DoubleLine Fortune 500 Equal Weight Strategy

Frequently Asked Questions | February 7, 2024

QUESTION 1:

What is the Fortune 500® list?

The storied history of Fortune® magazine began in 1929 with the goal of providing insight to its readers about the happenings of U.S. industrial businesses. In 1955, Fortune® started publishing its annual Fortune 500® list focused on energy, manufacturing and mining companies. In 1995, Fortune® announced it would include service companies, which have made up a majority of the 500 companies on the list since the change was introduced.

QUESTION 2:

How are Fortune 500® companies selected?

The Fortune 500® list selects the largest 500 U.S. companies based on their total revenues for the fiscal year. To be eligible for inclusion, a company must either be incorporated or operate in the U.S., or file financial statements with a U.S. government agency, including private companies that file financial statements with a government agency.[1] Currently, Fortune 500® companies represent two-thirds of U.S. gross domestic product with $18.1 trillion in revenues, $1.6 trillion in profits and $33.2 trillion in market value.[2]

QUESTION 3:

What is the Barclays Fortune 500 Equal Weighted Total Return Index?

The Barclays Fortune 500 Equal Weighted Total Return (TR) Index ("the Index") narrows the universe from the Fortune 500® list by excluding private companies, companies not traded on the New York Stock Exchange or Nasdaq stock exchange, and those that do not meet the Index's minimum liquidity threshold. Once those companies are excluded, the Index on average has had exposure to 449 stocks.[3] The constituents of the Index are equally weighted (EW), meaning all constituents receive the same weight at each annual reconstitution and quarterly rebalance regardless of a constituent's market capitalization.

The Index provides access to the highest-revenue-generating, publicly listed U.S.-based companies. The Index applies an objective approach to constituent selection, providing investors with a rules-based, transparent methodology to index construction. This approach differentiates the Index from other indices that can introduce subjective criteria in selecting their constituents, such as using a committee-based approach to determine eligibility.

QUESTION 4:

What are the differences between EW and market-capitalization-weighted stock indices?

EW stock indices have long been used in academia, and they garnered commercial adoption with the introduction of the S&P 500 Equal Weight Index in 2003. Prior to 2003, most commercially investible indices were weighted by market capitalization, although other methodologies exist. EW stock indices differ from market-capitalization-weighted ones, as the former allocates the same amount of capital to each stock while the latter allocates capital proportionate to each security's market capitalization. Both methods offer benefits and drawbacks.

EW stock indices offer investors a straight-forward methodology, more balanced and diversified exposure than market-capitalization-weighted indices, and the ability to capture the growth potential of smaller-capitalization companies. Given that each security within the Index will have a differentiated return over time, pursuing an EW exposure requires regular, periodic rebalancing, which in times of heightened cross-sectional volatility can lead to a potentially higher reward-to-risk ratio.[4] Some of the potential drawbacks of an EW index are: potential for greater turnover relative to a market-capitalization-weighted index, limited scalability, and such indices do not exploit any stock-specific information.

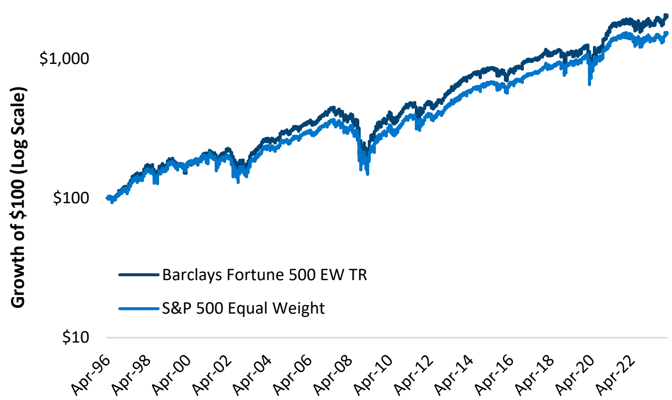
Using the market-capitalization-weighted approach offers an intuitive dynamic where the largest, most-familiar companies receive the largest amount of capital invested. This is inherently a momentum-based approach since companies that outperform will have their weights increase in the index relative to those that do not. In addition, the absence of rebalancing across securities results in reduced transaction costs relative to other approaches and lower maintenance as portfolio weights drift with price changes. Conversely, market-capitalization weighting might systematically overallocate to large, and even overvalued stocks; have a higher concentration in a few stocks; and is fundamentally backward-looking.

QUESTION 5:

What is the difference between the Barclays Fortune 500 Equal Weighted TR and S&P 500 Equal Weight indices?

The Barclays Fortune 500 Equal Weighted TR Index uses an objective, transparent approach while other indices might have more subjective criteria when selecting constituents. With the Fortune 500® list focused on the largest U.S. revenue generators, the Index also offers clients strategy diversification to both market-capitalization-weighted and other EW indices. Compared to the S&P 500 Index, the Fortune 500 Equal Weighted TR Index has included an average of 120 constituents that are not found in the S&P 500 Index.[5] Lastly, the Fortune 500 Equal Weighted TR Index has outperformed the S&P 500 Equal Weight Index, with similar volatility, resulting in higher risk-adjusted returns since inception.[6] *(Figure 1)*

Growth of $100 | April 30, 1996 through January 31, 2024



	Barclays Fortune 500 EW TR Index	S&P 500 EW Index
Annualized Geometric Return	11.43%	10.29%
Annualized Standard Deviation	20.54%	20.12%
Annualized Sharpe Ratio	0.53	0.48

Figure 1
Source: DoubleLine, Bloomberg

The **Barclays Fortune 500 Equal Weight Total Return Index** went live on August 15, 2018 and was backfilled to the start date shown in each chart. The **S&P 500 Equal Weight Index** went live on January 8, 2003 and was backfilled to the start date shown in each chart.

Any data on past performance, modeling or back-testing contained herein is no indication as to future performance. See Historical Index Performance Disclaimer in the back of this presentation. You cannot invest directly in an index.

QUESTION 6:

What characteristics can investors expect from an EW index versus market-capitalization-weighted indices?

Sector differences: indices tend to have broader, more diverse sector exposure relative to market-capitalization-weighted indices, which can diverge widely among sector weightings.

Size effects: A considerable size dispersion prevails within the market today, with a handful of stocks that have market capitalizations significantly greater than the mean of the market while a majority of stocks are valued below the mean. As a result, EW indices will underweight the largest companies while investing more heavily in smaller-market-capitalization names. There is a tradeoff in reward and risk via the size effect. While small- and mid-capitalization companies have the potential to offer higher returns if they grow into mid- and large-capitalization companies, they can also introduce more volatility into investors' portfolios.

Momentum versus mean reversion: Market-capitalization-weighted portfolios tend to have more of a momentum bias, whereas EW portfolios have a mean-reversion bias. The reason for this dynamic is that in market-capitalization-weighted indices, exposures increase to companies that are performing well, which in turn increases the companies' overall market capitalization and weighting, creating a momentum effect. These same outperforming companies in an EW index would experience price appreciation as well but ultimately would not represent an ever-increasing overall percentage of the index due to the rebalancing feature, which ensures an EW investment approach. When top-performing companies lose momentum or start underperforming relative to their peers, they tend to have a greater contribution to return in market-capitalization-weighted indices, whereas EW indices tend to have less exposure to top performers, which have less of an impact on return.

QUESTION 7:

What is the merit for an allocation to EW indices?

Historically, EW indices have provided investors with outsized returns relative to market-capitalization-weighted indices. While EW indices tend to exhibit slightly higher volatility relative to market-capitalization-weighted indices, EW indices can potentially generate higher excess returns, ultimately resulting in higher risk-adjusted returns. *(Figure 2)* In addition, the current market setup could be advantageous for investors looking to make an allocation to EW indices. Using history as a guide, the narrowness of the recent market runup, powered by the outperformance of seven stocks (the "Magnificent Seven"), is reminiscent of the pre-2000s when mega-capitalization tech stocks drove the majority of equity market returns. Given their size and momentum, market-capitalization-weighted indices significantly outperformed EW indices in the runup to the 2001 economic downturn. *(Figure 3)* Over the following seven years, EW indices significantly outperformed market-capitalization-weighted indices. A combination of mean reversion and an underweight to the large-capitalization tech names in EW indices relative to market-capitalization-weighted indices contributed to this period of outperformance. *(Figure 4)*

Growth of $100 | April 30, 1996 through January 31, 2024

	Barclays Fortune 500 EW TR	S&P 500
Annualized Geometric Return	11.43%	9.29%
Annualized Standard Deviation	20.54%	19.35%
Annualized Sharpe Ratio	0.53	0.46

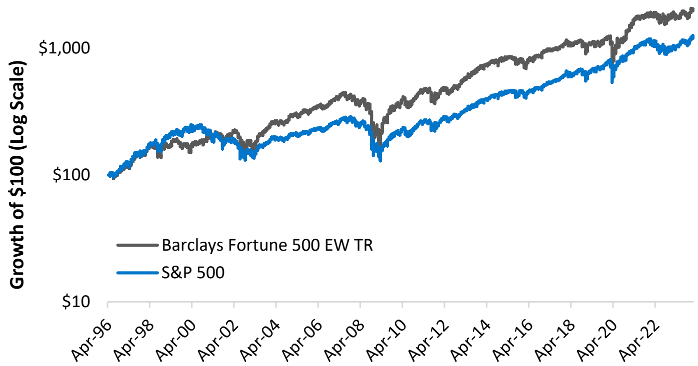


Figure 2
Source: DoubleLine, Bloomberg

Growth of $100 | April 30, 1996 through September 1, 2000

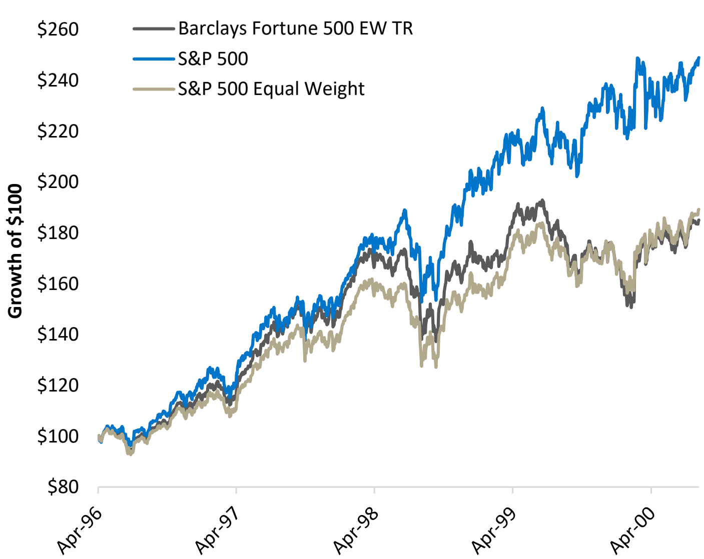


Figure 3
Source: DoubleLine, Bloomberg

Growth of $100 | September 1, 2000 through October 9, 2007

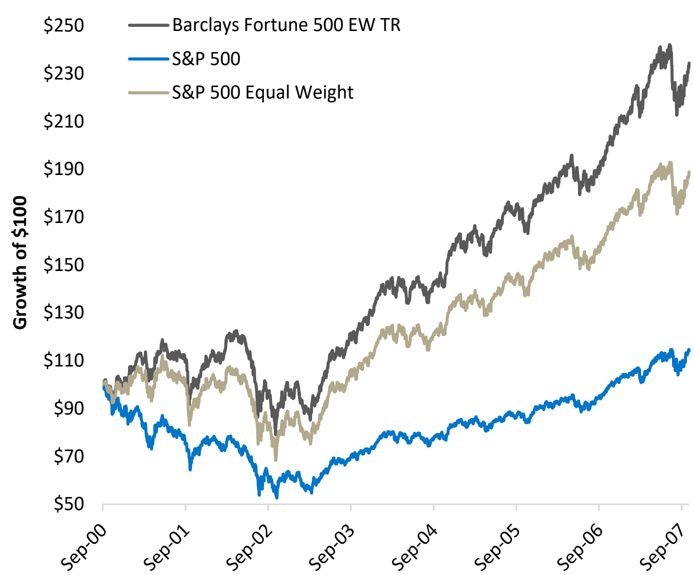


Figure 4
Source: DoubleLine, Bloomberg

The **Barclays Fortune 500 Equal Weight Total Return Index** went live on August 15, 2018 and was backfilled to the start date shown in each chart.
The **S&P 500 Equal Weight Index** went live on January 8, 2003 and was backfilled to the start date shown in each chart.

QUESTION 8:

What are the risks an investor faces using this strategy?

The main risk is exposure to the U.S. equity market. Equity-centric risks include, but are not limited to, economic slowdowns, shrinking corporate profit margins, restrictive monetary policy moves by the Federal Reserve and price multiple compression. Relative to market-capitalization-weighted indices, EW indices tend to have greater exposure to smaller-capitalization names that can be more economically sensitive and, therefore, tend to have greater volatility than large-capitalization names but also offer greater return potential. ■

Jeffrey Sherman, CFA
DoubleLine Deputy Chief Investment Officer

As DoubleLine's Deputy Chief Investment Officer, Jeffrey Sherman oversees and administers DoubleLine's Investment Management sub-committee coordinating and implementing policies and processes across the investment teams. He also serves as lead portfolio manager for multi-sector and derivative-based strategies. He is a member of DoubleLine's Executive Management and Fixed Income Asset Allocation Committees. He can be heard regularly on his podcast "The Sherman Show" (@ShermanShowPod) where he interviews distinguished guests, giving listeners insight into DoubleLine's current views. In 2018, Money Management Executive named Jeffrey Sherman as one of "10 Fund Managers to Watch" in its yearly special report. Prior to joining DoubleLine in 2009, he was a Senior Vice President at TCW where he worked as a portfolio manager and quantitative analyst focused on fixed income and real-asset portfolios. Mr. Sherman was a statistics and mathematics instructor at both the University of the Pacific and Florida State University. He taught Quantitative Methods for Level I candidates in the CFA LA/USC Review Program for many years. He holds a BS in Applied Mathematics from the University of the Pacific and an MS in Financial Engineering from the Claremont Graduate University. He is a CFA® charterholder.

Endnotes

[1] For more on the Fortune 500 methodology: https://fortune.com/franchise-list-page/fortune-500-methodology-2023/

[2] Fortune magazine, as of March 31, 2023. Fortune Media IP Limited, Fortune Media (USA) Corporation and their affiliates (collectively, "Fortune Group") are not the creator, developer or implementer of the Barclays Fortune 500 Equal Weighted Total Return Index (the "Index") or the Doubleline Fortune 500 Equal Weighted ETF based on the Index (the "ETF") and Fortune Group has no responsibilities, obligations or duties to investors in the ETF.

[3] Average number of stocks in the Index based on the annual Index rebalance period each year, 1996-2023

[4] "Stochastic Portfolio Theory and Stock Market Equilibrium," Journal of Finance, May 1982

[5] Average number of stocks in the Barclays Fortune 500 Equal Weighted TR Index based on the annual rebalance period, 1996-2023

[6] The Barclays Fortune 500 Equal Weighted TR Index went live on Aug. 15, 2018; its inception date is April 29, 1996.

Barclays Fortune 500 Equal Weighted Total Return (TR) Index – Takes the Fortune 500 list, which consists of the 500 largest companies in the United States based on revenue, and excludes: private companies (i.e., those without publicly listed equity securities) and those with equity securities not listed on the New York Stock Exchange or Nasdaq Composite Index; companies with listed equity securities that do not meet a minimum liquidity threshold or minimum listing period requirements; companies incorporated outside the U.S.; U.S. companies owned or controlled by other companies, domestic or foreign, that file with a government agency; and companies that failed to report full financial statements for at least three quarters of the current fiscal year. The index is reconstituted on an annual basis and rebalanced otherwise quarterly. Unlike most equity indices that are weighted by the market capitalizations of their component companies, the constituents of the index are equally weighted, meaning the index assigns each constituent the same weight at each reconstitution and quarterly rebalance, regardless of such constituent's market cap.

Nasdaq Composite Index – This index ("the Nasdaq") comprises the more than 3,000 common stocks and similar securities (e.g., American depository receipts (ADRs), tracking stocks, limited-partnership interests) listed on the Nasdaq exchange. The index, which includes U.S. and non-U.S. companies, is highly followed in the U.S. as an indicator of the stock performance of technology companies and growth companies.

S&P 500 Equal Weight Index (EWI) – This index is the equal-weight version of the widely used S&P 500 Index. The S&P 500 EWI includes the same constituents as the capitalization-weighted parent index, but each company in the S&P 500 EWI is allocated a fixed weight, or 0.2% of the index, at each quarterly rebalance.

S&P 500 Index – This unmanaged capitalization-weighted index of the stocks of the 500 largest publicly traded U.S. companies is designed to measure performance of the broad domestic economy through changes in the aggregate market value of the 500 stocks, which represent all major industries.

Sharpe Ratio – Used to help investors understand the return of an investment compared to its risk. The ratio is the average return earned in excess of the risk-free rate per unit of volatility or total risk. Volatility is a measure of the price fluctuations of an asset or portfolio. Subtracting the risk-free rate from the mean return allows an investor to better isolate the profits associated with risk-taking activities. The risk-free rate of return is the return on an investment with zero risk, meaning it's the return investors could expect for taking no risk. The yield for a U.S. Treasury bond, for example, could be used as the risk-free rate.

Standard Deviation – Measure of the variation or dispersion of a set of data from its mean or expected/budgeted value. A low standard deviation indicates that the data points tend to be very close to the mean, whereas a high standard deviation indicates that the data is spread out over a large range of values. A measure of an investment's volatility.

Money Management Executive, **10 Fund Managers to Watch**. Managers were chosen based on factors including long-and short-term performance in their specific categories, individual strategies and their length of time in the business. All funds considered were led by single managers.

You cannot invest directly in an index.

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Historical index performance can be assessed with respect to the index inception date:

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Pre-inception index performance refers to the period prior to the index inception date (defined as the period from the "Index Base Date" to the "Index Live Date"). This performance is hypothetical and back-tested using criteria applied retroactively. It benefits from hindsight and knowledge of factors that may have favorably affected the performance and cannot account for all financial risk that may affect the actual performance of the index. It is in Barclays' interest to demonstrate favorable pre-inception index performance. The actual performance of the index may vary significantly from the pre-inception index performance. You should not rely on hypothetical index performance information.

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All index performance data included in this communication are accompanied by a footnote specifying the relevant Index Base Date and Index Live Date. The Index Live date is defined as the date on which the index rules were established and the index was first published. Actual historical performance is highlighted in blue. Hypothetical performance is not highlighted.

Historical index performance is provided for a period of at least 10 years, unless the instruments underlying the index were only available or sufficiently liquid for a lesser period. In that case, historical index performance is provided from the time when the instruments underlying the index were available or sufficiently liquid. Performance, volatility, Sharpe ratio and correlation data are calculated using monthly returns and maximum drawdown data are calculated using daily returns.

The index methodology is available for review upon request, subject to the execution of a non-disclosure agreement.

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