Getting to the Core of Stock Market Behavior
An Undiscovered Treasure in Defensive Diversification

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The stock market has a core. It's the stocks that are in between value and growth. Some index providers compromise on these stocks by placing them in both value and growth on a pro-rata basis – a fraction of the stock is assigned to value with the balance assigned to growth. By contrast Surz Style Pure® indexes track and maintain a separate category called "Centric Core", not to be confused with "Blend Core", the more common usage of the word "Core." For clarification, the S&P500 has been used extensively as a core portfolio in core-satellite investing. The S&P is a blend core because it encompasses both value and growth stocks, as well as the stuff in the middle I call "Centric."

Centric Core is better than blend as a diversification partner for active manager portfolios because it does not dilute the active managers and because it behaves differently than value and growth, so it smoothes out the performance ride – the role of a diversification complement. Centric Core also adds an important insight to our understanding of stock market behavior.

In 2008 Centric Core outperformed value and growth by a substantial margin. Centric Core's 29% loss outperformed growth by 1600 basis point and value by 300 basis points. This is important because most managed money programs are making an unintended bet against Centric Core by allocating to the 4 corners of the style matrix – large value, large growth, small value and small growth. But Centric doesn't always win. In this past month of October Centric Core's 7% return lagged value by 500 basis points and growth by 400 basis points.

A close examination of relative performance is revealing. As shown in the chart below, Centric tends to perform better than value and growth in poor performing markets and worse in high performance markets. And Centric is outside the middle, not between value and growth, about half the time. In other words Centric surprises about half the time by not performing in between value and growth, in much the same way mid-cap companies surprise by not always performing in between large and small.

So what can be made of this relative performance? I have one interpretation and would certainly welcome others. The active management world is comprised of value and growth managers, with nothing in between. The managers who call themselves "core" are a blend of value and growth rather than the Centric version examined here. Active manager trading impacts market prices. When managers are buying, their demand for their type of stocks drives prices of those stocks up. When they are selling, their type of stock goes down in value. In this interpretation, the relative behavior of Centric Core is a reflection of professional investment management sentiment and the resulting market impact. Consequently, Centric is a diversification complement that performs well in distressed markets but suffers during happier times.

In other words Centric Core is a defensive play that rounds out multi-manager portfolios. Centric Core deserves your consideration. It can be easily incorporated because it is only 45 stocks, all of which are large liquid companies.