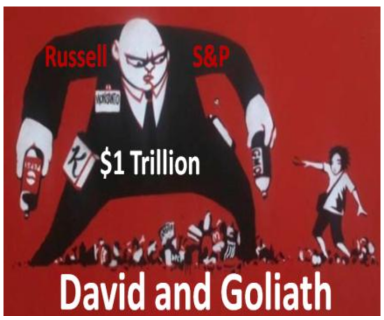
Russell and S&P Indexes are Rotten to the Core, and Molding Away.

- The mighty S&P 500 and Russell 3000 indexes are fading away, replaced by disruptive innovations
- Using the S&P 500 or Russell 3000 as core in core-satellite is like adding water to a fine 50-year old Scotch, a foolish and expensive waste.
- There's a better core that delivers Smart Alpha by getting out of the way of active managers, allowing them to do their jobs.



The gauntlet has been thrown down on the gigantic S&P 500 and Russell 3000 indexes, and these leviathans are losing. Hooray for the little guy! Fundamental indexing, also known as "smart beta", has attracted [$500 billion] or about half of the S&P500/Russell 3000 combined market value. This war is not over. The [controversy continues], and there is another contender for market share attacking the giants' flanks.

The S&P and Russell indexes are used for two reasons: to buy the market and to supplement active managers in core-satellite portfolios. Smart beta competes with the giants on owning the market, offering the potential for higher returns. Now enters a new contender that competes in core-satellite, offering the promises of higher returns and better diversification. This contender is called "Centric Core." Unlike smart beta's edge, which is based on historical observation (smaller companies and value stocks have performed well), Centric Core's advantage is based on common sense.

Core-satellite investing began in the 1970s, motivated by ERISA's expanded definition of diversification to encompass the entire pension portfolio as opposed to each individual fund in the portfolio. The original purpose of the core portfolio was a completeness fund, rounding out a team of specialist active managers. In its simplest form, an active growth stock manager and an active value stock manager are rounded out by a passive core, but the common practice for this core has been wrong. In practice, "core" is always a total market index, namely the S&P 500 or the Russell 3000. This practice dilutes active satellite managers rather than completes them. The S&P 500 and Russell 3000 indexes are value and growth and core, all wrapped into one. Active managers are paid high fees to pick concentrated portfolios of 20 or 30 superior companies. Adding in a market index brings in hundreds (S&P) or thousands (Russell) of deadweight stocks that the active managers don't like. It's like adding water to a fine 50-year old Scotch, a foolish and expensive mistake.

A better choice for core is the stocks that are not in active manager mandates – good companies that are not on active manager radar screens. Most active managers are either value or growth and they are scrutinized to stay within their proclaimed specialty. Some stocks are neither value nor growth -- they're the stuff in the middle between value and growth. There's a continuum in styles, running from deep value to aggressive growth, and along the way there's a collection of "fuzzy" stocks that don't qualify as value or growth. There are 45 such stocks in large U.S. company space. These are well-known great companies that are generally not held by active investment managers.

Core-satellite has been embraced as a way to diversify and lower costs, but the S&P 500 and Russell 3000 indexes as core do neither. They result in an underweight to the middle of the market, so they do not diversify. And they undermine active manager decisions with deadweight stocks the active managers deem unworthy. This dilution comes at a cost that can easily exceed the "savings" attributed to a passive index, so costs are actually increased rather than decreased. Centric is the new core that really does improve diversification and performance. Centric core is a disruptive innovation that replaces the S&P 500 and Russell 3000 as core.

The mighty S&P 500 and Russell 3000 indexes are fading away, replaced by disruptive innovations in both of their applications. Smart beta alternatives to market indexes offer the prospect of outperformance. The centric core alternative to core in core-satellite investing provides better diversification and higher returns. It's a smarter beta that delivers smart alpha by getting out of the way of active managers, allowing them to do their jobs.