The Size Factor

What is Size?

The Size factor may be the most intuitive of the factors. It simply demonstrates that investments in smaller companies tend to outperform those of larger companies over time. Preceded by Rolf Banz, much of the popular work on this came from Eugene Fama and Ken French, who showed that Size (small cap) works best in concert with Value.

How is it captured?

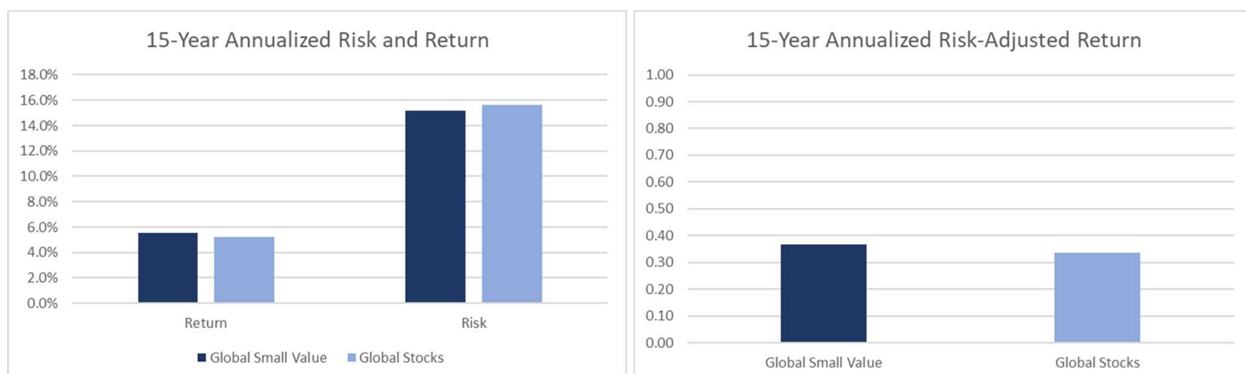
While the original work from Fama and French focused on the excess returns of small cap stocks over large cap stocks, there are several ways to get at the Size factor, including equal weighting stocks (instead of market cap weighting) in a benchmark or weighting them by their risk characteristics.

Why does it work?

The explanation for why smaller companies would outperform larger ones is perhaps the most straightforward. Because smaller companies are not as mature and haven't generated a track record of sales consistency, return on assets, and so forth, they entail more risk to the investor. As a result, they should generate a reward over a reasonable holding period.

How has it worked?

Over a 15-year period, Size (as measured by the MSCI ACWI Risk Weighted Index) has outperformed the market (as measured by the MSCI All Country World Index) on both an absolute and risk-adjusted basis.



Source: Morningstar

How do we use it in a portfolio?

Metric portfolios currently gain exposure to the Size factor in equities primarily by investing in small cap companies. We use ETFs that track the MSCI US Low Size (based on capitalization) and FTSE Global Small Cap ex US (based on capitalization) indexes. A key benefit of including Size in a portfolio, aside from its potential for excess return, is the diversifying effects when used with the other factors in the portfolio.

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