

# Follow-ups

From Morningstar:

## Alpha Isn't Dead. You've Just Been Measuring It Wrong

New research shows smarter portfolio construction—not new factors—is the real edge.

[Larry Swedroe](#) Mar 26, 2026

For decades, investors and academics have been locked in a hunt for alpha—the holy grail of risk-adjusted returns that can't be explained by known market factors. The quest has grown so frenzied it spawned what John Cochrane famously called the [factor zoo](#): a sprawling menagerie of hundreds of documented anomalies, each claiming to produce excess return. Yet, despite all this effort, alpha has been shrinking. Mutual fund alpha has declined, as has hedge fund alpha. The playbook that worked in 1993 looks considerably less potent today.

So, is alpha dead? Andrew Berkin and Christine Wang of Bridgeway Capital Management, authors of the study "[The Incredible Structural Alpha](#)," published in the Spring 2026 issue of *The Journal of Beta Investment Strategies*, believe the answer is an emphatic no. However, finding it requires a fundamentally different mindset.

### Alpha: What Did the Authors Examine?

Berkin and Wang set out to show that meaningful, persistent alpha is available not by discovering exotic new factors or mining ever-larger datasets but simply by being more thoughtful about constructing portfolios.

Their laboratory was the classic 5×5 grid of portfolios sorted by size and value—the same analytical framework that Fama and French used in their [landmark 1993 work](#). Using 60 years of US stock data (July 1963 through June 2023), they walked through four straightforward and easy-to-understand portfolio construction scenarios, measuring how each incremental design improvement affected both raw returns and risk-adjusted alpha.

The four levers they pulled were:

- 1. Deeper Factor Exposure:** Concentrating portfolios more tightly in the extremes of size and value (true small cap, truly cheap stocks), rather than broader splits.
- 2. Timely Data and More Frequent Rebalancing:** Using the most current market cap available rather than stale year-old data and switching to quarterly accounting data when it becomes available.
- 3. Removing Stocks With Unwanted Factor Exposure:** Screening out the worst-momentum stocks from value portfolios to avoid the drag of stocks that are cheap but falling for good reason and junk from small caps.
- 4. Using Multiple Value Metrics:** Combining four measures of value (book/price, sales/price, earnings/price, and cash flow/price) rather than relying on book/market alone.

### What Did They Find?

The results are striking, and they build on each other.

**1. Deeper Exposure Is Worth It:** Starting with the baseline Fama-French approach (Scenario 1), the smallest and deepest value stocks returned over 16.0% annually across the 60-year period—while small-growth stocks returned just 3.65%. Even after adjusting for their known factor exposures, the smallest, deepest value corner of the market generated a statistically significant alpha of nearly 2% per year. The smallest growth corner, meanwhile, produced a statistically significant *negative* alpha of 6%. The implication: The nonlinearities at the extremes of the size and value spectrum are real, persistent, and economically large.

**2. Fresh Data Changes Everything (Especially Through the Lens of Momentum):** When the authors switched to quarterly data and current market cap (Scenario 2), something interesting happened. Returns for the deepest value portfolios actually *fell* slightly—but their measured alpha *rose sharply*, from 1.97% to 4.53% for the smallest deep-value portfolio. Why? Because more timely classification of stocks as “value” means you’re often catching stocks that have recently dropped in price—stocks with negative momentum. Those stocks carry a momentum headwind that suppresses returns but isn’t fully accounted for in simple alpha calculations. The alpha is real; the momentum drag is a separate, identifiable cost.

**3. Removing the “Cheap for a Reason” Boosts Returns Directly:** Screening out the worst quintile of momentum stocks (Scenario 3) produced higher returns across nearly all 25 portfolio squares—with the gains largest among smaller stocks, where momentum is the strongest. The smallest deep-value portfolio’s return rose to 17.85%. Notably, alpha itself barely moved (4.53% to 4.57%), but its statistical significance increased substantially, with the t-statistic rising from 4.54 to 5.96. The message is clear: Removing poor-momentum stocks raises returns through better factor exposure, not through some mysterious new source of alpha.

**4. Multiple Value Metrics Unlock the Large-Cap Value Premium:** This is perhaps the most practically important finding for many investors. It is well known that using only book/market as the value measure works poorly for large-cap stocks—the traditional high-minus-low-value premium mostly comes from smaller companies. But when the authors combined four value metrics (Scenario 4), the largest deep-value portfolio’s return jumped from 9.73% to 12.65% annually. The value premium was restored across all size segments.

The mechanism is transparent: Metrics like sales/price, earnings/price, and cash flow/price also capture profitability. Stocks that look cheap on these measures tend to have solid underlying businesses. Because the standard alpha model uses only book/market as its value factor, the extra returns from these other measures show up as alpha rather than factor compensation—which is exactly what the authors observe.

## The Structural Size and Value Factors

Having demonstrated the benefits in portfolio terms, Berkin and Wang took the analysis one step further and constructed improved versions of the famous small minus big and HML factors themselves.

The results are sobering for fans of the conventional Fama-French factors—and encouraging for those willing to invest the effort in better construction:

- The standard SMB returned just 0.17% per month over the full 60-year period and was not statistically significant. The structural version returned 0.37% per month, rising to 0.44% per month when “cheap for a reason” low-value stocks were excluded from the small-cap side.
- The standard HML returned 0.29% per month. The structural version returned 0.33% per month.

The gap widens dramatically in the second half of the sample (1993–2023), when the conventional factors have struggled badly. The standard SMB averaged just 0.06% per month. The structural version earned 0.26%—

0.33% per month. Similarly, standard HML earned just 0.13% per month in this period, while the structural version maintained 0.28% per month.

This is the paper's most important practical finding: When the conventional factors were weakening, thoughtful portfolio construction preserved most of their return premium.

Finally, their findings were basically unchanged in a robustness check using the Fama-French six-factor model.

## Key Takeaways for Investors

- 1. Alpha From Construction, Not From New Factors:** The factor zoo is partly an illusion. Many apparent new anomalies may simply be capturing the structural alpha that already exists in well-known factors when they're properly constructed. Investors should be skeptical of claims that any new metric is truly distinct from size and value.
- 2. Go Deeper, Not Broader:** Concentrating in the true extremes of size and value—not the broadly defined “smaller half” or “high-30%”—produces meaningfully higher returns and alpha. Most mainstream indexes and many exchange-traded funds don't do this. Index funds cannot capture this structural alpha.
- 3. Pay Attention to Momentum Interactions:** A stock that looks cheap may be cheap for a reason. Screening out the worst-momentum stocks from value portfolios is a practical, disciplined way to improve returns without abandoning the value thesis. The momentum and value factors interact—ignoring that interaction leaves money on the table.
- 4. Use Multiple Value Metrics, Especially for Large Caps:** Book/market alone is a poor value signal for large-cap companies. Combining it with earnings yield, sales yield, and cash flow yield produces a more robust value signal across the full market-cap spectrum, particularly in the large-cap space where book value has become a less reliable anchor.
- 5. Implementation Is Not a Footnote:** The authors are explicit that disciplined execution matters as much as smart factor design. Patient trading, broad stock-selection pools, position bounds, securities lending, and—critically—closing a fund before it grows too large to execute its strategy are all levers that can add or destroy the structural alpha that portfolio design creates. A beautifully designed strategy, poorly executed, will still underperform.
- 6. Fees Matter, But Less Than You Might Think; Design Matters More:** The authors note that structural alpha can amount to several percent annually—an order of magnitude larger than typical fee differences between funds. Investors fixated on minimizing basis points may be optimizing the wrong variable if they're ignoring the quality of portfolio construction.
- 7. The Conventional Factors Aren't Broken; They're Just Poorly Measured:** The well-documented weakness of size and value in recent decades is largely a story of how those factors are conventionally defined and measured. Structural improvements to construction preserve the premium substantially. The factors work. The definitions need updating.
- 8. AUM Matters:** As my September column “[The Hidden Costs of Passive Investing](#)” explains, large systematic managers attempt to reduce slippage by remaining flexible and limiting their participation in daily trading volume, typically to 1% to 3% of average daily volume. For smaller managers, or highly liquid large-cap stocks, this constraint is immaterial. However, for megafirms trading less liquid small-value securities, it

creates a problem called *latency*—positions may take quarters, or even years, to build or unwind. The result is lower trading costs but also lower exposure to the factors with premiums.

## The Alpha Bottom Line

The search for alpha doesn't have to mean chasing increasingly exotic signals in increasingly crowded corners of financial markets. Berkin and Wang make a compelling case that the building blocks—size and value—still work, and work considerably better when handled with care.

The “incredible structural alpha” isn't magic. It comes from the disciplined application of things most sophisticated investors already know they should do: Concentrate on the true extremes of your target factors, keep your data current, avoid stocks with compounding headwinds, diversify your signal, and execute with precision. The paper's contribution is to quantify exactly how much each of those choices is worth—and the answer is: quite a lot.

For investors navigating a world where conventional factor premiums have compressed, that's a meaningful source of hope.

From VERDAD on Mar.16<sup>th</sup>:

## Hope Springs Eternal

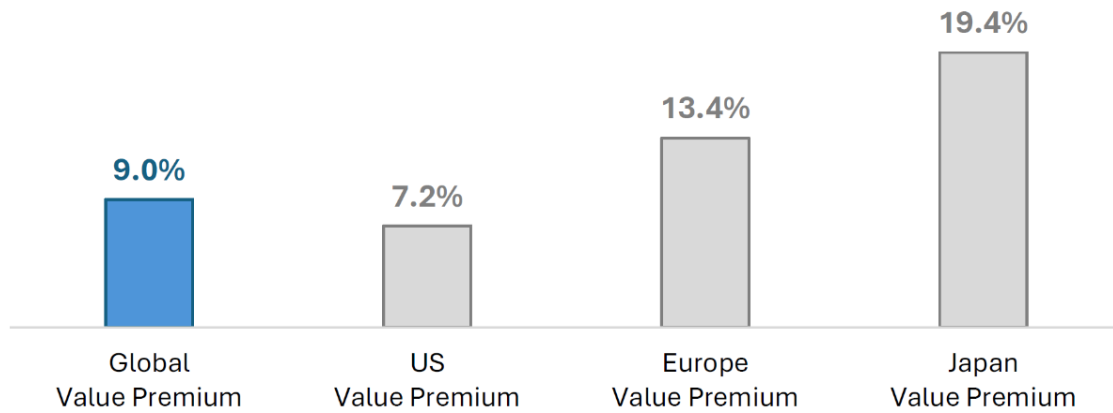
*After more than a decade of drought, the value premium has sprung back into positive territory, and the best years may be yet to come.*

By: [Brian Chingono](#)

Hope is classically defined as the patient, confident expectation of a good future. The attainment of this good future is often subject to forces beyond our control, requiring us to actively choose to practice patience in the present. Hence, the virtue of hope is more than just optimism.

Over the 14 years between January 2007 and December 2020, the value factor experienced a withering famine. During this horizon, value stocks trailed growth firms by -5.7% annualized, according to global data from Ken French. Even though the long-term record for value remained intact at the end of this famine, with a 3.3% value premium since 1926, it took profound patience and confidence to continue hoping for a good future in value by the end of 2020. Yet this patience was handsomely rewarded over the next five years, with value significantly outperforming growth globally, and particularly among international markets, as shown in the chart below.

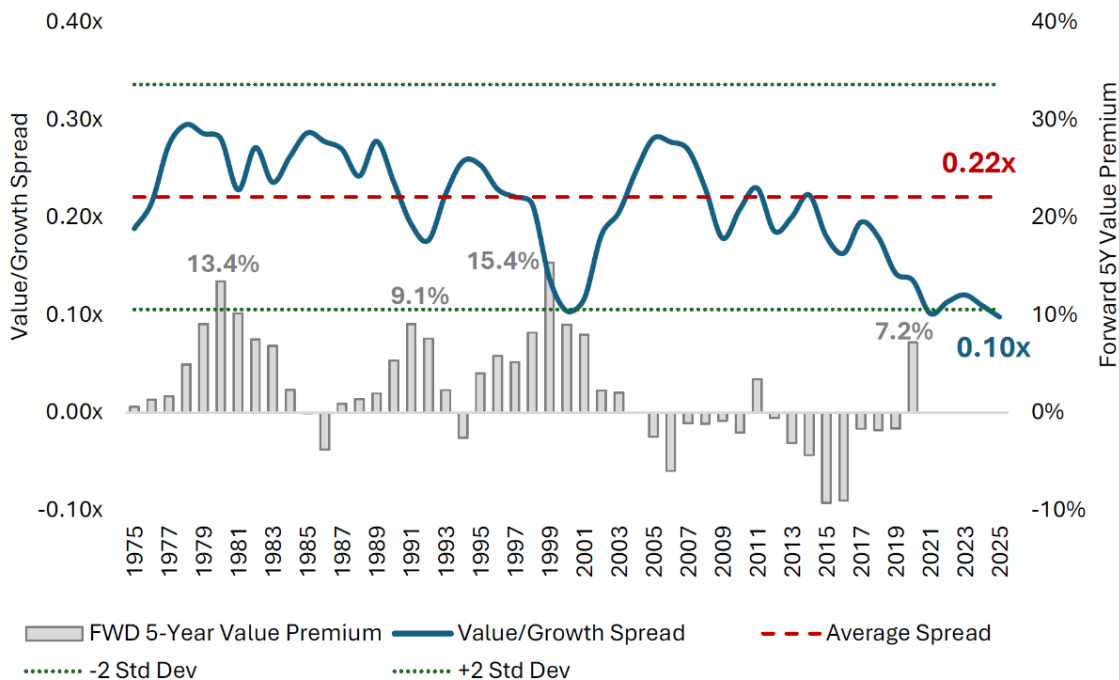
**Figure 1: Five-Year Annualized Value Premium (Jan. 2021 – Dec. 2025)**



Now that a good future for value appears to be dawning, a key question is how long it will last. From today’s standpoint, can we continue to hope for a good future in the value premium?

To answer this question, we can look at the long-term evidence from valuation spreads and forward returns. Valuation spreads tell us how cheaply value stocks are trading relative to growth stocks, and we measure this spread as the Price/Book ratio of value stocks divided by the Price/Book ratio of growth stocks. This effectively gives us the price of value relative to the price of growth. Across all years in our sample, we can map these starting valuation spreads to forward value premiums over the next five years, giving us a direct relationship between valuation spreads at each point in time and return outcomes for the value factor five years into the future. The figure below shows our results for the United States over the past five decades.

**Figure 2: US Valuation Spread and Forward 5-Year Value Premium (1975 – 2025)**



On average, US value stocks have traded at a 78% discount (i.e., 22 cents on the dollar) relative to growth stocks over the full five-decade horizon. Yet with the rise of Big Tech in the 2010s, this valuation spread has now widened to historically extreme levels, with value stocks trading at 10 cents on the dollar relative to growth stocks today. This discount is so extreme that even if today's relative valuation of cheap stocks were to double going forward, we would only be returning to the long-term average valuation spread in the US. Evidently, there seems to be plenty of room for value to run through mean reversion going forward.

Over the full horizon, the five-year forward value premium has averaged 2.3% annualized, even though this sample includes the longest stretch of value underperformance in recorded US history since 1926. In the above bar graph representing five-year forward value premiums, we could think of each year in terms of vintages. Before 2005, the norm was to see long stretches of positive vintage years for the value premium (e.g., 1975–1983, 1987–1993, and 1995–2004) interrupted by short corrections of negative five-year value premiums. Since positive value premiums have historically been clustered in 7- to 10-year windows, it's plausible to assume that the 7.2% value premium we see most recently is just the beginning of another cluster that could similarly run over a 7- to 10-year window of vintage years.

US valuation spreads today remain as wide as they were at the end of 2020, when value proceeded to outperform growth by 7.2% annualized over five years. Therefore, we believe it's reasonable for today's value investors to assume a similar level of outperformance over the next five years. There is also reason to hope that value outperformance over the next five years could be even greater than 7.2% per year because the value premium peaked at 9–15% annualized during previous clusters of positive value premiums.

Since the US value premium has only recently turned positive, with only one positive five-year vintage since the end of the value famine, it may be instructive to look internationally to see whether we find more durable evidence of value's comeback.

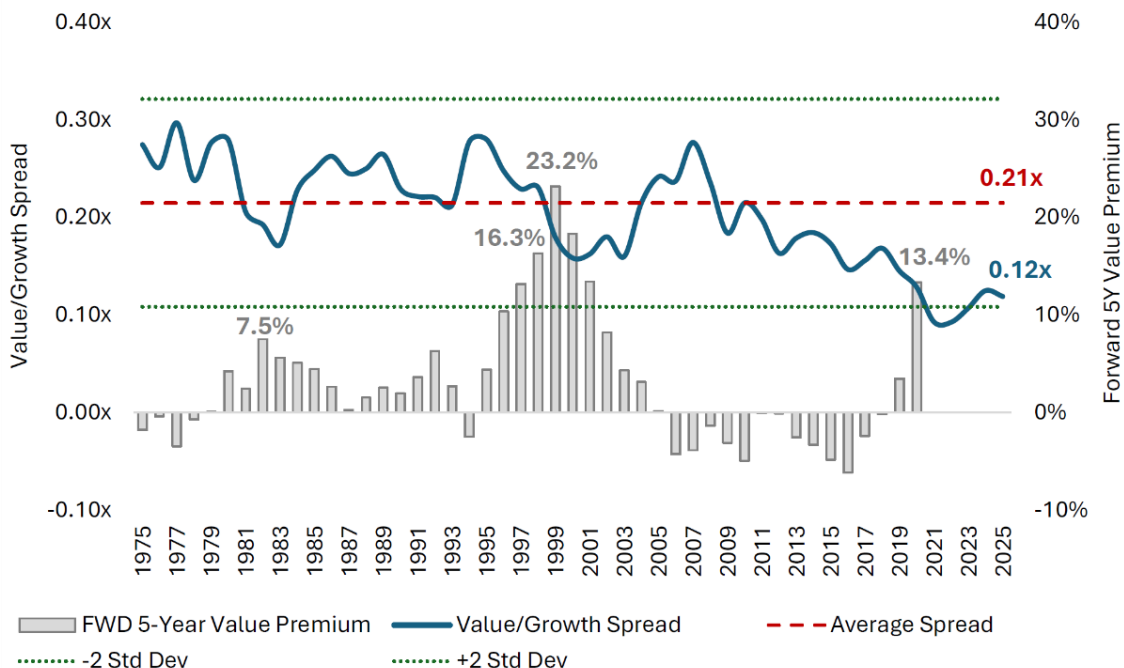
After the great value famine ended around 2019 in Europe, we can see two vintages with positive five-year outcomes for the value premium. Importantly, the second positive vintage (2020) had a bigger five-year value outperformance than the first positive vintage (2019). These successive positive vintages provide more evidence that we may be entering another decade-long cluster of vintages with positive five-year value premiums.

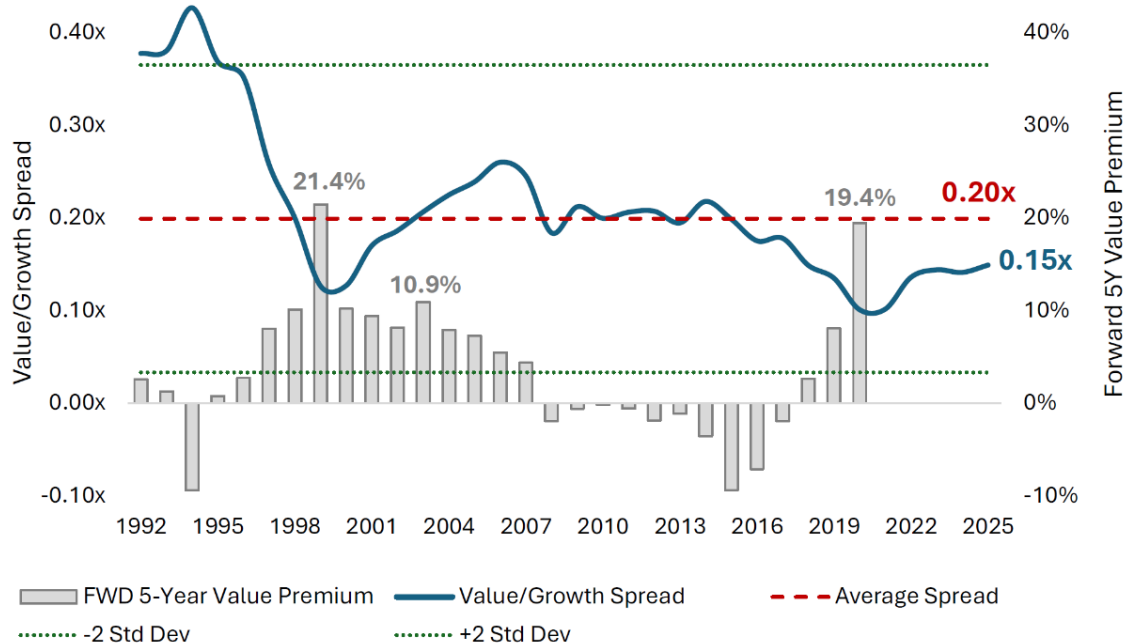
In today's European market, value stocks trade at 12 cents on the dollar relative to growth firms, compared to an average historical discount of 21 cents on the dollar. Again, we see that a doubling of cheap stocks' relative valuation would simply revert the spread to its historical average. There seems to be plenty of upside remaining for Europe's value stocks from multiple expansion, and we also see clearer evidence of mean reversion underway since the end of 2019.

**Figure 3: Europe Valuation Spread and Forward 5-Year Value Premium (1975 – 2025)**

In Japan, we see the clearest evidence of a new cluster of positive vintage years after the end of the great value famine. In recent years, we can see three vintages with positive five-year outcomes for the value premium (December 2018, 2019, and 2020). Even after value has outperformed growth by a whopping 19.4% annualized in Japan over the past five years, valuation spreads continue to remain wider today than their long-term history. Specifically, Japan’s value stocks trade at 15 cents on the dollar relative to growth firms today, compared to an average historical discount of 20 cents on the dollar. For context, today’s valuation spread in Japan is similar to the level reached in December 1999 near the peak of the dot-com bubble. Over the five years that followed the dot-com bubble, Japan’s value stocks outperformed growth firms by 21.4% annualized.

**Figure 4: Japan Valuation Spread and Forward 5-Year Value Premium (1992 – 2025)**





In addition to today’s opportunity to buy value at a discount relative to history, we believe the best news for value is visible when we take a long-term view. Over the past five decades, the global value premium has averaged 3.1% annualized, offering robust outperformance to buy-and-hold investors. Hope springs eternal, and it appears that value is best realized over a long horizon.

## [The Magnificent 7 and the Myth of Concentration](#)

### Why Diversification Still Matters

[Larry Swedroe](#)

Mar 4

The recent dominance of tech giants—particularly the “Magnificent 7” (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, and Tesla)—has sparked a provocative question among investors: Is diversification dead? When a handful of stocks drive the majority of market returns, why not just concentrate your portfolio in the winners?

Daniel Aguet, author of the study “Why Diversification Still Matters for Investors,” published in the Winter 2025 [issue](#) of “The Journal of Beta Investment Strategies, tackled this question, examining 50 years of market data to understand concentration dynamics in the US stock market. His findings offer crucial insights for anyone tempted to abandon the principle of diversification.

#### What the Research Examined

Aguet analyzed the concentration levels of the S&P 500 index from 1970 to 2023, with particular focus on how the largest-capitalization stocks—especially the Magnificent 7—have influenced market performance. The study used the “effective number of stocks” metric—measured as the inverse of the sum of squared weights—to

reveals how concentrated a portfolio truly is from a diversification perspective. On average, the US 500 cap weighted index had an effective number of stocks of 114 over the sample period.

The data indicate that although the S&P 500 index comprises 500 companies, as of mid-2023 its effective diversification corresponded to holding only 63 stocks—a degree of concentration unprecedented since the 1970s. Holding this portfolio was equivalent, from a diversification perspective, to holding an equally weighted portfolio of just 114 of the largest stocks of the US universe, which corresponds to only 22.8% of the number of stocks in the index. The research examined what drives this concentration, how long such periods typically last, and critically, what happens to these high-flying stocks afterward.

## Key Findings: History Doesn't Repeat, But It Rhymes

### The Current Situation Is Extreme—But Not Unique

The 2023 outperformance of the largest stocks was dramatic: in the first half of the year, the top 5% of stocks (representing 42% of market cap) gained 32.5%, while the remaining 475 stocks actually underperformed by 9.3%. The Magnificent 7 alone contributed nearly 70% of the S&P 500's gains despite representing just 25% of its market capitalization.

However, this concentration isn't unprecedented. Similar periods occurred in the early 1970s, late 1980s, around the dot-com bubble, and in 2012. History shows a clear pattern: extreme outperformance doesn't last forever.

### What Drives Concentrated Returns

The research reveals that concentrated portfolios like the Magnificent 7 derive their performance from three sources:

- Market beta exposure (about 26-47% of returns)
- Factor exposures like profitability (about 28-39% of returns)
- Idiosyncratic and industry-specific risks (25-35% of returns)

This last component is crucial—it represents unrewarded risk that could just as easily work against investors as for them.

### Winners Don't Keep Winning

Perhaps the most important finding: after periods of extreme outperformance, the largest-cap stocks systematically underperformed in subsequent years. Across seven historical episodes of extreme concentration, the top 25 stocks underperformed the broader market over 1-year, 3-year, 5-year, and 10-year horizons following their peaks.

For context, after reaching peak outperformance in July 2012, Apple fell 48% relative to the market over the next year. While it eventually recovered over a decade, the average experience across all 25 largest stocks at that time was persistent underperformance.

Over the full 50-year period studied, the largest 5% of stocks underperformed the S&P 500 by 0.6% annually.

### Diversified Portfolios Deliver Better Risk-Adjusted Returns

Yes, diversified portfolios underperformed during periods of increasing concentration—but this is simply the mathematical consequence of being underweight the surging large-caps. When concentration decreased, diversified portfolios outperformed.

More importantly, over the long term, diversified portfolios delivered substantially better risk-adjusted returns. Compared to concentrated portfolios of the largest stocks, well-diversified strategies showed:

- 41-59% higher Sharpe ratios
- 6-17% lower volatility
- 5-18% smaller maximum drawdowns
- 13-49% better extreme downside protection

### Key Takeaways for Investors

#### 1. Don't Chase Recent Winners Based on Past Performance Alone

The companies dominating today's market aren't guaranteed to dominate tomorrow's. Past episodes show that extreme outperformers often become significant underperformers. General Electric, IBM, and Cisco were once untouchable market leaders.

#### 2. Concentration Adds Risk Without Long-Term Reward

Holding concentrated positions in large-cap stocks exposes you to idiosyncratic risks—company-specific and industry-specific factors that aren't compensated with higher returns over time. You're taking on more risk without being paid for it.

#### 3. Short-Term Underperformance Doesn't Mean Diversification Has Failed

If your diversified portfolio has lagged the S&P 500 recently, that's not a sign that diversification is broken—it's working exactly as expected during a period of increasing concentration. The research shows this is temporary, and diversification provides superior outcomes over full market cycles.

#### 4. Risk Management Matters as Much as Returns

Diversification's true value often appears during market downturns. The significantly smaller drawdowns and better downside protection of diversified portfolios can help investors stay invested during difficult periods, which is crucial for long-term wealth building.

#### 5. Factor Exposures and Industry Bets Aren't Permanent Advantages

Much of the Magnificent 7's recent outperformance came from being in the right sectors (technology and consumer cyclicals) at the right time. History shows that sector leadership rotates, and what works today won't necessarily work tomorrow.

### The Bottom Line

The temptation to concentrate in recent winners is understandable but historically dangerous. While the Magnificent 7 have delivered extraordinary returns, the research demonstrates that such periods of dominance

inevitably end, often followed by significant reversals. In fact, While the S&P 500 returned 17.9% in 2025, only two members of the Magnificent Seven—Nvidia and Alphabet—exceeded that benchmark.

Company	2025 Return (%)
<a href="#"><u>Amazon</u></a>	5.2
<a href="#"><u>Apple</u></a>	9.0
<a href="#"><u>Tesla</u></a>	11.4
<a href="#"><u>Meta</u></a>	13.1
<a href="#"><u>Microsoft</u></a>	15.5
<b>S&amp;P 500</b>	<b>17.9</b>
<a href="#"><u>Nvidia</u></a>	38.9
<a href="#"><u>Alphabet Inc A</u></a>	65.2

Diversification remains a cornerstone of sound investing not because it maximizes returns in every period, but because it optimizes risk-adjusted returns over the time horizons that matter for most investors. The math is clear: over 50 years, diversified portfolios delivered better Sharpe ratios, lower volatility, and smaller losses during difficult periods.

As the author concludes, there’s no reason to expect the current concentration to become “the new normal.” Smart investors should resist the siren call of chasing concentrated bets on recent winners and stick to the time-tested principle that diversification still matters—perhaps now more than ever.