S&P 500 | MARKET CAPITALIZATION VS. EQUAL WEIGHTED

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FOREWORD

Last year saw the record-breaking outperformance of the traditional, market capitalization weighted S&P 500 Index over the equal weight version—the S&P 500 Equal Weight Index—by almost 12.5%! The reason: strength in tech-related sectors such as Info Tech, Communication Services and Consumer Discretionary, which dominate in the traditional market cap version, drove the unprecedented outperformance of the market cap weighted S&P 500. Because of this outperformance, market consensus coming into 2024 forecasted a broadening out of equity performance beyond what many call the 'Magnificent Seven'—the most dominate mega-cap technology-related stocks. As a result, there has been increased attention paid to the differently constructed S&P 500 Equal Weight Index. With tech-related sectors continuing to outperform in early 2024, the debate around which version is 'better' has only intensified. In this paper, we detail the differences and characteristics of the two methodologies and emphasize that understanding the nuances is important in selecting and positioning these investments in your portfolio.

KEY TAKEAWAYS

There are different index construction methodologies for the S&P 500. The more commonly used version of the index weights companies using their total market capitalization. The S&P 500 Equal Weight Index gives each company an equal weight. Index construction can impact performance.

The market cap weighted S&P 500 Index (the traditional version) is not rebalanced and has higher concentrations to larger, growth companies, while the equal weight index has more exposure to smaller and value-oriented companies.

Over longer time horizons, the risk and return characteristics of the two indexes are comparable. Time in the market is more important than timing the market.

WHAT ARE THE DIFFERENCES?

Rebalancing | The Equal Weight Index is rebalanced quarterly with all constituent companies receiving an equal weight toward quarter end. The market cap weighted index is not rebalanced.

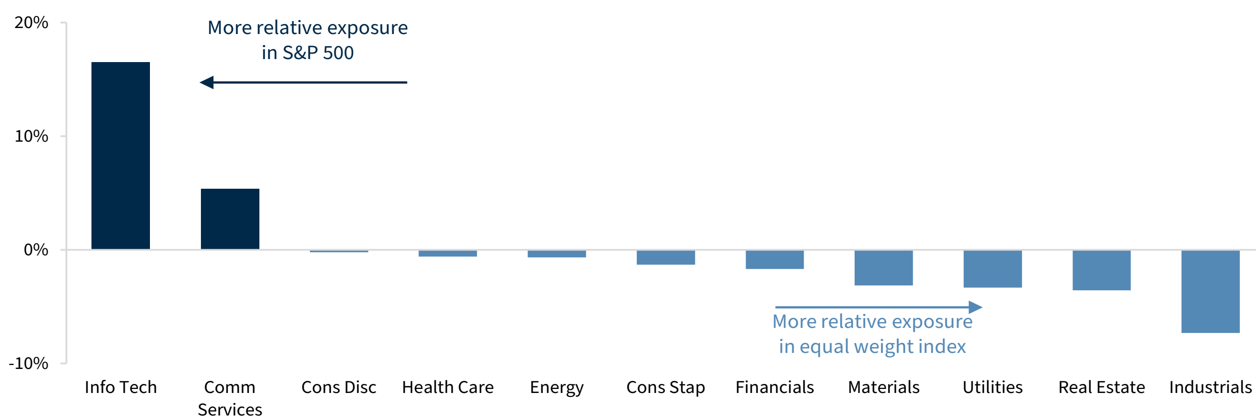
- All else equal, more rebalancing leads to higher transaction costs and tax implications.
- The market cap weighted index has more exposure to a momentum or trend-following factor. The Equal Weight Index is considered more contrarian since it allocates to under-performing sectors and securities from those areas that have recently outperformed as part of the quarterly rebalance.

Concentrations | Because the S&P 500 Index is not periodically rebalanced, heavy concentrations can emerge and decrease diversification while the Equal Weight Index remains more diversified and relatively stable over time.

- Sector Concentrations: The market cap weighted index has a much larger tech-related weighting (30% vs. 14%) and Info Tech, Communication Services, and Consumer Discretionary make up 50% of the index. On the other hand, the Equal Weight Index has higher allocations to Industrials, Real Estate, and Utilities. These three sectors make up 27% of the index, so the Equal Weight Index has more of a value tilt.
- Company Concentrations: The market cap weighted index provides more exposure to larger, growth companies while the Equal Weight Index has more exposure to smaller and value-oriented companies since each company is given the same weight. The top five companies in the market cap weighted index are ~30% of the index (nearly the highest level since 2000) while the top five in the Equal Weight Index comprise just 1% of the index.

Scale And Popularity | The market cap weighted index is more popular from an investor perspective. For example, the assets under management (AUM) of the largest market cap weighted ETF are close to $500 billion, while the AUM of the largest equal weighted ETF is about $50 billion. In this example, the market cap weighted ETF comes with approximately half the expense ratio (0.0945% vs. 0.20%), partly because of limited rebalancing costs.

Relative Sector Differences (Market Cap Weighted Minus Equal Weighted)



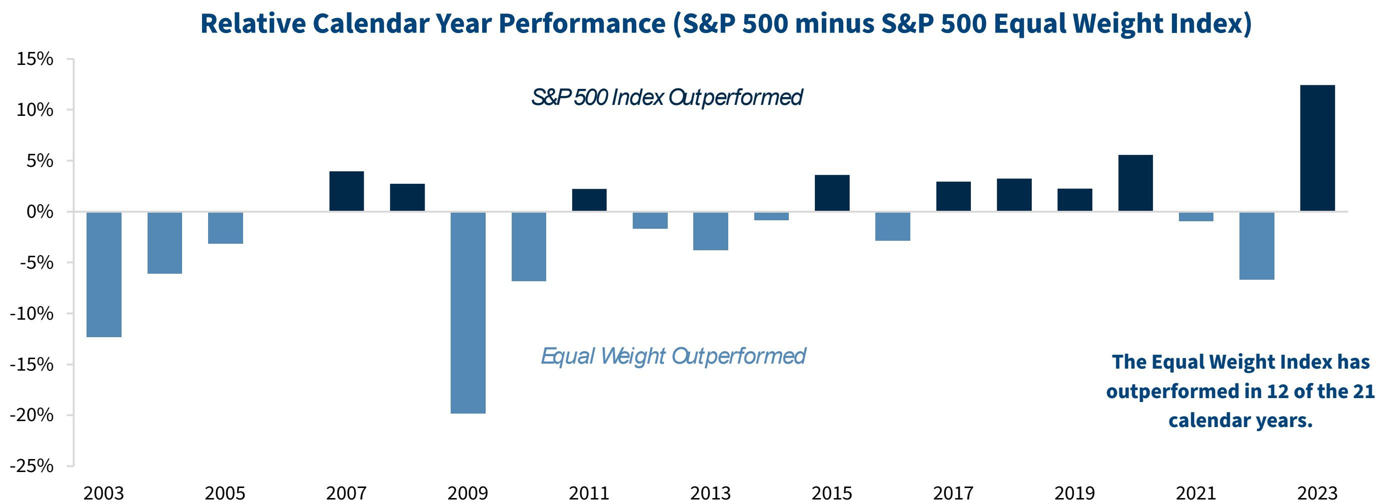
Source: FactSet as of 2/29/2024

RELATIVE RETURNS & RISK

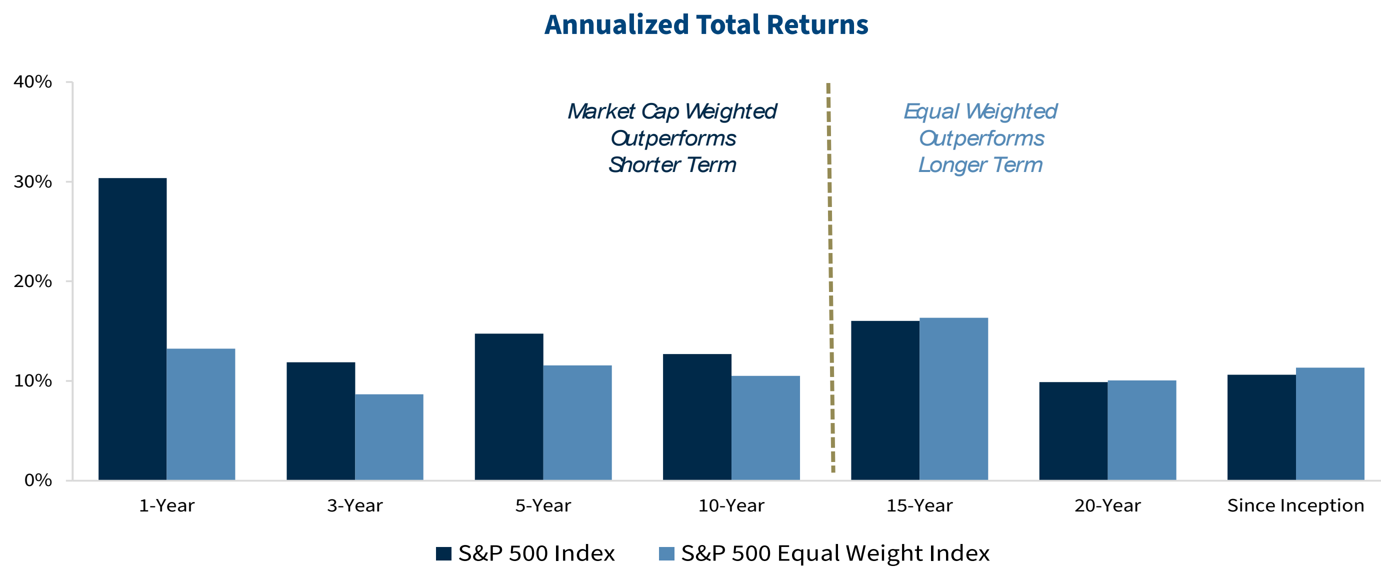
Returns | Given the recent outperformance of the tech-heavy market cap weighted index (the traditional S&P 500), it may be surprising to learn that the Equal Weight Index has outperformed over its history on a total return basis. Since its inception in January 2003, the S&P 500 Equal Weight Index outperformed in 12 of the 21 calendar years. It has also slightly outperformed over longer periods (15-years, 20-years, and since inception). However, over shorter 3-, 5-, and 10-year periods, the traditional, market cap weighted S&P 500 has outperformed the Equal Weight Index.

Sharpe Ratios | Near term, over the last five years, the market cap weighted index generated a higher Sharpe Ratio, but over longer periods, the Sharpe Ratios are more closely aligned.

Risk | From a risk perspective, there are not significant differences between the two indices over longer-term time horizons. When comparing the drawdowns of the two indices, results have been broadly in line. As one might expect, due to its more elevated exposure to relatively smaller companies, the Equal Weight Index generally has a higher (albeit only slightly) annualized volatility.



Source: FactSet as of 2/29/2024



Source: FactSet as of 2/29/2024

GROWTH EXPECTATIONS VS. VALUATION DISCOUNT

EPS Growth | Over the longer term, coinciding with its stronger performance, the Equal Weight Index has experienced stronger EPS growth. While data only goes back to 2009, the Equal Weight index has grown its earnings 12% on an annualized basis over that period, while the market cap weighted index has grown its earnings 9%. However, due to its higher exposure to tech-related sectors, the market cap weighted index is expected to see stronger annualized EPS growth over the next three years (11% vs. 9%).

Relative Valuation | When comparing the P/E ratios of the two indexes, the Equal Weight Index is trading at a significant discount to the market cap weighted index as of the time of this writing. In fact, the Equal Weight Index is trading at a nearly 20% discount to the market cap weighted index, the largest discount since 2010 when data first became readily available (the average discount has been about 2% since 2010).

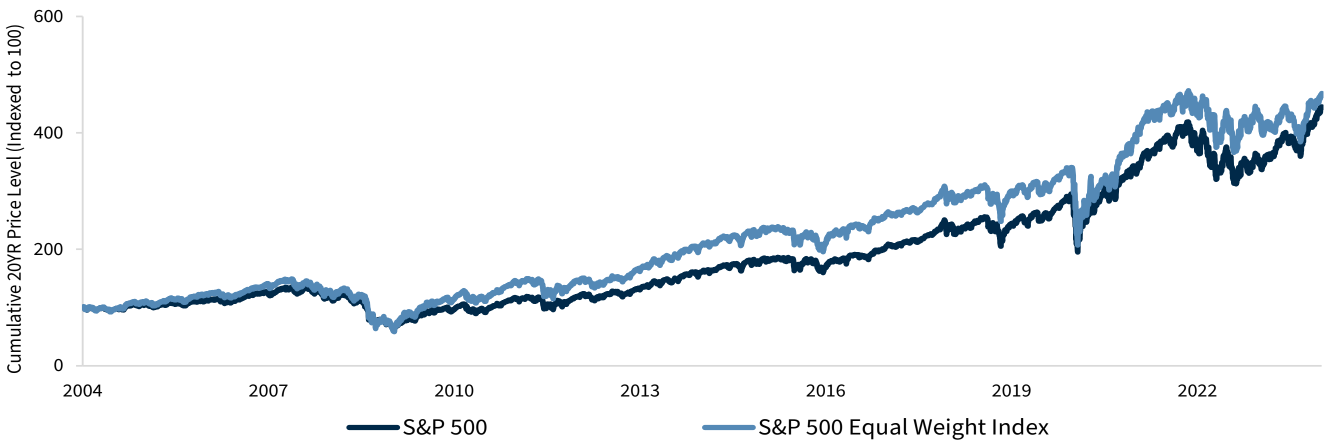
Income Dyamics | In the past, the Equal Weight Index was viewed as more of an income play given its higher dividend yield (~0.50% higher). However, given the current higher yield environment in fixed income markets, the relative attractiveness of that income differential has become less of a differentiator for investors.

BOTTOM LINE: "TIME IN THE MARKET, NOT TIMING, IS IMPORTANT!"

Investors should be aware of what they're buying as there are aspects to both indices that align with our views. For the S&P 500 (market cap weighted index), the higher allocation to tech-related sectors is consistent with our favorable outlook toward tech-related themes like Artificial Intelligence. The higher expected earnings growth is important in an environment in which earnings are likely to be the driver of performance with elevated valuations. For the S&P 500 Equal Weight Index, a higher exposure to one of our favorite sectors, Industrials, and a higher allocation to smaller-capitalization companies is consistent with our expectation of broader equity participation in the upcoming year.

At the end of the day, both have the potential to outperform in the near term but there is no clear path as to which has the ultimate advantage. While certain characteristics of each index may better align with one's investing preferences (e.g., growth vs. value, sector preferences), what is more important is that both methodologies provide exposure to the US equity market. When investing in equities, time in the market is far more important for investors with longer-time horizons than trying to time which flavor of the S&P 500 will outperform in the near term. Over longer periods of time, the winner of these two strategies has been a toss-up; but the average long-term performance they have both provided has been helpful to investors in achieving their long-term goals and objectives.

Price Performance Over 20 Years (Indexed to 100)



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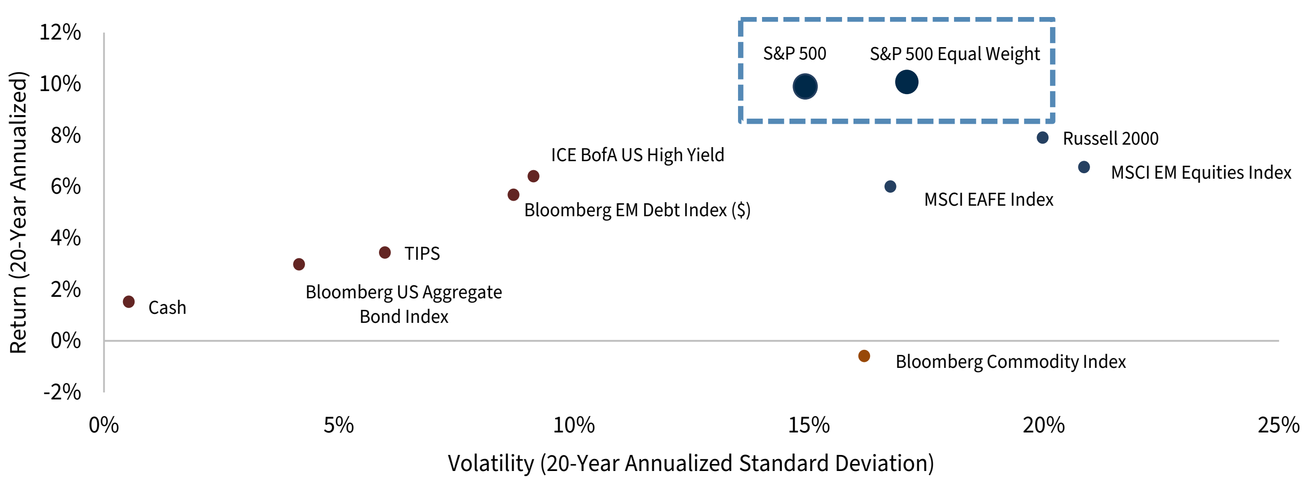
Risk/Return Characteristics



Source: FactSet as of 2/29/2024

A Primer: The Market Cap Weighted S&P 500 Vs. The S&P 500 Equal Weight Index

	S&P 500	S&P 500 Equal Weight Index	
Strategy	Momentum tilt	Value tilt	The equal weight index has a value tilt, larger weights to relatively smaller companies and an anti-momentum bias.
PE (NTM)	20.61	16.56	The S&P 500 has a greater exposure to growth-oriented companies.
EPS Growth (Since 2009)	9%	12%	Outperformance in the immediate aftermath of the last 2 recessions boosted the equal weight's EPS growth.
Projected EPS growth (Next 3 Years)	11%	9%	Forecasted earnings growth over 2024 provides the bulk of the difference.
Dividend Yield	1.34%	1.86%	The Equal Weight Index has a higher exposure to value-oriented companies.
Rebalanced?	No	Yes	The equal weight index is rebalanced quarterly with weights set to 1/N (1/500) for each company.
Top 3 Index Sector Weightings	55%	44%	Info Tech is 30% of the S&P 500 and 14% of the Equal Weight index. Industrials is the largest sector in the Equal Weight Index (~16%).
Top 5 Index Company Weightings	30%	1%	Google, Microsoft, Apple, Nvidia, and Amazon make up about 30% of the S&P 500.
Trailing 1YR Return	30.36%	13.24%	The market cap weighted S&P 500 has outperformed recently.
Since Inception Annualized Return*	10.63%	11.33%	Performance is more closely aligned over longer periods.
Annualized Daily Volatility*	18.63%	20.13%	A small-cap bias in the equal weight index generated slightly more volatility.
Sharpe Ratio*	0.28	0.30	On a risk-adjusted basis, there are neglible differences over longer periods.
Correlation*	0.97	0.97	Over a longer horizon, the indexes are strongly positively correlated.
Beta*	1.00	1.05	The equal weight index has a beta greater than 1 to the S&P 500.

Data as of 2/29/2024
*Since Inception of the S&P 500 Equal Weight Index (1/3/2003)

All content written and assembled by Raymond James Investment Strategy.

ADDITIONAL DISCLOSURES

REBALANCING | Adjusting constituent weights to a target or previously defined weight after the occurrence of price drift.

EARNINGS PER SHARE | The net earnings available to common shareholders divided by the number of shares outstanding. This metric is a key measure of corporate profitability and is commonly used to price stocks.

P/E RATIO | The current share price divided by the most recent earnings per share. This metric is commonly used by investors to compare performance of similar companies or groups of companies. A forward P/E ratio uses projected earnings in the denominator while a trailing P/E uses past earnings.

DIVIDEND YIELD | Dividend divided by price per share. Used along with capital appreciation to calculate total return.

EXPENSE RATIO | A management fee to a fund company used to cover operational costs, expressed as a percentage of net assets.

ASSETS UNDER MANAGEMENT | TThe total market value of assets that an entity manages or handles on behalf of clients.

SHARPE RATIO | A risk-adjusted measure calculated by using standard deviation and excess return to determine reward per unit of risk. The higher the Sharpe Ratio, the better the historical risk-adjusted performance. The Sharpe Ratio can be used to compare two risky assets to determine how much risk had to be taken to earn an excess return over the risk-free rate.

ETF | Exchange-traded funds are designed to provide investment results that generally correspond to the price and yield performance of their respective underlying indexes, the funds may not be able to exactly replicate the performance of the indexes because of fund expenses and other factors. ETF shareholders should be aware that the general level of stock or bond prices may decline, thus affecting the value of an exchange-traded fund. The prospectus contains this and other information about ETFs. The prospectus and summary prospectus is available from your financial advisor and should be read carefully before investing.

STANDARD DEVIATION | Standard deviation is a measure of the dispersion of a set of data from its mean. It is calculated as the square root of variance by determining the variation between each data point relative to the mean. If the data points are further from the mean, there is higher deviation within the data set. In finance, standard deviation is a statistical measurement; when applied to the annual rate of return of an investment, it sheds light on the historical volatility of that investment. The greater the standard deviation of a security, the greater the variance between each price and the mean, indicating a larger price range.

SECTORS | Sector investments are companies engaged in business related to a specific economic sector and are presented herein for illustrative purposes only and should not be considered as the sole basis for an investment decision. Sectors are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification Sector investments are companies engaged in business related to a specific economic sector and are presented herein for illustrative purposes only and should not be considered as the sole basis for an investment decision. Sectors are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

S&P 500 | The S&P 500 is widely regarded as the best single gauge of large-cap US equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization. The S&P 500 Equal Weight Index is the equal-weight version of the widely-used S&P 500 Index.

RUSSELL 2000 | A market index that tracks the performance of around 2,000 small-cap companies in the US. Maintained by FTSE Russell, a subsidiary of the London Stock Exchange Group (LSEG).

MSCI EAFE | An equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the US and Canada.

MSCI EMERGING MARKETS | An equity index which captures large and mid-cap representation across 24 Emerging Markets.

BLOOMBERG US AGGREGATE | A broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasurys, government-related and corporate securities, fixed-rate agency MBS, ABS and CMBS (agency and non-agency).

BLOOMBERG EMERGING MARKETS USD AGGREGATE | A broad-based flagship hard currency Emerging Markets debt benchmark that includes fixed and floating-rate US dollar-denominated debt issued from sovereign, quasi-sovereign, and corporate EM issuers.

BLOOMBERG COMMODITY INDEX | A benchmark made up of 23 exchange-traded futures on physical commodities, representing 21 commodities which are weighted to account for economic significance and market liquidity.

ICE BofA US TREASURY BILL INDEX | Measures the performance of USD denominated US Treasury Bills.

ICE BofA US INFLATION-LINKED TREASURY INDEX | Measures the performance of USD denominated US Treasury Bills.

ICE BofA US TREASURY BILL INDEX | Tracks the performance of U.S. dollar-denominated inflation linked sovereign debt publicly issued by the U.S. government in its domestic market

ICE BofA US HIGH YIELD INDEX | Tracks the performance of U.S. dollar-denominated below investment grade rated corporate debt publicly issued in the US domestic market.

INDICES USED FOR SCATTER CHART | Cash: ICE BofA US Treasury Bill Index, US Agg: Bloomberg US Aggregate Bond Index, TIPS: ICE BofA US Inflation-Linked Treasury Index, US High Yield: ICE BofA US High Yield Index, Bloomberg EM Debt ($USD): Bloomberg Emerging Markets USD Aggregate Index, Bloomberg Commodity Index, MSCI EAFE Index, MSCI EM: MSCI Emerging Markets Index, Russell 2000 Index (Small-cap US equities), S&P 500 Index, S&P 500 Equal-Weight Index.

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