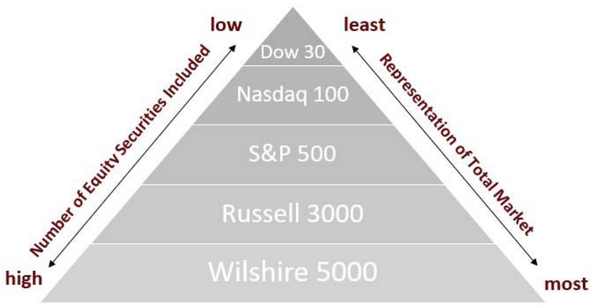
"Normal is the wrong name often used for average."

--*Henry S. Haskins*

News outlets throughout the day talk in terms of *the market* is up, or *the market* is down, *the market* is setting new highs, or more recently, *the market* is setting new lows. But what is it that most people think of when they hear *the market*? There are a variety of indices that track the performance of a group of companies that trade on various stock exchanges, each is composed of different groups of companies and calculated in different ways. We thought it might be beneficial to outline some of the differences and bring some level of understanding to the benefits and pitfalls associated with each.

Let's focus our attention on U.S. equity markets, although similar comparisons could be made for fixed income markets, as well as foreign markets.



The majority of equity indices utilize a market capitalization approach in their construction. This approach uses a company's current market price and the number of shares outstanding to determine the percentage weighting for the company's inclusion in the index. The larger the company's capitalization, the larger the company will be weighted in the index portfolio. An oft-cited reason for utilizing this approach is that it weights the index to the larger companies which (theoretically at least) are more heavily reflected in the economy. While the most common argument against the market cap-weighted approach is that a few larger companies can drive the performance of the index thereby somewhat negating the diversification benefits of including a large number of companies. Additionally, momentum plays a factor in the index's performance as company's whose prices are increasing the most will become increasingly larger positions in the index.

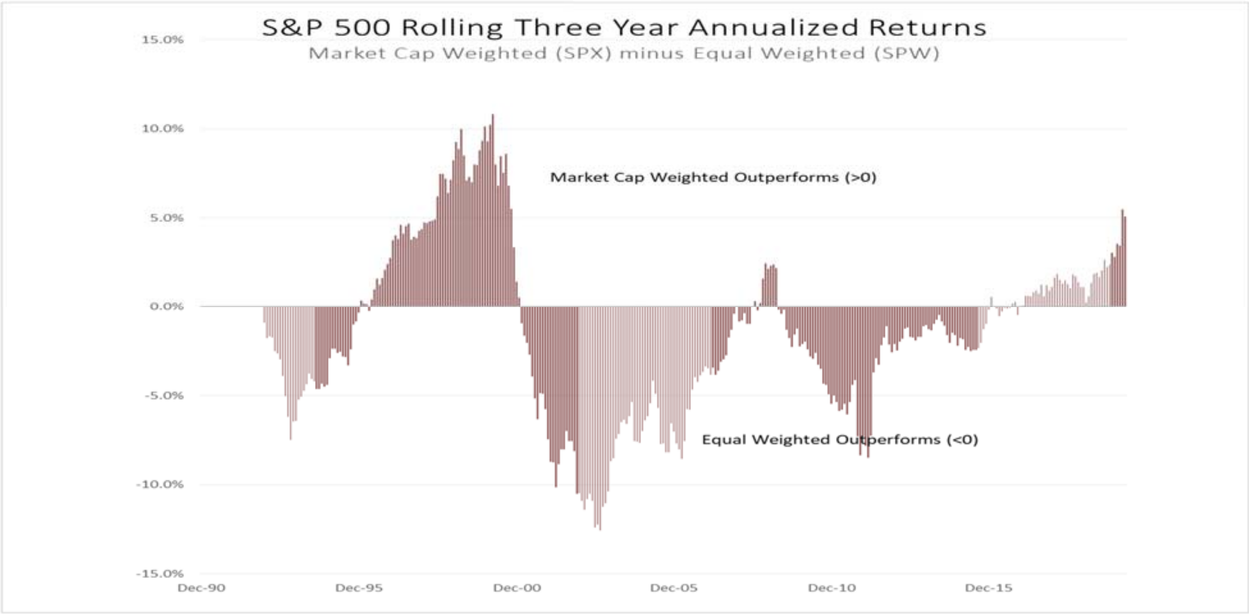
A less utilized and less reported construction approach is an equal weighted approach to the same portfolio of securities. Equal weighting distributes the same investment amount into each company stock. All companies in the index, regardless of their capitalization, are therefore represented equally in the index. The argument for this approach is that a wider more equally dispersed portfolio is achieved with all the companies in the index having an equal effect on the index performance. The effect also gives small- and mid-capitalization companies a greater impact which can be a positive as they are generally faster growing, but also introduces a higher degree of risk due to their smaller size.

So why are we bringing this up? Is one approach better than the other? We are not addressing this because one is better than the other, but because financial reporting can lead to erroneous conclusions about what is going on in *the market*. At the end of April, the top five names in the S&P 500 represented about 20.4% of the value of the index. This is the highest in history and means that the successes (or failures) of those companies is driving the news cycle while the other 490 constituents may be realizing a different experience.

Another way to look at the difference in index construction is to simply observe which has performed better over time. The chart at the bottom of this page a long-term chart of the S&P 500 showing the difference in performance for the S&P 500 calculated both market-cap weighted and equal weighted.

We can let you draw your own conclusions from the data, but ours is that a portfolio constructed of more or less equal weighted positions has a history of outperforming over long time periods. And a parting thought … while *the market* (cap weighted) has recovered off its recent lows, the *the market* (equal weighted) is performing more in-line with the economy and what you might expect.

Performance of the S&P 500 as of April 30,2020		
	Market Cap Weighted (SPX)	Equal Weighted (SPW)
Year to Date	-9.9%	-16.7%
1 Year	-1.1%	-10.9%
3 Year	6.9%	1.8%
5 Year	6.9%	3.4%
10 Year	9.4%	8.3%
since Dec 1989	7.2%	8.2%



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