Stock Market Perspective: Digging into the S&P 500

The Dow Jones Industrial Average (the "Dow") is the oldest and most often mentioned index of how the U.S. stock market is doing. However, the Standard and Poors 500 index is generally considered to be a better measure of the performance. The total market capitalization of its components are around 80% of the total for all publicly traded domestic stocks. It is typically used in analyses of stock market movements and trading models for the broad market. The other "major" index is the Nasdaq Composite, which is heavily weighted by technology issues. Even so, the Dow, S&P, and Nasdaq usually show the same patterns of ups and downs with differing percent changes.

An outstanding graphic quickly shows the relative weights of the major sectors, the largest stocks, and 2012 performance.

The Dow is designed to reflect the major sectors of the U.S. economy and to some extent their relative importance, except for transportation and utilities issues that are in separate Dow Jones indices. Those sectors are included in the S&P. The S&P's relative market capitalizations are a measure of each of ten major sectors[1] portion of the economy.

The December 26 issue of *The Wall Street Journal* had an article discussing the performance of each sector for the year (as of December 21). The one with largest gains was Financials at 26%, and only one, Utilities, was down, at -1.8%.

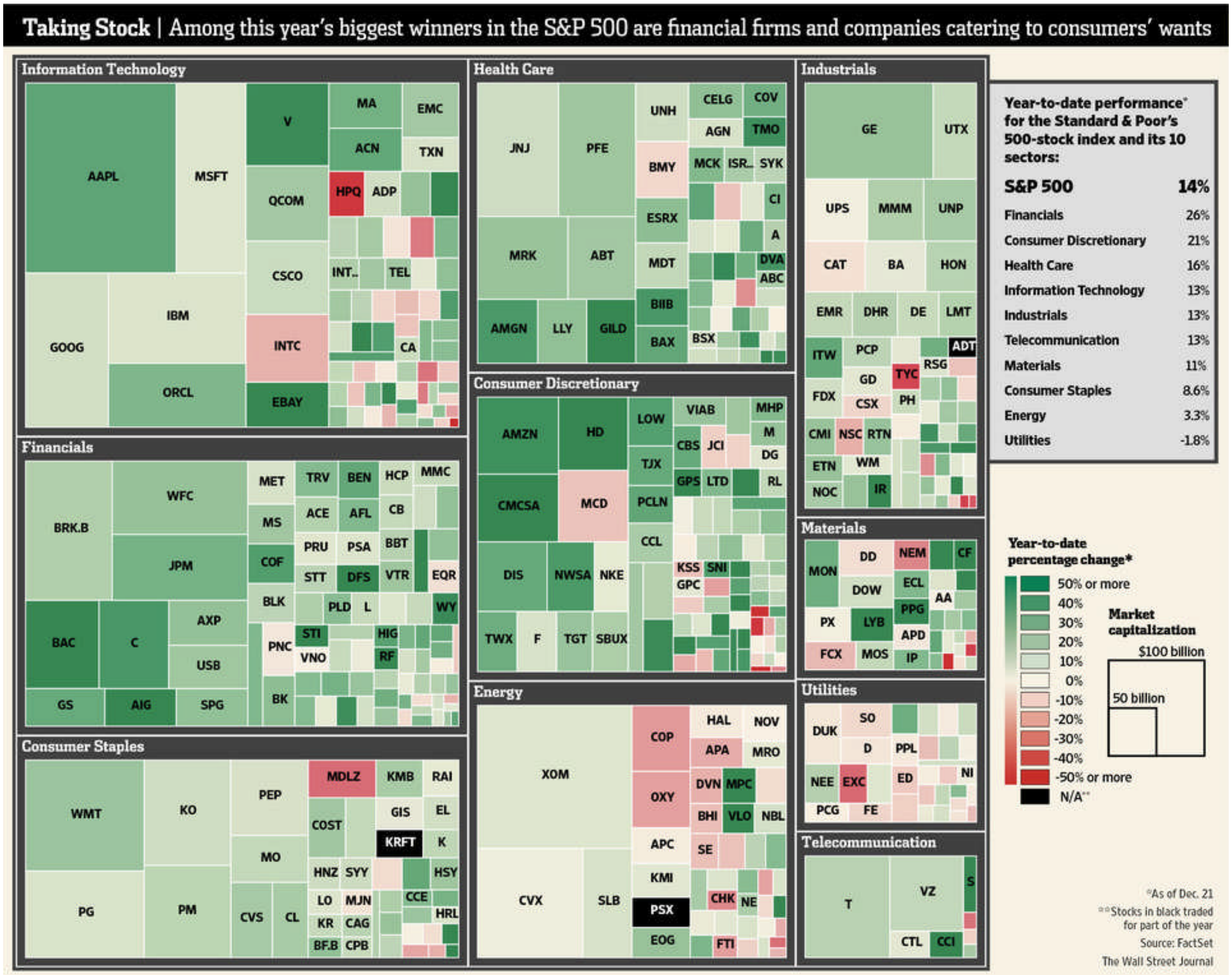
Of greatest interest was a graphic showing the component stocks with sizes proportional to their market capitalizations and grouped by the ten major sectors. That chart courtesy of *The Wall Street Journal* is on the next page. To see it larger, visit the newspaper's web site: http://si.wsj.net/public/resources/images/MI-BT218_STOCKS_G_20121225171218.jpg. (If typing the address, use underscores, not spaces, in three places.) I can also e-mail you a file with the graphic. If you do not recognize a ticker symbol and want to find out what stock it is, you can enter it in just about any quote request box on a financial web site.

The largest sector is Information Technology, in the upper left corner. For some reason, it does not include Amazon (AMZN), which is in Consumer Discretionary. E-Bay is in Info Tech, and to me those two should be in the same sector. We can see that Apple (AAPL) is the largest capitalization stock, and, perhaps not as obviously, that Exxon Mobil (XOM) is the second largest. Some of the other highest cap stocks in Info Tech are Microsoft (MSFT), Google (GOOG), IBM, and Oracle (ORCL). I find it interesting that Visa (V) and MasterCard (MA) were put in this sector (by Standard and Poors) rather than in Financials.

The second largest sector is Financials, which have recovered considerably from the severe problems about four years ago. The largest in this sector is Berkshire Hathaway, the "baby" B shares (BRK.B). Each of them equals 1/1500 of the full size Berkshire shares (BRK.A) that Warren Buffett refuses to split. There were not enough of the A shares outstanding to permit inclusion in an index, so the company was not in the S&P until the issuance of the B shares. Berkshire is an insurance company, so the Financials are the best fit for it, but it is much more like a mutual fund that holds stocks in a broad spectrum of industries. The next largest companies in the Financials are all banks: Wells Fargo (WFC), J.P. Morgan Chase (JPM), Bank of America (BAC), and Citigroup (C).

The three smallest capitalization sectors are Materials, Utilities, and Telecommunications. Utilities does not have a few companies that are much larger than the rest. Materials has several

[1] Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Telecommunications, Utilities.



companies that are of similar sizes; the three largest are Monsanto (MON), DuPont (DD), and Dow Chemical (DOW). Telecomm is essentially the combination of AT&T (T) and Verizon (VZ).

The colors indicate how each stock has done in 2012 (through December 21). The ones in green have gained, and the darker the color, the greater the gains. The ones in pink to red have losses. The two largest bright red losers, down more than 50%, are Hewlett-Packard (HPQ), which is also a component in the Dow, and Tyco International (TYC) in Industrials, which makes and sells a variety of security and safety related products.

I hope the paper will publish this type of chart at least annually. It provides a quick view of how the stock market views the relative importance of the major sectors, which companies are dominant in their sectors, and how various stocks have done for the year.

I have a model that I use for client and personal accounts designed to trade mutual funds or ETFs that track the S&P 500 or a broad market index. The typical funds, the most well known being the Vanguard Index 500 (VFINX) and the S&P "spiders" ETF (SPY), track the S&P as it is composed, weighted by market capitalization. Such funds have greater investments in Apple than any other stock. My research has shown that in rising markets the smaller capitalization stocks as a group tend to do better than the larger caps, and the reverse is true in falling markets. Consequently, I normally use the Rydex Equal Weight ETF (RSP) when the model gives a buy signal. With quarterly rebalancing, it has an equal investment, 0.2%, in each of the S&P's components.