Introducing the Global X Russell 2000 ETF (RSSL)

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On June 5, 2024, we listed the Global X Russell 2000 ETF (RSSL) on the New York Stock Exchange. RSSL is an ETF designed to provide investors convenient exposure to many of the small-cap equities that are listed within the United States. It does so by purchasing the relevant underlying stocks that make up the Russell 2000 RIC Capped Index and packaging them within the ETF wrapper.

In the world of equity investing, the importance of maintaining a diversified portfolio has been well documented. And though institutions and individuals might often seek to address this concern by branching out across various geographies, industries, and product types, the potential benefits of size diversification should not be overlooked. Investing in companies of the small-cap variety might offer higher growth potential, as they often pursue expansion from the earlier stages of their respective life cycles. They might also help to lower a portfolio's beta coefficient because their performances sometimes deviate from that of their mid- and large-cap counterparts. The Global X Russell 2000 ETF (RSSL) grants investors the opportunity to take share in the small-cap equity space, providing exposure to the Russell 2000 RIC Capped Index with the convenience and potential liquidity of an ETF product.

Key Takeaways

- The Russell 2000 Index is constructed with a specific methodology in mind. However, by seeking to track the Russell 2000 RIC Capped Index, RSSL can gain exposure to an underlying basket of small-cap stocks with modestly differentiated portfolio dynamics.
- Pricing is an important factor in determining core equity exposure. The Global X Russell 2000 ETF is competitively positioned in this regard with an expense ratio of 0.08%.
- Although small-cap equities have a tendency to trade with elevated relative volatility, size diversification can still represent a means by which to reduce risk within a portfolio. Concurrently, investors might gain the ability to broaden portfolio growth potential by adding these exposures to a basket of positions.

The Global X Russell 2000 ETF Offers a Differentiated Small-Cap Exposure

The Russell 2000 Index is broadly recognized as the primary temperature gauge for the small-cap equity market within the United States. Its constituency is in fact a subset of the larger Russell 3000 Index, made up of companies that as of April 28, 2023 had a market capitalization below $4.2 billion.[1] The index is market-cap weighted, making the largest of the small caps generally its primary performance contributors, and it is reconstituted on an annual basis to be sure that companies who no longer meet its requirements make way for new participants that fit the bill.

The Global X Russell 2000 ETF (RSSL) roughly provides investors exposure to this index, but with a few caveats to consider. Specifically, the fund seeks to track the Russell 2000 RIC Capped Index, which is an index that maintains exposure to all of the same companies that exist in the Russell 2000, but with a weighting cap contingency. The Russell 2000 RIC Capped Index is float adjusted and market cap weighted much like the base Russell 2000 Index. However, individual constituents are capped quarterly so that no particular stock can make up more than 20% of the index. Further, the sum of the weights of all constituents that represent more than 4.5% of the index should not exceed 48% of the total index weight. RSSL's exposure is achieved through implementation of a representative sampling strategy that involves investing in a sample of the securities that exist in the index, which collectively maintain a risk/reward profile similar to that of the underlying. This means that the fund is not expected to hold exposure to 2000 companies like the Russell 2000. Its investment base is, however, expected to be positively correlated with the Russell 2000 to the tune of 95%-100%.

TRACKING THE RUSSELL 2000 RIC CAPPED INDEX CAN LIMIT SINGLE-STOCK DEPENDENCE

Sources: Global X ETFs with information derived from FTSE Russell. Market Cap Breakpoint represents the highest market capitalization of an index constituent on rank date April 28, 2023, at which time FTSE Russell reconstitutes the Russell US indexes, employing its "banding" methodology to break out constituents of the Russell 3000 into the Russell 1000 and Russell 2000. Market Cap Breakpoint will vary over time

Characteristic	Russell 2000	Russell 2000 RIC Capped
Float Adjusted	✓	✓
Market-Cap Weighted	✓	✓
$4.2 Billion Market Cap Breakpoint	✓	✓
Reconstitution Schedule	Annually	Annually
Cap Stipulation	None	Quarterly 20% Individual Company/48% for All Companies with >4.5% Weight

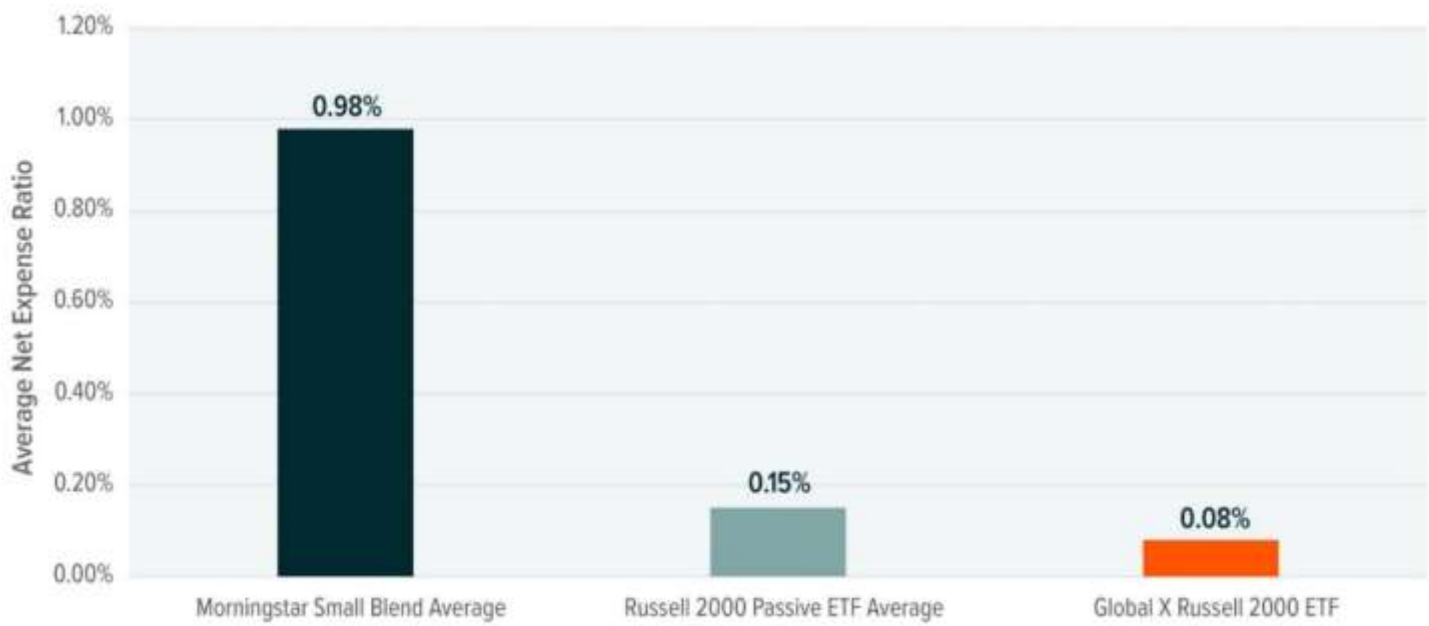
The differentiated methodology behind the RIC Capped Index may have benefits from a diversification perspective as well. By maintaining the capping methodology employed by the RIC Capped Index, an investor might be less dependent upon the performance of any individual company and maintain the measure of diversification that is meant to be provided by an interest in a broad 2000 stock constituency. Even so, investors would still have the opportunity to participate in the price appreciation of a specific stock, up until it grows to represent 20% of the value of the index at the next rebalance. This may help maintain desired exposures within a basket of stocks and, likewise, an investor's broader risk profile.

RSSL Comes in at a Largely Competitive Pricing Position

When seeking to establish core equity exposure through an ETF or alternative vehicle, investors might consider the cost of participation in their overall returns. For funds that seek to track broad equity indices, specifically, it would be expected for these fees to be rather minimal. Compared to the wealth of other funds that exist in the Morningstar Small Blend Category, RSSL carries with it an expense ratio that is well beneath the group average. Specifically, it is charging 8 basis points compared to an average of 98 basis points for the lot.[2] This is a credit to the fund's passive management style, the expectation that it will trade its underlying constituency infrequently, and its intent to track the underlying Russell through its representative sampling strategy.

SMALL-CAP EXPOSURE AT A POTENTIALLY APPEALING PRICE POINT

Sources: Global X ETFs, Morningstar Direct, and fund documents. Morningstar Small Blend Average net expense ratio derived from Morningstar Small Blend fund category, excluding leveraged and inverse mutual funds and ETFs; Russell 2000 Passive ETF Average derived from the net expense ratio of all passively-managed ETFs seeking to harness the Russell 2000 as their primary prospectus benchmark as categorized by Morningstar, discounting leveraged and inverse ETFs. Data as of June 30th, 2024. Retrieved July 23rd, 2024. RSSL is not included in the averages as the fund seeks to harness the Russell 2000 RIC Capped index as its primary prospectus benchmark.



Over the long term, this could have a material impact on the returns received by maintaining a position in the fund. Investors should also consider the potential benefits that come with implementing via an ETF product. Mutual funds tend to have a greater likelihood of having to distribute capital gains at year-end. In fact, in 2023, 49% of the mutual funds that harness the Russell 2000 as their primary prospectus benchmark had a capital gains distribution, while none of the ETFs with the same primary benchmark did.[3] This is a product of the in-kind creation and redemption process that is associated with ETFs, where Authorized Participants (APs) will deliver and redeem baskets of underlying securities to and from ETF issuers to maintain their liquidity rather than exchanging cash that would result in a taxable event. This might help investors save money and prevent erosion of their total returns.

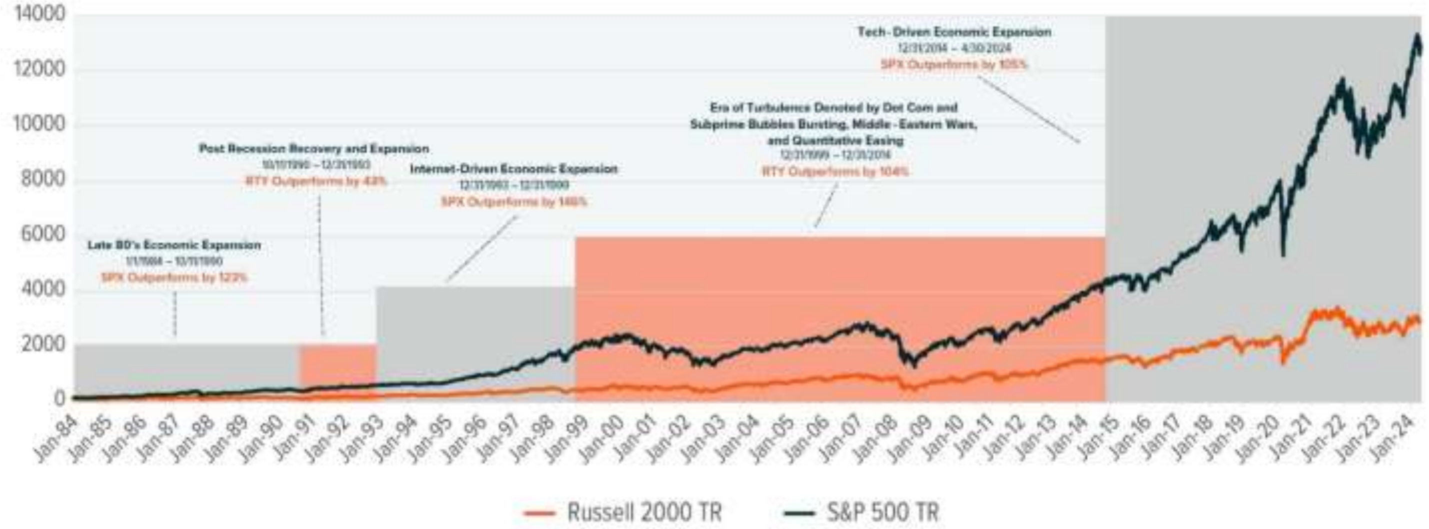
Small Cap Equity Diversification Might Help Improve Both Risk and Reward Profiles

The Russell 2000 Index is sometimes perceived to be made up of companies that boast more prospects than profits. And because it might be difficult to ascertain if and when its constituents will reap the physical benefits of their labor, their stock values sometimes trade with a wider degree of volatility relative to more well-established entities. This might act as a deterrent to investors who are considering entering the small-cap space. However, in the context of a core holding within a broader portfolio, the degree of price oscillation with which these equities might trade could mean very little.

Looking at its value on a price-to-earnings basis, relative to the S&P 500, the Russell 2000 is significantly discounted as of May 31, 2024.[4] Small-cap equities also have a tendency to trade at a lower multiple to larger firms based on price to book, price to equity, and price to cash flow valuations.[5] These characteristics potentially set these companies up to be relative outperformers over the long haul. And while past performance is not a guarantee of future results, this is in fact evidenced when viewing performance during instances of elevated underlying volatility and market recoveries.

SMALL-CAP EQUITIES HAVE SHOWN THE ABILITY TO OUTPERFORM OVER LONG PERIODS

Sources: Global X ETFs and Morningstar Direct. S&P 500 and Russell 2000 cumulative total returns from January 1, 1984 (Russell 2000 Inception) to April 30, 2024. Retrieved May 15, 2024.

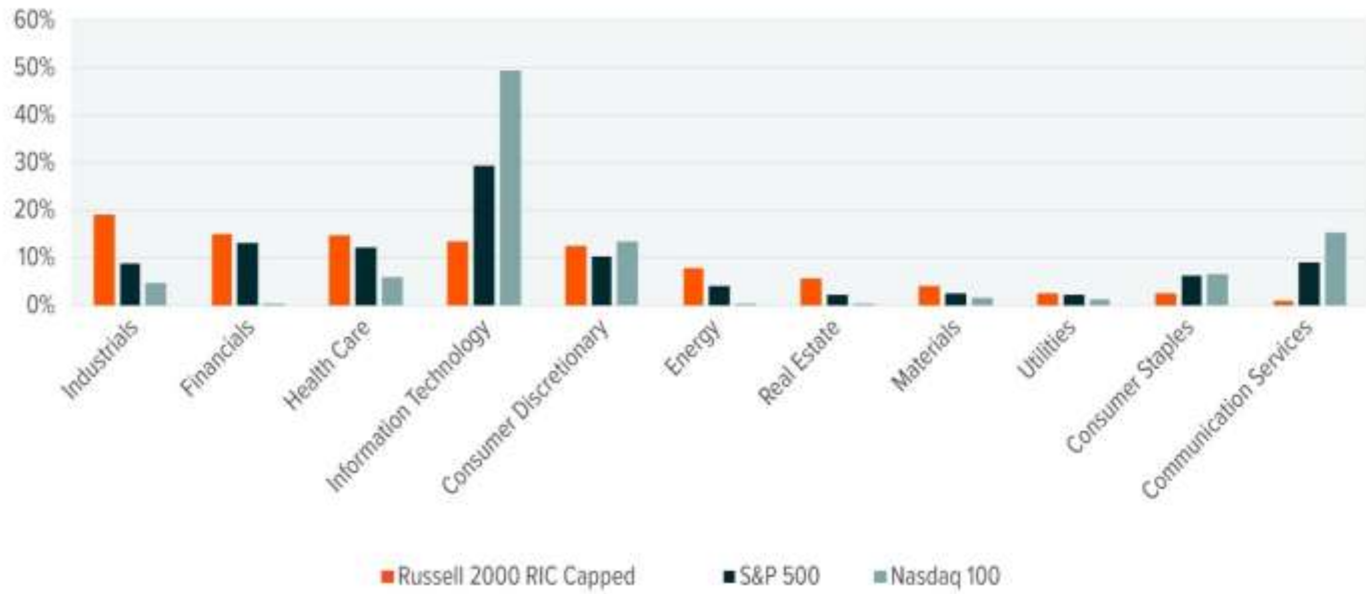


Index returns are for illustrative purposes only and do not represent actual Fund performance. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

With core equity investments meant to represent long-term positions that form the foundation of a portfolio, investors ought to be willing to ride out some of the aforementioned volatility in an effort to attain a final result. There's more to small-cap investing than just solid growth potential, however, as investors might also benefit from the size and sector diversification provided by the Russell 2000 RIC Capped Index as they wait for their allocations to bear fruit. Indeed, we believe the Russell 2000 RIC Capped Index represents a nice complement to an S&P 500 investment, in part because that index has become increasingly concentrated in the information technology sector over the last few years. Relative to the S&P 500, as well as the growth-oriented Nasdaq 100, the Russell 2000 RIC Capped Index is more heavily exposed to sectors like energy, financials, and industrials.[6]

THE RUSSELL 2000 RIC CAPPED INDEX COMPLEMENTS HIGHER WEIGHT SECTORS WITHIN THE S&P 500 AND NASDAQ 100

Sources: Global X ETFs with information derived from S&P Global, FTSE Russell, and Morningstar Direct. Data as of April 30, 2024. Retrieved May 6, 2024.



The long runway for growth that small caps carry makes them potentially more suitable for investors with long-term time horizons. While acknowledging the inherent risks that accompany smaller corporations, many former members of the Russell 2000 Index have since blossomed into large cap status thanks to market disruption, capable management, or novel business strategies; some notable former constituents of the Russell 2000 include the likes of Netflix, Chipotle, and Amazon. The wide array of these index constituents makes the Russell 2000 an incubator of sorts for potential growth opportunities. Meanwhile, its status as a broad 2000 stock index may add to investor diversification and can help reduce portfolio idiosyncratic risk.

Opportunistic Investors and Buy-and-Hold Accounts May Find Russell 2000 Exposure Similarly Appealing

U.S. markets have grown increasingly concentrated over the last few years as consequence of a small cohort of mega-cap tech stocks, informally dubbed the "Magnificent Seven (Mag 7)", experiencing strong value appreciation and high rates of ownership within both institutional and retail investor portfolios. As 2024 has unfolded, however, investors have witnessed some of these issues lose momentum, while the recent market rally has maintained an upward trajectory.[7] This undertaking, potentially characterizing a widening of breadth, could represent an opportunity for small-cap companies to capture some of the gains that have escaped them in recent years. Notwithstanding this potential opportunity, the growth and diversification benefits that might be provided by taking stake in the small cap space could be pursued by a position in the Global X Russell 2000 ETF.

Related ETFs

RSSL – Global X Russell 2000 ETF

Click the fund name above to view current performance and holdings. Holdings are subject to change. Current and future holdings are subject to risk.

Footnotes

1. London Stock Exchange Group. Russell U.S. Four Decades of Russell US Indexes Reconstitution (May 2024).
2. Global X and Morningstar Direct. Average net expense ratio of all ETFs and mutual funds that exist in the Small Blend Category, as categorized by Morningstar, excluding leveraged and inverse mutual funds and ETFs. Data as of June 30, 2024. Retrieved July 23, 2024.
3. Global X with information derived from Morningstar Direct. Based on capital gains distributions in 2023 by funds with the Russell 2000 Index as their primary prospectus benchmark. Retrieved May 6, 2024.
4. Bloomberg L.P. Russell 2000 vs S&P 500 Price-to-Earnings ratio as of May 31, 2024. Data retrieved June 3, 2024.

5. Bloomberg L.P. Russell 2000 vs S&P 500 Price-to-Book ratio, Price-to-Equity ratio, and Price-to-Cash Flow from January 1, 1984 (Russell 2000 inception date) to May 31, 2024. Data retrieved June 3, 2024.
6. S&P Global, FTSE Russell, and Morningstar Direct. Sector distributions as of April 30th, 2024. Data retrieved May 3, 2024.
7. Factset Workstation. Nvidia Corporation (NVDA), Meta Platforms, Inc. (META), Alphabet, Inc. Class C (GOOG), Microsoft Corporation (MSFT), Tesla, Inc. (TSLA), Apple, Inc. (AAPL), Amazon, Inc. (AMZN), and S&P 500 Equal Weight Index cumulative price returns from January 1, 2024 to April 30, 2024. Data retrieved May 2, 2024.

Glossary

Beta Coefficient: Measures the volatility of a fund's price relative to the volatility in a market index and can also be identified as the percentage change in the price of the fund given a 1% change in the market index. A beta below one suggests that the fund was less volatile than the market benchmark. A beta above one suggests that the fund was more volatile than the market benchmark.
Russell 2000 Index: The small-cap market index consists of the smallest 2,000 markets in the Russell 3000 Index.
S&P 500: The index includes 500 leading U.S. companies and captures approximately 80% coverage of available U.S. market capitalization.
Nasdaq 100: The NASDAQ 100 index includes 100 of the largest non-financial companies listed on its stock market.
