Investors tend to be intentionally overweight to growth stocks and underweight to value stocks when investing in broad-based index funds, such as the SPDR S&P 500 ETF Trust (SPY). More specifically, investors tend to be more underweight to cyclical value stocks in their broad-based index fund – that is, value stocks within cyclical sectors such as Energy, Materials and Industrials. This poses the problem of both factor and sector imbalances in core portfolios, where investors tend to be underinvested in value stocks/sectors when a value rotation occurs.

Since September 2020, as global markets transitioned out of the COVID-19 fog, value stocks have been the clear winners over growth stocks. That style box rotation has now reversed to favor growth stocks in 2023, as inflationary expectations decline and investors bet on the Federal Reserve cutting its overnight interest rate in the latter half of 2023 on recession fears – something that Fed Chairman, Jerome Powell, has continuously tried to debunk in his comments. Importantly, fundamentals for value stocks can still thrive in this environment of elevated interest rates, high inflation and potentially slowing economic growth – and 2023 consensus earnings estimates reflect that. Indeed, value stocks in the S&P 500 are expected to grow earnings much faster than growth stocks for the balance of 2023.

With FAANG stocks (Mega-Cap tech) leading growth stocks over value in 2023, mega-cap valuations on artificial intelligence (AI) hype are beginning to look artificially inflated. High interest rates make the expected longer duration of cash flows from AI much less valuable today, and they are still very uncertain with many regulatory hurdles to come. Per Bloomberg, currently, the top seven stocks in the S&P 500 by market cap are nearly twice as expensive as the bottom 493 stocks, while accounting for 59% of the Index’s returns in 2023. More specifically, it is evident that the top five names by market cap in the S&P 500 (AAPL, MSFT, GOOGL, AMZN, NVDA) are driving performance year-to-date (YTD) with peaking levels of technical resistance that has led to ensuing weakness at these levels over the last three years.

1 Source: Bloomberg L.P., as of 6/30/2023

Source: Credit Suisse Research, as of 6/16/2023

Source: Bloomberg Intelligence, as of 6/30/2023
On a relative price basis to the S&P 500, the price dispersion between growth and value is still at extreme levels, even in the context of the powerful value cycle that began in September 2020. It also remains at a much wider dispersion than during the Dot-com bubble in 1999-00 when growth stocks collapsed on similarly stretched valuations.

With a sustained value cycle occurring in each decade going back to the 1970s, it is common for growth to regain some ground on value before the value rotation kicks into gear again. Growth fund flows have disproportionately outpaced value fund flows in 2023, presenting a contrarian play for the value rotation to snap back in relative performance, given we are only 2.5 years into the 5-year duration of an average value cycle. Additionally, the peak-to-trough outperformance of a typical value rotation since the 1970s is, on average, around 40%. The current value cycle that began in September 2020 has seen a 30% peak-to-trough relative outperformance over growth as of the end of June 2023, leaving room for value to run in the coming years based on historical value cycles.
Know your Value Cycle Cues

It’s important to note that nominal interest rates and value stocks’ relative performance against growth stocks tend to be correlated, where value tends to outperform growth as nominal interest rates rise and vice versa. With nominal interest rates expected to continue their upward trend into 2023 as the Federal Reserve hints at more rate hikes to try to tamp down sticky inflation, rising nominal interest rates tend to act as a tailwind for value stocks to outperform growth stocks.

So far in 2023, long-term interest rates on US Treasuries have remained flat relative to rising short-term interest rates, resulting in many investors calling for a forthcoming recession based on an inverted yield curve. However, the current business cycle backdrop portrays a mix of both early and late-cycle traits: economic growth with a corporate earnings recession in the first half of 2023, caused by inflation and resilient consumer spending. During these late-cycle recessions and early economic recoveries, cyclical sectors, and more specifically value stocks within cyclicals, tend to exhibit staying pricing power and potential for stronger earnings growth. Cyclical sectors, including Energy, Materials, Industrials and Financials, tend to perform well in sticky inflationary environments while generating attractive dividends. Meanwhile, defensive sectors, such as Consumer Staples, Healthcare, Utilities and Communication Services, tend to benefit from disinflationary periods that damper economic growth.

What history shows us about economic cycles is that the market typically collapses and recovers before the economy does, a mechanism of investors’ discounting future cash flows. This typically leads cyclical sectors outperforming defensive sectors coming out of market troughs (full economic recession) and into bull markets (early economic recovery). As corporate earnings growth is set to accelerate in the second half of 2023 with the economy potentially coming out of a brief period of weakness, the early economic/corporate earnings recovery sets up well for cyclicals and especially cyclical value stocks – that is not the case with defensives and defensive value during early recoveries. It’s important for investors to differentiate their value allocations as not all value stocks/funds are the same: cyclical or defensive value allocations within a portfolio can perform quite differently given the economic cycle.

Past performance is no guarantee of future results.
Source: Bloomberg L.P., as of 5/31/2023 & Fama French 3 Factor, Kevin French’s Data Library – Dartmouth College, as of 5/31/2023, most recent data available.
High dividend-paying value stocks, especially those with a history of steadily increasing their dividend, are typically less volatile and tend to outperform non-dividend-paying stocks in late to early economic cycles. For example, SDOG has seen its reinvested dividends contribute to over 55% of the fund’s total return since its inception, compared to 26% for the S&P 500 over the same period. This is especially pronounced during market drawdowns, where “getting paid to wait” with deep value, high yielding stocks can help bolster total returns through compounding dividends.

For all those investors that have plowed into money market funds in 2023 that are yielding in excess of 3.7%, there is very little compounding on those money market yields since there isn’t any price return. And with dividend growth for the S&P 500 expected to lag the rate of inflation through the rest of 2023, income-based investors need to enhance their core dividend streams to combat elevated inflation. With SDOG’s high dividend yield and cyclical value tilt to combat and capture the current inflationary environment, its dividend income is set up to withstand the dilutive effects of inflation on income-based investors, while also helping to smooth the volatility of sector imbalances in a core portfolio.

The ALPS Sector Dividend Dogs ETF (SDOG) equally-weights the five highest yielding stocks within each GICS sector (ex Real Estate) with holdings selected from a universe of the 500 largest companies by market cap. High equity dividend yields as a selection criteria upon each December reconstitution results in owning large cap, deep value companies that are temporarily out-of-favor (“Dogs”), where their dividend yields are artificially high due to stock price weakness that is ripe for mean reversion. Equal-weighting on the stock and sector level helps to smooth sector volatility, but also positions SDOG as a cyclical value ETF with its overweight to Energy, Materials and Industrials sectors when compared to the S&P 500. As mentioned previously, a 54% weight to growth stocks in the S&P 500 implies that investor portfolios are overexposed to the growth factor. Advisors would be wise to add more value, and specifically cyclical value, to their core allocations to balance out the factors and sectors from a portfolio positioning standpoint.

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Past performance is no guarantee of future results.

Source: Bloomberg L.P, as of 6/30/2023
Important Disclosures & Definitions

An investor should consider the investment objectives, risks, charges and expenses carefully before investing. To obtain a prospectus containing this and other information, call 1-866-759-5679 or visit www.alpsfunds.com. Read the prospectus carefully before investing.

Shares are not individually redeemable. Investors buy and sell shares on a secondary market. Only market makers or “authorized participants” may trade directly with the Fund, typically in blocks of 5,000, 25,000 or 50,000 shares.

Performance data quoted represents past performance. Past performance is no guarantee of future results; current performance may be higher or lower than performance quoted.

All investments are subject to risks, including the loss of money and the possible loss of the entire principal amount invested. Additional information regarding the risks of this investment is available in the prospectus.

The Fund is subject to the additional risks associated with concentrating its investments in companies in the market sector.

Diversification does not eliminate the risk of experiencing investment losses.

The Fund employs a “passive management” - or indexing - investment approach and seeks investment results that correspond (before fees and expenses) generally to the performance of its underlying index. Unlike many investment companies, the Fund is not “actively” managed. Therefore, it would not necessarily sell or buy a security unless that security is removed from or added to the underlying index, respectively.

Dogs of the Dow Theory: an investment strategy which proposes that an investor annually select for investment the ten Dow Jones Industrial Average stocks whose dividend is the highest fraction of their price.

FAANG: Facebook (Meta), Apple, Amazon, Nvidia, Google (Alphabet).

S&P 500 Index: widely regarded as the best single gauge of large-cap US equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

S&P 500 Growth Index: a capitalization-weighted index containing the stocks from the S&P 500 Index with Growth characteristics.

S&P 500 Value Index: a capitalization-weighted index containing the stocks from the S&P 500 Index with Value characteristics.

Trailing Twelve Month Yield: refers to the percentage of income a portfolio has returned to investors over the last 12 months.

One may not invest directly in an index.

ALPS Advisors, Inc. is affiliated with ALPS Portfolio Solutions Distributor, Inc.

ALPS Portfolio Solutions Distributor, Inc. is the distributor for the Fund.

Not FDIC Insured • No Bank Guarantee • May Lose Value

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