PANDEMIC FORCES NEW REALITIES ON S&P 500 AND DOW INDEXES

By Matt Schmitt, CFA®

Historic events in the stock exchanges can slip by quietly as the coronavirus pandemic changes the way we do business.

It seemed appropriate to point out two recent major developments that investors should factor into their thinking.

First is the continued surge of the six mighty mega-cap tech stocks that hold titanic sway over the S&P 500, and the second is the Dow Jones Industrial Average's attempt to better match its member companies with the new economy we live in today.

Let's look at the mega-caps first. It seemed timely to share an update on our commentary from this past May, given recent market volatility. These six companies stretched more, and now represent almost 25% of the S&P 500 market capitalization and approximately 20% of the earnings, as of the end of August. The big six companies referred to are Facebook, Apple, Amazon, Netflix, Google and Microsoft, and as investment advisors tend to do, we give them an acronym – FAANGM.[1]

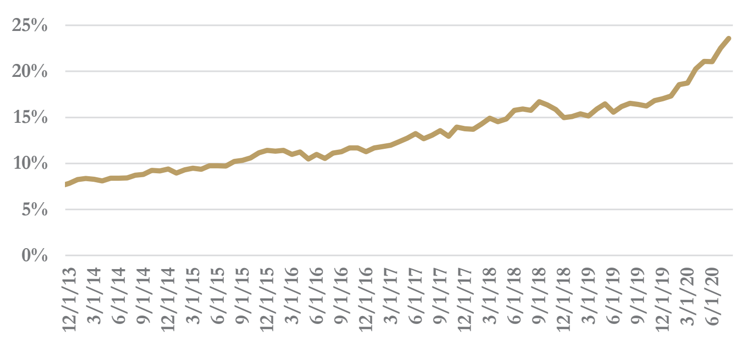
These six companies now represent over $7 trillion of market capitalization, up from roughly $4 trillion in April 2020. Apple, the largest of the six, is valued at over $2.2 trillion in market cap and is now larger than the combined market cap of the companies that comprise the Russell 2000 Index. Collectively, these six companies have a larger market capitalization than the combined market cap of the Energy, Materials, Industrials and Financials sectors of the S&P 500.

While this overwhelming size and weight feels like a good thing as it continues to lift market indexes to new record highs, it can be just as scary when those same market indexes drop lower as investors decide it is time to sell.

We feel it is important for investors to understand the great influence and impact that these largest companies can have on market returns. Evidence of this is clear in the year-to-date returns through August 31st with the S&P 500 returning 9.7% compared to the return of the six FAANGM companies of 56.6% and a decline of -0.10% for the other 494 companies in the Index. Longer term, a similar pattern exists where over the past five years these six companies have outperformed the S&P 500 Index by 20.3% per year.

Meanwhile, another major market index, the Dow Jones Industrial Average (DJIA) recently announced some changes to the stocks in its Index. These changes were announced shortly after Apple announced their 4-for-1 stock split, which lowered the index weight to the technology sector because the DJIA is a price-weighted index versus a market cap-weighted Index like the S&P 500. Apple's stock split in effect lowered the Index exposure to technology so it was announced that Salesforce.com would replace Exxon Mobil to boost the technology weighting. In addition, Amgen replaced

FAANGM WEIGHT IN S&P 500



Factset, S&P Global, FTSE Russell Data, Commerce Trust Company Quantitative Research.

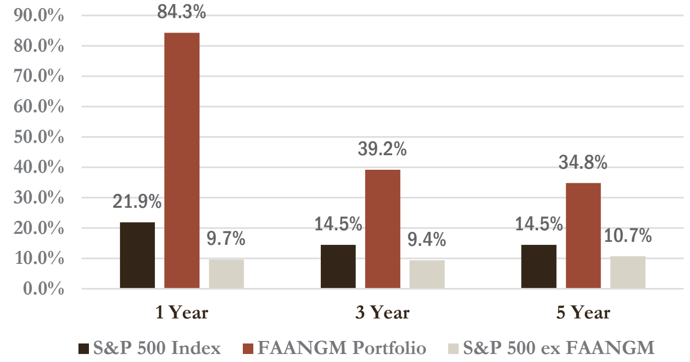
WEIGHTING OF THESE 6 COMPANIES HAS GROWN SUBSTANTIALLY OVER THE PAST 7 YEARS, GROWING FROM 7.8% OF THE S&P 500 TO NOW REPRESENTING 23.5%. THIS IS UP FROM 17.0% AT THE END OF 2019.

Pfizer and Honeywell International replaced Raytheon Technologies.

Add this to the fact that General Electric, maker of everything from light bulbs to jet engines and a 110-year charter member of the Dow, was unceremoniously booted from the exchange in June of 2018. GE was replaced by Walgreens Boots Alliance, not exactly a household name. Yet a good choice to reflect the changing market dynamics.

We are not calling for the end of the strong results from this group of companies who have all proven to be well-positioned to continue growing their earnings through the challenging economic conditions of 2020. We share this information in hopes that investors will better understand what factors are impacting market returns and, from time to time, causing what look to be larger swings in the results of the S&P 500 Index on a day-to-day basis.

ANNUALIZED RETURN, ENDING ON 8/31/2020



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IMPACT OF THESE 6 COMPANIES ON BENCHMARK RETURNS HAS BEEN MEANINGFUL. ADDING 10.9% ON A 1 YEAR BASIS, 4.6% PER YEAR OVER THE PAST 3 YEARS, AND 3.6% PER YEAR OVER THE PAST 5 YEARS.

IN THE FIRST 8 MONTHS OF 2020, THESE 6 COMPANIES RETURNED 49.8% WHILE THE S&P 500 RETURNED 9.7%.

1 Editorial note: Another important aspect about the FAANGM group is to recognize its impact on the results of growth versus value. Growth stocks are outperforming value stocks by nearly 40% thus far in 2020. Another question that comes up on the FAANGM group is why do we not include Tesla in this group of companies? While it has certainly been a "hot" stock that has gone up almost six-fold in 2020, it is not in the S&P 500 Index, so it is not having the same impact on a common market benchmark.

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Matt is the director of equity strategy as well as a portfolio manager for Commerce Trust Company. In addition to his other responsibilities, Matt chairs the equity strategy team, is a member of the investment policy team, and serves as co-manager for the Commerce value, growth, and mid-cap growth strategies. Prior to joining Commerce in 2002, Matt worked as a portfolio manager, an investment specialist, and a financial analyst. Matt received a bachelor of science degree in business administration and business management with an emphasis in finance from Drake University. Matt holds the Chartered Financial Analyst® designation and is a member of both the CFA Society of Kansas City and the CFA Institute.