manager informs the client that some changes are being made to their account: the addition of three Mag 7 tech giants, Alphabet, Amazon, and Meta. The conversation with the client might go as follows:

"Why did you buy nearly half of the Mag 7?"

They have very large market capitalizations, so they have been added to your portfolio.

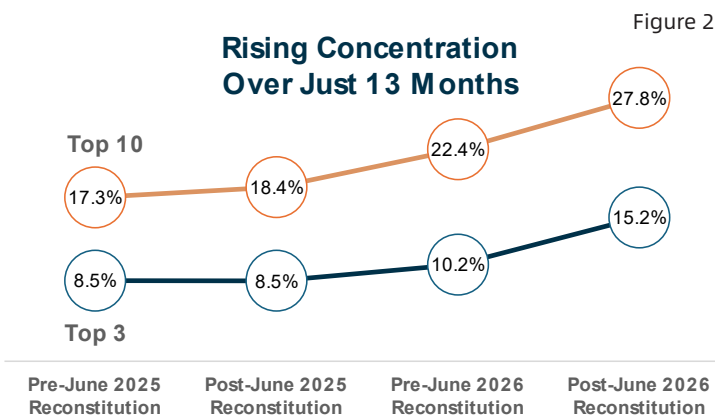
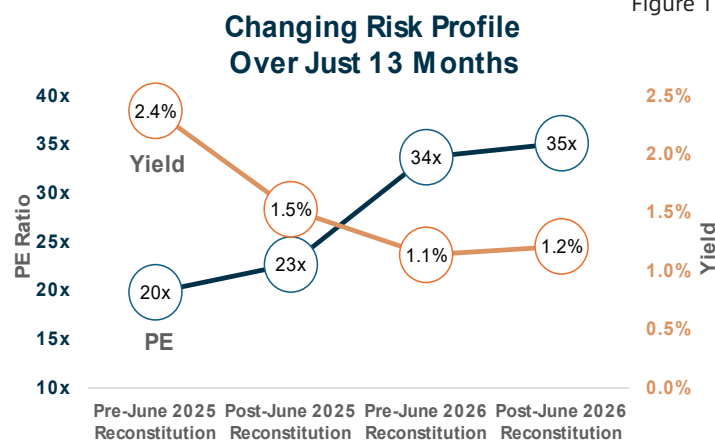
"Why is the yield on my new portfolio about 40% lower?"

It's just a function of what's in your portfolio. Yield is not taken into account.

One year later, the client returns for the annual check-in and finds their portfolio looks different again. The average P/E multiple has jumped to 34x, the yield has fallen to 1.1%, and there's now a heavy weighting to the IT sector, led by a large position in semiconductors

"My second largest holding is Micron? What's the rationale?"

Micron is a highly cyclical semiconductor manufacturer, but it's been a hot sector with a lot of momentum.



(Sources: Confluence, FactSet)

A few months later, the client is told it's time to change the portfolio again. Going forward, three positions, two of them new, will make up a much larger share of the account, and IT businesses will represent nearly half of the largest holdings. The average P/E is now 35x.

"My life situation hasn't changed. Why are we making wholesale changes to my portfolio?"

Because it's June.

"Three stocks I didn't own a year ago now make up 15% of my portfolio, nearly double the concentration of my largest holdings before. What's the thinking behind this?"

Some of your positions performed really well, and another client's portfolio, the Growth index, was becoming disproportionate. So, we moved some of your outperformers into their account and, to balance it out, moved some of their big positions into yours. The two portfolios are just linked that way.

Forgive the satirical tone of this example, but the portfolios described above represent the top 10 largest holdings in the Russell 1000 Value Index, pre- and post-reconstitution across 2025 and 2026 (see tables below). This is a simplified example considering only the largest holdings, but it's representative of how much the index's composition can shift inside a single year. This benchmark is the de facto yardstick that value managers are measured against, yet the yardstick itself is perpetually morphing, shaped by prevailing investor psychology and by whatever happens to be occurring inside the Growth index at the same time.

Micron Technology (MU) was the Value index's best-contributing stock in the first half of 2026. After being reclassified into the Growth index in June, it underperformed. Imagine a growth manager and a value manager who reach the same conclusion: neither wants to own Micron. Despite agreeing, the value manager endures negative relative performance while the growth manager gets credit for avoiding it. An active manager focused solely on outperforming the benchmark in every period would need to continuously change their stripes to mimic the benchmark's underlying composition. It would require frequent trading, rapid repositioning, and riding every wave of momentum.

The Confluence Value Equity strategies are built to meet specific portfolio objectives, not to track a constantly shifting benchmark. That means our risk profile doesn't move with the index's composition or with the current inning of the market cycle. It comes from a consistent focus on high-quality businesses with durable competitive advantages, the pricing power and returns on capital that come with these advantages, strong free cash generation, conservative balance sheets, experienced ownership-minded management, and the discipline to buy these companies at a discount to our estimate of intrinsic value.

Figure 3

Pre-June 2025 Reconstitution						Post-June 2025 Reconstitution					
Ticker	Name	Sector	Weight (%)	PE	Yield	Ticker	Name	Sector	Weight (%)	PE	Yield
BRK.B	Berkshire Hathaway Inc. (Class B)	Financials	3.7%	25x	0.0%	BRK.B	Berkshire Hathaway Inc. (Class B)	Financials	3.2%	24x	0.0%
JPM	JPMorgan Chase & Co.	Financials	3.0%	14x	2.0%	JPM	JPMorgan Chase & Co.	Financials	2.9%	16x	2.0%
XOM	Exxon Mobil Corp.	Energy	1.8%	16x	3.6%	GOOG	Alphabet Inc.	Comm. Services	2.4%	19x	0.3%
WMT	Walmart Inc.	Cons. Staples	1.7%	38x	0.8%	AMZN	Amazon.com, Inc.	Cons. Discretionary	2.1%	35x	0.0%
JNJ	Johnson & Johnson	Health Care	1.5%	15x	3.4%	XOM	Exxon Mobil Corp.	Energy	1.7%	16x	3.6%
PG	The Procter & Gamble Co.	Cons. Staples	1.3%	25x	2.3%	WMT	Walmart Inc.	Cons. Staples	1.4%	38x	0.8%
BAC	Bank of America Corp.	Financials	1.2%	12x	2.3%	PG	The Procter & Gamble Co.	Cons. Staples	1.3%	23x	2.6%
PM	Philip Morris International Inc.	Cons. Staples	1.1%	24x	4.4%	JNJ	Johnson & Johnson	Health Care	1.3%	14x	3.4%
UNH	UnitedHealth Group Inc.	Health Care	1.0%	13x	1.6%	BAC	Bank of America Corp.	Financials	1.1%	13x	2.3%
CSCO	Cisco Systems Inc.	Info. Technology	1.0%	17x	3.3%	META	Meta Platforms, Inc.	Comm. Services	1.0%	29x	0.3%
Top 3			8.5%	18x	1.9%	Top 3			8.5%	19x	0.8%
Top 10			17.3%	20x	2.4%	Top 10			18.4%	23x	1.5%

Pre-June 2026 Reconstitution						Post-June 2026 Reconstitution					
Ticker	Name	Sector	Weight (%)	PE	Yield	Ticker	Name	Sector	Weight (%)	PE	Yield
GOOG	Alphabet Inc.	Comm. Services	3.8%	25x	0.3%	AMZN	Amazon.com, Inc.	Cons. Discretionary	5.9%	27x	0.0%
MU	Micron Technology, Inc.	Info. Technology	3.7%	16x	0.4%	AAPL	Apple Inc.	Info. Technology	5.4%	33x	0.4%
BRK.B	Berkshire Hathaway Inc. (Class B)	Financials	2.7%	24x	0.0%	MSFT	Microsoft Corp.	Info. Technology	3.9%	22x	1.0%
JPM	JPMorgan Chase & Co.	Financials	2.6%	15x	1.8%	BRK.B	Berkshire Hathaway Inc. (Class B)	Financials	2.6%	24x	0.0%
AMZN	Amazon.com, Inc.	Cons. Discretionary	1.8%	27x	0.0%	JPM	JPMorgan Chase & Co.	Financials	2.5%	15x	1.8%
INTC	Intel Corp.	Info. Technology	1.8%	130x	0.0%	INTC	Intel Corp.	Info. Technology	1.7%	130x	0.0%
JNJ	Johnson & Johnson	Health Care	1.8%	22x	2.5%	JNJ	Johnson & Johnson	Health Care	1.7%	22x	2.5%
XOM	Exxon Mobil Corp.	Energy	1.7%	12x	3.3%	XOM	Exxon Mobil Corp.	Energy	1.6%	12x	3.3%
CSCO	Cisco Systems, Inc.	Info. Technology	1.3%	27x	2.4%	CSCO	Cisco Systems, Inc.	Info. Technology	1.3%	27x	2.4%
WMT	Walmart Inc.	Cons. Staples	1.3%	39x	0.8%	WMT	Walmart Inc.	Cons. Staples	1.3%	39x	0.8%
Top 3			10.2%	22x	0.2%	Top 3			15.2%	27x	0.5%
Top 10			22.4%	34x	1.1%	Top 10			27.8%	35x	1.2%

(Sources: Confluence, FactSet, iShares Russell 1000 Value ETF (IWD))

As we've demonstrated, the style indexes and their metrics can shift sharply with each rebalance, so a benchmark-driven approach may leave clients with a risk profile or level of diversification that no longer fits their investment goals. If a client's risk tolerance and objectives have not changed, their investments should still reflect their priorities, regardless of what happens within the index.

For advisors, that raises several questions worth asking:

- *What unintended risks can arise from a passive approach to investing?*
- *Has your client's risk tolerance changed materially?*
- *Has the manager's process or definition of value changed?*
- *What metrics are most important when evaluating a value manager?*

While the indexes and market environment may be changing dramatically, Confluence's consistent approach to value investing has remained steady for over 30 years.

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DISCLOSURES

Data sources: Confluence, FactSet; reflects constituents of the iShares Russell 1000 Value ETF (IWD). Pre-June Reconstitution data as of 5/31/2025 and 5/31/2026 and Post-Reconstitution data as of 6/30/2025 and 6/30/2026.

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