KOVITZ INSIGHTS

2020 Vision on the S&P 500 Index

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In the most remarkable of turnarounds, the S&P 500 index—widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products—finished July in positive territory for the year, despite having dropped as much as 34% in the 23 trading sesssions subsequent to the all-time high set on February 19. The rebound into positive territory at the end of July from the March 23rd low has hardly been pedestrian, with 56 of 91 trading days in the black and 12 of those days gaining more than 2%.

Yet the good news makes it easy to overlook the lag in performance by the average stock in the index, which is down around 7% including dividends this year. Significant differences in performance and weighting by sector have emerged, resulting in a widened chasm between the haves and the have-nots. To us, it remains very much a market of stocks and not a stock market, and we believe that many of the broad-market indexes, including the S&P 500, may fail to have the diversification needed to be considered a fair performance or valuation proxy for the overall U.S. stock market.

DECONSTRUCTING THE S&P 500'S PERFORMANCE

We present the S&P 500's attribution—a review of the underlying factors that contributed to the index's overall return—through July 31 in Figure 1, which shows the Information Technology sector drove most of the index's overall return this year thanks to a big weight and large total return, with Consumer Discretionary, Health Care and Communication Services also positive contributors. The Financials, Energy and Industrials sectors detracted from performance, as companies in those sectors took the Q1 thumping harder than most.

At a company level, Amazon, Apple and Microsoft were the largest contributors, while JPMorgan Chase, Wells Fargo and Exxon Mobil were the largest detractors thanks in large part to quickly falling interest rates, a reduction in business activity and tumbling oil prices.

Year-to-Date S&P 500 Index Attribution

Sector	Average Index Weight (%)	Contribution to Index Return (%)	Company	Average Index Weight (%)	Contribution to Index Return (%)
Info Tech	25.50	5.43	Amazon	3.82	2.28
Cons. Disc.	10.22	1.82	Apple	5.17	2.13
Health Care	14.67	0.74	Microsoft	5.40	1.55
Comm. Services	10.74	0.73	Facebook	1.98	0.49
Materials	2.51	0.00	Nvidia	0.74	0.48
Cons. Staples	7.28	-0.02	PayPal Holdings	0.61	0.42
Real Estate	2.91	-0.24	Google	3.26	0.35
Utilities	3.32	-0.24	Netflix	0.71	0.31
Industrials	8.22	-1.23	Adobe	0.71	0.22
Energy	3.16	-1.71	Home Depot	0.99	0.22
Financials	11.13	-2.96	**Top 10 Total**	**23.39**	**8.45**
Total	**100.00**	**2.31**	**All Other S&P Stocks**	**76.61**	**-6.14**

Figure 1: S&P 500 Index Attribution by Sector and Stock
From 12.31.19 through 07.31.20. For attribution purposes, the S&P 500 is represented by the SPDR S&P 500 ETF (SPY), an exchange-traded fund that tracks the S&P 500 index. Figures may not sum due to rounding. Source: Kovitz via Bloomberg Finance L.P.

Expanding the performance review to the last five years ended July 31, the story is not substantially different, as shown in Figure 2. Information Technology represented nearly half of index's overall 71.4% gain (despite representing just 19.4% of the index weight on average), and all sectors were positive contributors except Energy. Apple contributed 7.6% to the index's cumulative return, while Microsoft added 7.4% and Amazon added 6.1%. Owners of the trio have benefited, sure, but the large weights plus terrific performance became self-fulfilling prophecies in an index that is not able to trim large weights and redeploy the capital to other opportunities like an actively managed portfolio. However, relatively large exposure to big weights can certainly work in reverse, as was the case in 2000 when the S&P 500 was down 9% including dividends, while the equally weighted version of the index was up 8%. In fact, the capitalization-weighted S&P 500 failed to outperform the equal-weight index on an annual basis between 2000 and 2006.

Figure 2:
S&P 500 Index Attribution by Sector and Company

From 07.31.15 through 07.31.20. For attribution purposes, the S&P 500 is represented by the SPDR S&P 500 ETF (SPY), an exchange-traded fund that tracks the S&P 500 index. Figures may not sum due to rounding. Source: Kovitz via Bloomberg Finance L.P.

Five-Year S&P 500 Index Attribution

Sector	Average Index Weight (%)	Contribution to Index Return (%)	Company	Average Index Weight (%)	Contribution to Index Return (%)
Info Tech	19.36	29.95	Apple	3.81	7.61
Cons. Disc.	9.67	9.49	Microsoft	3.30	7.40
Comm. Services	10.18	8.20	Amazon	2.38	6.11
Health Care	14.67	7.37	Facebook	1.68	2.32
Industrials	9.61	4.68	Alphabet	2.74	3.01
Financials	13.38	4.55	Nvidia	0.41	1.41
Cons. Staples	8.07	4.12	Visa	0.99	1.25
Utilities	3.15	1.99	Home Depot	0.92	1.16
Materials	2.75	1.51	Mastercard	0.72	1.15
Real Estate	2.89	1.34	UnitedHealth	0.89	1.13
Energy	5.74	-1.84	**Total**	**17.84**	**32.54**
Total	**100.00**	**71.36**	**All other S&P Stocks**	**82.16**	**38.82**

PORTFOLIOS OF TOP STOCKS ONLY

Although the near-term attribution shows the largest stocks have had an outsized influence on recent index performance, since the end of 1995, this has been true during other brief periods as well. In Figure 3, we constructed portfolios of the largest stocks by weight on December 31 of each year and found that the Top 10 stocks gained on average 10.2% in the subsequent year, while the Top 20 stocks gained 9.4% and the Top 500 stocks (approximating the S&P 500) gained 11.1%. Since 2015, the opposite was true. The Top 10 stocks gained an average of 14.5%, compared with 12.0% for the Top 20 stocks and 8.9% for the Top 500 stocks.

The composition of the largest stocks in the index has also evolved significantly, presented in Figure 4. At the end of 1995, the largest public companies were General Electric, AT&T and Exxon, a very different composition from the list at the end of 2019 which had Microsoft, Apple and Alphabet in the top spots. The Top 10 index weights have evolved too, with companies in the Information Technology sector now accounting for as much of the group as in 1999, meanwhile the weights of companies in the Energy and Consumer Staples sectors (most recently Procter & Gamble) have lost their prominence.

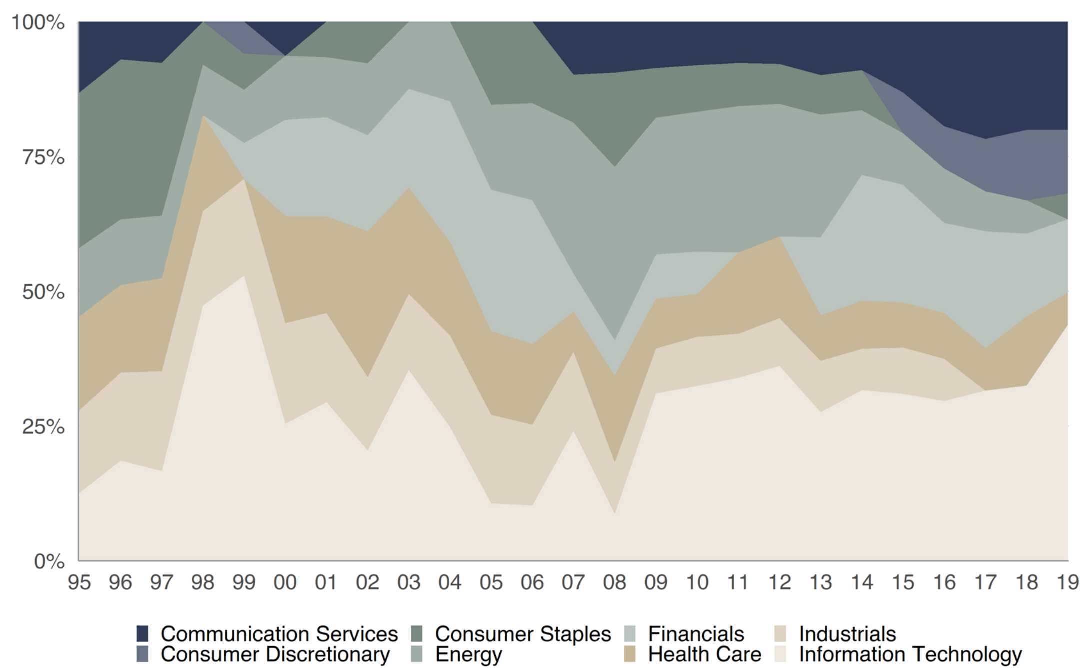
Figure 3: Hypothetical Portfolios of Top Stocks

As of 07.31.20. Market capitalization is presented in billions of dollars. For Top 10, Top 20 and Top 500 portfolios and the related discussion, we used the Russell 1000 index to benefit from the maximum available historical individual stock data and selected the top securities by weight. Source: Kovitz using data from Bloomberg Finance L.P.

Portfolio Performance by Year						
Year	Top 10 Weight (%)	Top 20 Weight (%)	Top 500 Weight (%)	Top 10 Return (%)	Top 20 Return (%)	Top 500 Return (%)
1996	15.8	24.0	89.8	40.7	28.8	20.5
1997	16.4	24.8	90.1	35.4	38.9	29.5
1998	16.2	25.5	90.7	38.6	34.0	16.3
1999	18.5	30.1	93.0	31.6	21.3	17.5
2000	22.7	34.4	93.9	-26.9	-17.6	8.1
2001	21.3	32.4	93.8	-10.1	-10.1	-8.8
2002	22.7	33.8	92.7	-24.7	-23.2	-19.0
2003	21.2	32.4	92.3	14.6	23.8	34.7
2004	20.4	30.5	91.3	2.2	4.5	15.8
2005	18.9	28.9	90.5	0.0	-1.0	9.5
2006	17.9	27.3	90.3	17.1	17.9	14.3
2007	18.2	27.8	90.3	1.2	6.6	5.9
2008	17.6	27.8	90.9	-33.9	-35.0	-39.1
2009	20.1	31.0	92.1	11.2	18.4	33.4
2010	17.4	29.1	90.8	14.1	7.0	21.8
2011	16.5	26.5	89.9	9.5	2.2	-0.1
2012	18.0	28.2	90.6	13.0	13.5	16.0
2013	17.3	27.3	90.4	22.4	24.4	33.9
2014	16.0	25.1	89.7	11.0	7.4	14.3
2015	15.7	24.4	89.6	7.0	3.8	-0.4
2016	16.7	26.0	90.4	14.3	14.6	12.2
2017	17.3	27.1	90.6	20.0	20.4	20.3
2018	18.9	27.8	90.9	-2.2	-0.4	-7.4
2019	20.0	29.4	91.5	32.9	31.8	30.2
2020/YTD	21.7	30.7	91.6	15.0	2.1	-1.2
Mean: All Years	**18.5**	**28.5**	**91.1**	**10.2**	**9.4**	**11.1**
Mean: 2015-2020	**18.4**	**27.6**	**90.7**	**14.5**	**12.0**	**8.9**

Figure 4: Weight of the Top 10 Stocks within Sectors over Time

From 12.31.95 through 12.31.19. Source: Kovitz using data from Bloomberg Finance L.P.



THE AVERAGE STOCK REMAINS LESS EXPENSIVE

We would be remiss to discuss S&P 500 index performance without at least touching on valuations. The published S&P Forward P/E ratio is 24 and that is certainly not cheap by historical standards. However, as shown in Figure 5, the index varies in its valuation depending on the metric, with many of the smaller companies trading at a discount compared to the larger ones, an effect enhanced by the generally negative YTD returns for companies outside of the top 10 companies by weight.

The equity market has long been an anticipatory mechanism with information quickly discounted, which at times can result in significant price moves over short periods of time. But the long-term trend in prices has historically been higher as corporate profits have generally grown over time, despite the occasional hiccup. No guarantees, of course, that past performance is indicative of stock prices continuing their long-term uptrend. We cannot ignore, however, the fact that valuations for many individual stocks remain reasonable despite aggregate index metrics looking expensive.

Figure 5:
Mean Valuation Metrics by Ranking

As of 07.31.20. For these metrics, we used the Russell 1000 index constituents and ranked the stocks by weight. Extreme values and companies with negative earnings have been omitted. Valuation ratios selected are commonly used to assess value relative to the overall market, peers and across sectors. Source: Kovitz using data from Bloomberg Finance L.P.

Mean Valuation Metrics							
Group	Current Market Cap ($ billion)	Price to Earnings Ratio	Price to Fwd. Earns. Ratio	Price to Sales Ratio	Price to Book Ratio	Price to Cash Flow Ratio	Estimated Dividend Yield
Top 10	853,523	28.5	27.7	7.4	10.9	23.5	1.13%
11-20	251,531	43.5	31.6	9.4	17.2	37.3	1.28%
21-50	171,033	29.0	25.5	4.4	9.1	18.5	2.75%
51-100	86,630	29.1	28.9	5.7	10.7	23.4	1.93%
101-150	52,358	23.4	23.8	6.8	8.4	19.0	1.51%
151-200	34,689	30.5	29.3	7.3	10.8	24.6	1.46%
201-250	26,236	24.1	24.1	4.3	7.0	16.7	2.41%
251-300	23,118	28.7	27.9	7.4	9.6	19.9	1.57%
301-350	18,013	26.3	26.4	6.2	7.8	17.7	1.42%
351-400	15,636	31.3	30.9	6.0	6.9	22.3	1.55%
401-450	13,556	28.7	26.3	5.0	9.1	18.9	1.53%
451-500	11,367	25.3	22.6	7.1	6.5	22.5	2.30%
AVERAGE	**129,808**	**29.0**	**27.1**	**6.4**	**9.5**	**22.0**	**1.74%**

WHERE TO FROM HERE?

Unfortunately, there are plenty of things to be concerned about. The novel coronavirus is spreading quickly in many states, including some that previously had shown substantial reductions in cases (adjusted for additional testing). Global stocks may have additional revenue and earnings volatility in the nearer term, as they navigate this unusual environment. And the U.S. Presidential Election in November looms large, though it has historically proven unwise to change a diversified portfolio solely based on politics, a theme we will discuss in September's Insight. Yet, as market participants rotate from near-term trading towards positioning with the longer term in mind, the still-discounted valuation of the average stock, plus the supportive Federal Reserve and opportunities continuing to present themselves across our investment universe leave us enthusiastic about our long-term oriented, broadly diversified portfolios of individual stocks.

For more information on working with our financial professionals contact us at wealth@kovitz.com or 312.334.7300.

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The Russell 1000 Index consists of the largest 1000 companies in the Russell 3000 Index. This index represents the universe of large capitalization stocks from which most active money managers typically select and represents apprimately 90% of the investible U.S. equity market. The index was developed with a base value of 130.00 as of December 31, 1986.

The Russell 3000 Index is composed of 3000 large U.S. companies, as determined by market capitalization. This portfolio of Securities represents approximately 98% of the investable U.S. equity market. The Russell 3000 Index is comprised of stocks within the Russell 1000 and the Russell 2000 Indices. The index was developed with a base value of 140.00 as of December 31, 1986.

The S&P 500 is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

For attribution purposes, the S&P 500 is represented by the SPDR S&P 500 ETF (SPY), an exchange-traded fund that tracks the S&P 500 index. For Top 10, Top 20 and Top 500 portfolios and the related discussion, we used the Russell 1000 index constituents and selected the top securities by weight to benefit from the maximum window of historical individual stock data. Companies that did not have returns for the entire subsequent year were omitted.

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