Alerian S•NETWORK GLOBAL INDEXES

Will Your Equity Allocation Miss Out on the Value Trade?

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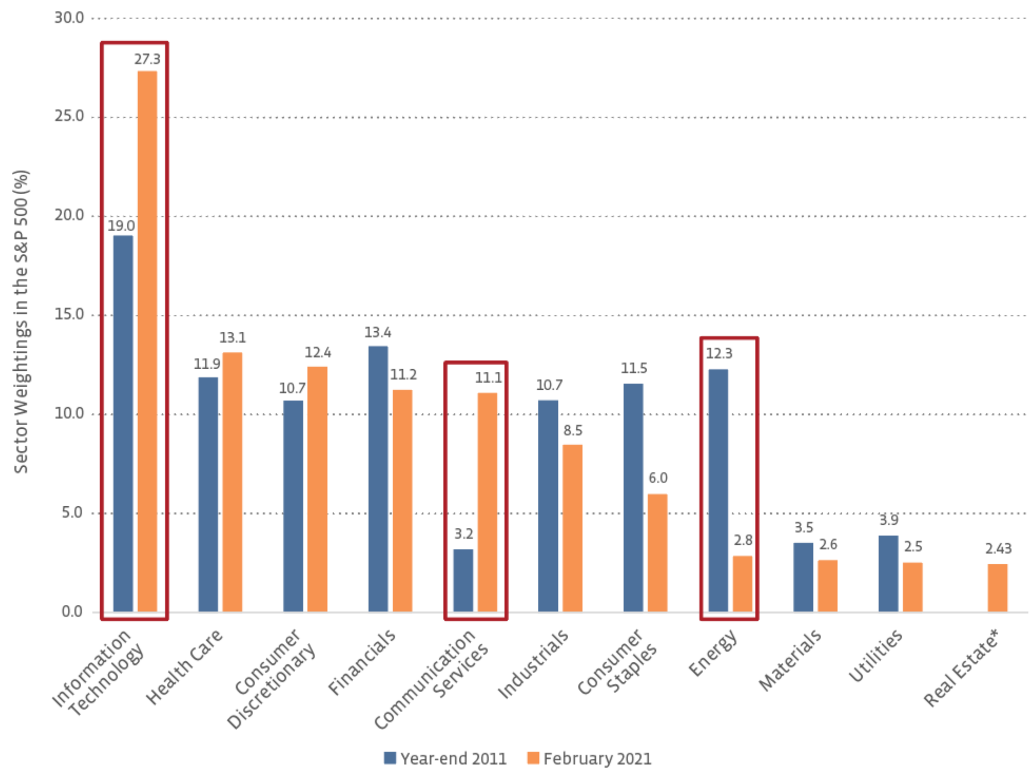
Summary

- For broad equity indexes weighted based on market capitalization, years of strong performance by growth-oriented companies have resulted in significant weightings to growth stocks and minimal exposure to value sectors like energy.
- Investors wanting to capitalize on the value trade could select value-oriented funds that screen companies on a variety of valuation metrics, but concentrated sector exposure could be a drawback of these strategies.
- The S-Network Sector Dividend Dogs Index (SDOGX), which is the underlying index for the ALPS Sector Dividend Dogs ETF (SDOG), uses the S&P 500 as its starting universe and selects the five stocks in ten sectors with the highest dividend yield and equally weights those 50 stocks. The index has a value orientation but also offers attractive diversification.

Broad market indexes tend to have more exposure to growth sectors.

On the surface, broad equity market indexes weighted based on market capitalization (or float-adjusted market capitalization) may not seem to take a view on growth or value. However, years of strong performance by growth-oriented companies have resulted in significant weightings to growth sectors like information technology and growth stocks within other sectors. The opposite is true of the value-oriented energy sector. Years of underperformance and the oil price crash in 2020 saw energy's weighting in major indexes shrink to multi-decade lows. The chart below compares weightings by sector for the S&P 500 Index at the end of February 2021 to year-end 2011.

Select S&P 500 Sectors Have Seen Significant Weighting Changes Since 2011



* Real estate was broken out from Financials in 2016.
Source: Bloomberg as of March 16, 2021

Since 2011, information technology has become an even more dominant part of the index with a weighting over 27%. Keep in mind some former constituents were reclassified in 2018 into the new communication services sector (replaced telecommunications). Communication services includes growth-oriented names such as Facebook (FB) and Alphabet (GOOG) that used to reside in the information technology sector and Netflix (NFLX), which was previously in the consumer discretionary sector. With changes to the sector classification and strong performance, the communication services sector has seen its weighting increase to over 11% from roughly 3% in 2011. Meanwhile, weakness in oil prices and investor sentiment has driven energy from a 12% weighting in 2011 to less than 3% today.

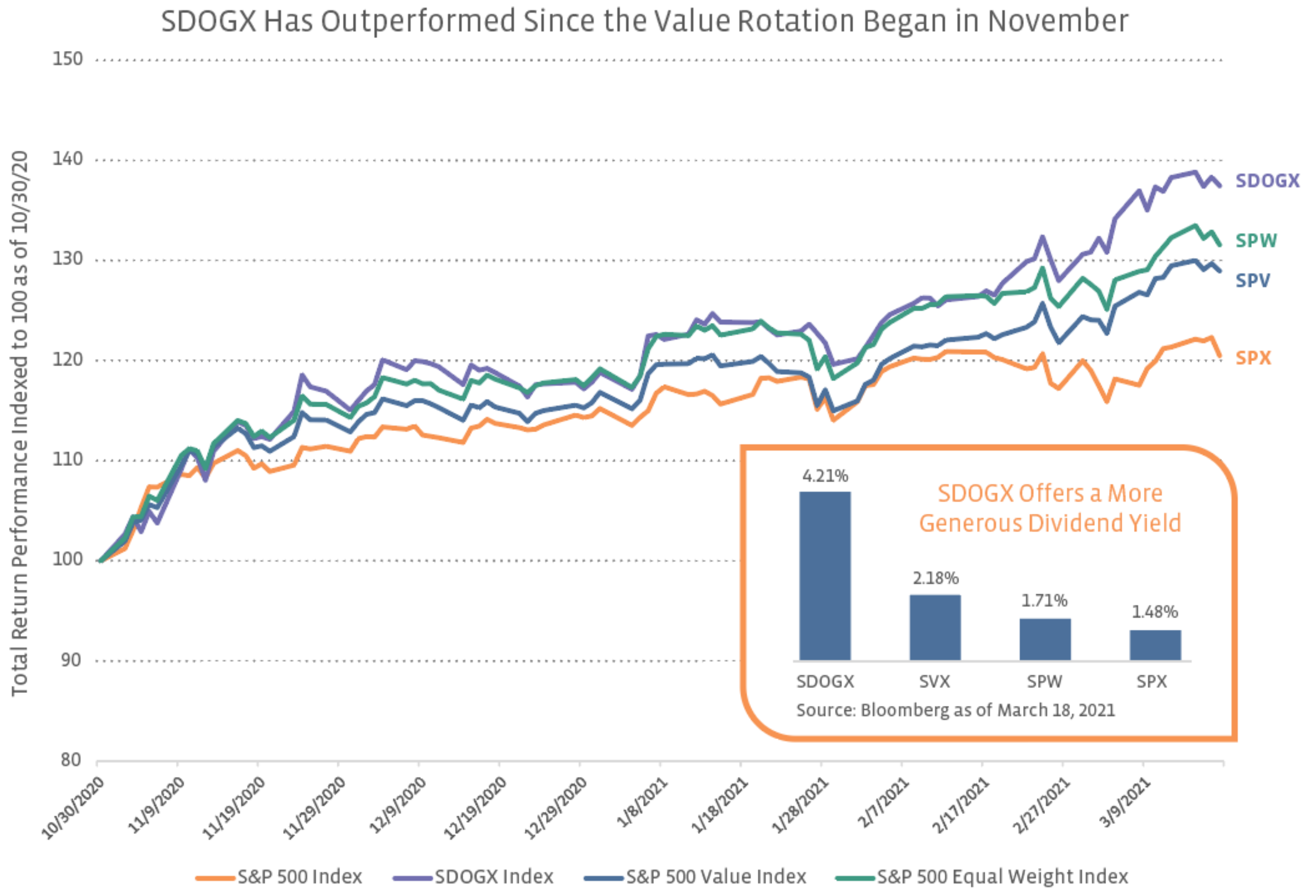
In 2020, the relative weightings to information technology and energy were ideal as tech led all sectors with gains over 40% for the year, while energy was the worst-performing sector, falling by more than 35%. However, so far in 2021, energy has been the best-performing sector thanks to improving oil prices, the reflation trade, value rotation, and the improving outlook for energy demand as vaccines are widely deployed. Year-to-date through March 18, energy is up approximately 30% while information technology is nearly flat. If value-oriented sectors such as energy, financials, and industrials continue to outperform this year, an investment in a product tracking a broad equity capitalization-weighted index may leave investors disappointed.

How can investors gain more exposure to value sectors?

Investors worried about missing out on the value trade have plenty of investment options at their disposal. There is no shortage of value-oriented funds that screen constituents on valuation metrics; however, their high relative weightings to sectors like financials or industrials could give some investors pause. For those wanting more diversification, an investment option that weights sectors equally could be more attractive. Relative to the S&P 500, this would provide more exposure to value sectors like energy, industrials, and materials and less exposure to growth-oriented information technology. In the event the value trade stalls or even reverses, the equal weight exposure would likely prove beneficial relative to value strategies concentrated in a few sectors. Diversification and a value focus are combined in the S-Network Dividend Dogs Indexes, which select the top five-yielding names across ten sectors of their respective universes and use an equal-weighting scheme.

The S-Network Dividend Dog family includes international, emerging market, and REIT indexes, but for comparing with broad market indexes, it is best to examine the S-Network Sector Dividend Dogs Index (SDOGX). SDOGX uses the S&P 500 as its starting universe and selects the five stocks in ten sectors (real estate is excluded) with the highest dividend yield and applies an equal weighting scheme. SDOGX is the underlying index for the ALPS Sector Dividend Dogs ETF (SDOG). Consistent with the Dogs of the Dow strategy, the index is designed to capitalize on mean reversion. High-yielding names added to the index in the annual reconstitution in December are value stocks trading at a discount to peers and may see their prices rise (and yields fall) over the course of the year as investors reevaluate these companies. The strategy resets in December as constituents with lower yields are replaced with high-yielding stocks. Quarterly rebalancing maintains the equal-weighting scheme.

As shown in the chart below, SDOGX has outperformed the S&P 500 (SPX), the S&P 500 Equal Weight Index (SPW), and the S&P 500 Value Index (SVX) on a total-return basis since the value trade started to unfold in November 2020. For context, SVX had a 20.5% weighting to financials and 14.5% weighting to healthcare at the end of February, while energy was 5.9% of the index. On the other hand, SDOGX had a 11.5% weighting to financials and 10.7% weighting to energy at the end of February. Additionally, because SDOGX selects constituents of the S&P 500 with the highest yields, it also offers more attractive income compared to the other three indexes as also shown on the following page.



Source: Bloomberg as of March 18, 2021

Bottom line

If the current value rotation continues, investors in broad equity market indexes may miss out given a growth tilt in indexes weighted based on market capitalization. The construction of SDOGX provides a value orientation given its screening based on dividend yield, while its equal-weighting scheme offers diversification without underweighting growth-oriented sectors.

SDOGX is the underlying index for the ALPS Sector Dividend Dogs ETF (SDOG).

Related Indexes	Associated Product
S-Network International Sector Dividend Dogs Index (IDOGX)	ALPS International Sector Dividend Dogs ETF (IDOG)
S-Network Emerging Sector Dividend Dogs Index (EDOGX)	ALPS Emerging Sector Dividend Dogs ETF (EDOG)
S-Network REIT Dividend Dogs Index (RDOGX)	ALPS REIT Dividend Dogs ETF (RDOG)

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