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Market Stats & Commentary

Market Vital Signs as of 5/31/2024

Stock Indexes	May	YTD	1 Year
S&P 500	4.96%	11.30%	28.19%
Dow Jones Industrial Average	2.58%	3.52%	19.97%
NASDAQ Composite	6.88%	11.48%	29.37%
Russell Mid Cap Index	2.85%	5.66%	23.11%
Russell 2000 Small Cap Index	5.02%	2.68%	20.12%
MSCI EAFE Developed Int'l Index	3.87%	7.07%	18.53%
MSCI Emerging Markets Index	0.56%	3.41%	12.39%
Bond Indexes			
BBgBarc US Aggregate Bond Index	1.70%	-1.64%	1.31%
BBgBarc US Corp High Yield Bond Index	1.08%	1.55%	11.15%
Interest Rates	5/31/24	12/31/23	5/31/23
Fed Funds Target Range	5.25%-5.50%	5.25%-5.50%	5.00%-5.25%
10 Yr U.S. Treasury Rate	4.48%	3.94%	3.63%

Markets rebounded nicely in May from the drubbing they took in April. The 10 yr U.S. Treasury yield dropped by .19% for the month, giving both equity and bond markets a nice tailwind.

However, returns were not uniformly positive. The tech heavy NASDAQ index and the now relatively tech heavy S&P 500 both posted much stronger gains than the Industrials index. Add to that the significant outperformance of small caps to mid caps for May, and you have an interesting mixed bag of returns.

International markets were also uneven. Developed international markets rallied along with U.S. markets while the emerging markets index was barely positive for the month. Normally this is where I blame the underperformance of the index on Chinese markets – but not this time. China was slightly positive for May (as was India), but the rest of the EM index struggled. I attribute at least part of the EM struggles in May to the 6% drop in oil prices. Many EM economies rely heavily on commodities (particularly oil) and the sell off in May didn't help large EM countries like Brazil, UAE, Saudi Arabia, or Mexico.

A Narrow Market Gets Even More Narrow

A good way (at least to me) to judge health of the market in general is to look at the S&P 500 equal weight index. I have discussed this in the past, but I think there is good reason to revisit the topic, given the handful of stocks driving S&P 500 returns once again in 2024. To set the table, so to speak, here is a return comparison of the S&P 500 and the S&P 500 equal weight from 2014 to 5/31/2024:

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD as of 5/31/2024
S&P 500 Equal-Weight TR	14.49%	-2.20%	14.80%	18.90%	-7.64%	29.24%	12.83%	29.83%	-11.45%	13.87%	5.55%
S&P 500 TR	13.69%	1.38%	11.96%	21.83%	-4.38%	31.49%	18.40%	28.71%	-18.11%	26.29%	11.30%
Difference in Return	0.80%	3.58%	2.84%	2.93%	3.26%	2.25%	5.57%	1.12%	6.66%	12.42%	5.75%

Source: S&P Global

The table references annual returns of each index along with the annual difference in return. Keep in mind, both indexes are made up of the same stocks – but one is weighted by market cap (total $ amount of all shares outstanding) and one is weighted equally.

There are a few takeaways from this that I want to emphasize:

- The S&P 500 index has outperformed the S&P 500 equal-weight index 6 of the last 10 calendar years, and is ahead by a sizable margin through the first 5 months of 2024.
- The margin of outperformance, regardless of which index outperformed, has materially increased over the last 5 years.
- There are really no correlations to good or bad markets. There were times of outperformance for each index in both good and bad times.

You may be thinking to yourself, gee, that's interesting, but what does it mean to me, and more importantly, to my account value?

What This Means for Markets and Investors

For the first time ever, the aggregate total of money in passive funds (think index funds) surpassed the total aggregate amount of money in active funds (think traditional mutual funds) by the end of 2023. This may not sound like a big deal, but it might actually be a big, big deal. Keep in mind - every dollar invested in an index fund has a preordained destination based on a stock's weighting in the index.

The table to the right lists the top 10 components, along with weightings, for the S&P 500 as of 6/12/24. So, for every new dollar that is invested into a fund tracking the index, 7 cents buys Microsoft, 6+ cents buys Nvidia, etc. Thus, the majority of the new money which flows into index funds goes to purchase shares of a small basket of the largest companies. This buying pusher prices and market caps up, which in turn make the companies *even larger* components of the index. It becomes a positive reinforcement cycle for shares of the largest companies and a neutral to negative cycle for everyone else.

Holdings	% Portfolio Weight
Microsoft Corp	7.05
NVIDIA Corp	6.67
Apple Inc	6.22
Amazon.com Inc	3.79
Meta Platforms Inc Class A	2.45
Alphabet Inc Class A	2.29
Alphabet Inc Class C	1.93
Berkshire Hathaway Inc Class B	1.66
Eli Lilly and Co	1.53
Broadcom Inc	1.41

Source: Morningstar

It also creates structural differences in valuations. The passive money flow pushes prices and P/E ratios of the largest companies higher, while being neutral for the bulk of the index. This results in the mega cap stocks looking overvalued on a P/E basis and the rest of the market look undervalued, at least on a relative basis.

To me, it appears that the increase in new money flows and overall assets in passive funds over the past few years has created a structural bias in the U.S. market which favors the largest of the large companies. This is pushing returns and P/E ratios higher in those stocks and creating persistant imbalances in fundamental valuations.

Is this a bad thing? I don't know. This has concerned me over the last few years because it fuels over concentration in markets and investor portolios. Early in my career I heard the phrase "concentrated positions are a great way to get rich and a terrible way to stay rich". After 25+ years I have seen that play out several times, so you will have to excuse my lack of enthusiasm.

But, this seems to be the result of a real and structural change in the way money flows into the U.S. equity market. At this point, I am not sure it makes sense to fight a trend that continues to get stronger over time, even if it creates situations that don't make fundamental sense. I have done a considerable amount of reseach, data analytics, and thinking about this over the past year or so and I hope to publish a series of commentaries on the subject soon. I promise to try to make it as interesting and digestible as possible.

June 12, 2024

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Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary.

Index Descriptions

S&P 500: Representing approximately 80% of the investable U.S. equity market, the S&P 500 measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested.

Dow Jones Industrial Average Total Return: The Dow Jones Industrial Average is a composite of 30 stocks spread among a wide variety of industries, such as financial services, industrials, consumer services, technology, health care, oil & gas, consumer goods, telecommunications, and basic materials. The index represents approximately 23.8% of the U.S. market, and is price weighted (component weightings are affected by changes in the stocks' prices). Maintained by the Averages Committee, components are added and deleted on an as-needed basis.

Russell Midcap: A subset of the Russell 1000 index, the Russell Midcap index measures the performance of the mid-cap segment of the U.S. equity universe. Based on a combination of their market cap and current index membership, includes approximately 800 of the smallest securities which represents approximately 31% of the total market capitalization of the Russell 1000 companies. The index is created to provide a full and unbiased indicator of the mid-cap segment.

Russell 2000: Based on a combination of their market cap and current index membership, this index is comprised of approximately 2,000 of the smaller securities from the Russell 3000. Representing approximately 10% of the Russell 3000, the index is created to provide a full and unbiased indicator of the small cap segment.

NASDAQ: The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system.

MSCI EAFE (Europe, Australasia, Far East) Index: A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada. As of June 2, 2014, the index consists of 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

MSCI Emerging Market Index: A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of June 2, 2014, the index consists of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates.

Bloomberg Barclays U.S. Aggregate (BCAG): A representation of SEC-registered, taxable, and dollar denominated securities. The index covers the U.S. investment grade fixed rate bond market, with index components for asset-backed securities, government and corporate securities, and mortgage pass-through securities. Must be rated investment grade (Baa3/BBB- or higher) by at least two of the following rating agencies: Moody's, S&P, Fitch; regardless of call features have at least one year to final maturity, and have an outstanding par value amount of at least $250 million.

Bloomberg Barclays U.S. Corporate High Yield: Covers the universe of fixed rate, non-investment grade debt which includes corporate (Industrial, Utility, and Finance both U.S. and non-U.S. corporations) and non-corporate sectors. The index also includes Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. Must publicly issue, dollar-denominated and non-convertible, fixed rate (may carry a coupon that steps up or changes according to a predetermined schedule), and be rated high-yield (Ba1 or BB+ or lower) by at least two of the following: Moody's, S&P, and Fitch. Also, must have an outstanding par value of at least $150 million and regardless of call features have at least one year to final maturity.

U.S. government bonds and Treasury notes are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. U.S. government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury notes are certificates reflecting intermediate term (2-10 years) obligations of the U.S. government. There is an inverse relationship between interest rate movements and bond prices. Generally, when interest rates rise, bond prices fall and when interest rates fall, bond prices generally rise.

International investing involves special risk, including currency fluctuations, differing financial accounting standards, and possibly political and economic volatility.

Investing in emerging markets can be riskier than investing in well established foreign markets.