

The Hidden Flaw in Style Index Funds

Style investing has grown to become an enormous portion of the stock market with \$14 trillion (23% of the \$62 trillion U.S. stock market) passively tracks or is benchmarked to traditional style indices.

Research Affiliates Chris Brightman, Campbell Harvey, Que Nguyen, and Omid Shakernia, authors of the November 2025 [study](#) "Why Hold Expensive Slow-Growing Stocks? An Alternative Framework for Value and Growth Indices," revealed a structural weakness in how most style index funds are constructed. The findings suggest that billions of dollars are being invested based on a flawed framework, and the performance drag has been significant.

The Completeness Problem

The issue stems from what's called the "completeness principle." Major index providers design their style indices so that combining their value and growth funds in equal proportions recreates the entire market. For example, Russell, S&P, and MSCI all build their standard style indices by splitting the weight of "crossover" stocks into both their value and growth indices. While the choice of characteristics to define style and methods for defining crossover stocks differ, this methodology creates a problem: both value and growth indices end up holding stocks that are neither truly value nor truly growth.

What the Research Uncovered

The research team examined U.S. stock performance from March 1970 through June 2025, sorting companies into a simple two-by-two matrix based on valuation (measured by book-to-price) and growth (measured by five-year sales growth). This created four quadrants:

- **Cheap/Fast:** Inexpensive stocks of fast-growing companies.
- **Cheap/Slow:** Traditional value stocks.
- **Expensive/Fast:** Traditional growth stocks.
- **Expensive/Slow:** The problematic quadrant.

The results were striking. The Expensive/Slow quadrant underperformed the market by 2.0% per year over the study period. Meanwhile, the Cheap/Fast quadrant outperformed by 0.8% annually.

Unfortunately, they found that the traditional style indices, by design, force investors to hold positions in that underperforming Expensive/Slow quadrant.

A Simpler Framework

The researchers propose an alternative approach: define value portfolios based solely on cheap stock prices and growth portfolios based solely on fast-growing companies. This eliminates the expensive slow-growers from both portfolios.

When they tested this framework, the results were compelling. An equal-weighted combination of the 500 cheapest stocks and 500 fastest-growing stocks outperformed the market by 0.8% annually with a

tracking error of only 2.3%. The four-factor model alpha was 0.6% with a statistically significant t-statistic of 2.7.

In contrast, the traditional equal-weighted mix of value and growth indices delivered essentially zero alpha—by design, since it simply reconstructs the market.

Concentration Amplifies Returns

The research also examined whether concentrating these portfolios could improve performance. Moving from the top 500 stocks in each category to the top 200, and then to the top 100, consistently enhanced returns. “Importantly, factor loadings also intensify performance. The HML loading of the cheap portfolio becomes more strongly positive, and the HML loading of the fast portfolio, more strongly negative. As a result, the excess returns of the two portfolios become more negatively correlated, improving diversification.”

The most concentrated version—combining the 100 cheapest and 100 fastest-growing stocks—showed particularly strong results, with concentration improving both excess returns and information ratios (measures of a fund manager's returns against a benchmark and the volatility, or consistency, of those returns).

The Style Timing Opportunity

Perhaps most intriguingly, the researchers found that timing between value and growth styles can further enhance performance. Their timing approach builds on a growing body of research documenting [factor momentum](#)—factor returns display short to intermediate-term persistence with momentum of specific stocks largely reflecting momentum in factor exposures. Using a momentum turning points framework that combines 12-month and six-month trends, they showed that strategic shifting between styles added meaningful value. The style-timed portfolio of the 100 cheapest and 100 fastest stocks earned 18.2% per year over the study period, compared with 11.1% for the broad market.

Key Investor Takeaways

- 1. Understand what you own.** If you invest in traditional style index funds, recognize that these funds are likely holding expensive stocks of slow-growing companies.
- 2. The completeness principle may cost you.** While ensuring that value and growth funds combine to replicate the market sounds convenient, it comes at a performance cost by including underperforming stocks in both indices.
- 3. Simpler can be better.** A framework that defines value purely as cheap and growth purely as fast-growing eliminates the structural drag of expensive slow-growers and has historically delivered superior risk-adjusted returns.
- 4. Consider concentration.** More concentrated portfolios focusing on the strongest value and growth characteristics have historically improved both absolute and risk-adjusted performance.

5. Style cycles create opportunity. The relative performance of value versus growth runs in persistent cycles. Investors willing to time these shifts strategically may capture additional returns, though this requires active management.

Why Does This Persist?

If the flaw is so obvious, why hasn't the market corrected it? The researchers point to structural incentives. For asset managers, traditional style funds are easy to explain, create, and sell. Once billions are invested, there's strong financial incentive to perpetuate the existing structure. Investor behavior reinforces this. Many prefer familiar, household-name companies because they feel safer, even if those companies represent expensive stocks with slow growth.

The Bottom Line

Traditional style index construction has a built-in weakness that has cost investors meaningful returns over decades. By removing expensive slow-growth stocks and building value portfolios on truly cheap stocks and growth portfolios on genuinely fast-growing companies, investors can construct a more logical framework.

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