



Concentrated Returns Challenge Small Cap Alpha

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Key Takeaways

- ▶ The Russell 2000's top 10, 20 and 30 contributors have recently accounted for 29%, 44% and 54% of benchmark gains, respectively — similar to the widely cited concentrated performance of the S&P 500.
- ▶ However, unlike the S&P 500, where owning a few mega cap stocks can help mitigate tracking error and relative underperformance, the Russell 2000's dispersed weights mean top contributors are often mid-tier stocks that surge unexpectedly, making them much harder to capture.
- ▶ While recent signs of small cap dispersion may not yet signal a durable shift, a wider set of winners ultimately supports healthier markets and creates a more favorable backdrop for fundamental research and active management.

Market observers have spent much of the past few years highlighting the dominance of the Magnificent Seven in driving returns for U.S. large cap indexes. Less appreciated, however, is that a similar phenomenon has been playing out further down the capitalization spectrum in the Russell 2000 Index.

Traditionally, active small cap managers have largely been insulated from narrow market advances due to the Russell 2000 Index's lower average weights — a product of a larger number of stocks within the index as well as the annual rebalance process that removes the largest companies (often among the year's top performers). However, in recent years, data shows that the Russell 2000 has seen fewer stocks account for more of the gains than at any time outside of the dot-com era. Specifically, on average over the last three years through June, the top 10 contributors to Russell 2000 returns have accounted for 29% of the benchmark's gains, with the top 20 and 30 contributors capturing 44% and 54%, respectively. These are nearly double the long-term averages since 1993, where the top 10 names contributed about 15% on average, the top 20 about 23% and the top 30 about 30%. This has presented active managers with the challenge of correctly identifying and owning the narrow band of top contributors or facing an uphill climb to beat their benchmark.

Exhibit 1: Russell 2000 Winners Are Increasingly Concentrated

12 Months Ending	Russell 2000 Index Return (%)	10 Largest Contributions	20 Largest Contributions	30 Largest Contributions
6/30/1993	25.9	11%	18%	23%
6/30/1995	19.9	12%	19%	25%
6/30/1996	24.0	11%	17%	21%
6/30/1997	16.3	9%	16%	22%
6/30/1998	16.5	12%	19%	24%
6/30/2000	14.4	43%	65%	82%
6/30/2004	33.3	5%	8%	11%
6/30/2005	9.5	13%	23%	31%
6/30/2006	14.6	11%	20%	27%
6/30/2007	16.5	9%	16%	21%
6/30/2010	21.5	10%	15%	19%
6/30/2011	37.4	6%	10%	14%
6/30/2013	24.2	6%	11%	16%
6/30/2014	23.6	8%	13%	17%
6/30/2015	6.5	28%	46%	59%
6/30/2017	24.6	9%	13%	17%
6/30/2018	17.6	12%	19%	25%
6/30/2021	61.9	8%	13%	16%
6/30/2023	12.3	18%	29%	38%
6/30/2024	10.1	36%	51%	61%
6/30/2025	7.7	34%	51%	64%
Average	21%	15%	23%	30%
Median	18%	11%	18%	23%

As of June 30, 2025. Source: FactSet, ClearBridge Investments analysis. Data uses annual periods ending June 30 and includes only years in which Russell 2000 Index returns exceeded 5% for the year.

Small Cap Managers Face Unique Hurdles

These historically elevated levels of concentration have created challenges for small cap managers compared to larger cap peers. For example, the top 10 stocks within the S&P 500 Index accounted for approximately 40% of the index as of June 30.¹ As such, these top stocks can have a far more significant impact on benchmark returns, but they also allow large cap managers the opportunity to hedge their exposure and inoculate their tracking error and relative performance by owning a few of these stocks. However, the same cannot be done with the Russell 2000 Index, where the top 10 stocks currently account for less than 4% of the total index. With a tighter weight dispersion, the top contributors to the Russell 2000 from one rebalance to the next are rarely the largest weights at the start of the period. The result is that it is incredibly challenging for active small cap managers to hedge the risk from a narrow market advance in a concentrated portfolio. Ultimately, we believe stock picking is the key to beating the Russell 2000 benchmark, but recent years have required much greater precision than in the past due to the concentration of winners.

Recent weeks have seen a broadening of performance across the market cap spectrum. While we cannot and will not attempt to say whether or not this is a new, sustainable trend, we believe that such a move is ultimately inevitable and healthy for small cap markets and creates more conducive conditions for fundamental research and disciplined stock selection.

¹ Includes both Alphabet share classes as one holding.

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