

# Breadth

Hundreds of indexes are available today for measuring trends in and performance of financial markets. This development reflects the role technology tools has played in the breadth of available indexes. Exchange-traded indexes provided a ready market for new investment ideas. It no longer is the case that just one index is presented as representative of large and/or closely followed markets or market sectors. Most market participants are well-aware of the longstanding indexes of broadest interest that track markets and sector. At the same time, understanding of the nuances of market index construction and the implications across market environments likely varies widely. The perspective here provides some thoughts on market indexes, their construction and use, with implications for financial markets and portfolio construction.

## Q PERSPECTIVE

Two frequent index format schemes are cap-weighted (returns for stocks in the index are weighted by market size) and equal-weighted (returns for stocks in the index are given the same weight). These formats have been available for the Wilshire 5000 U.S. stock index for the past 28 years. **Chart I** shows the return advantages of the index formats measured on a rolling 12-month frequency. The return frequency advantage goes to the cap-weighted format, with returns higher than those of equal-weighted 53% of the time. At the same time, equal-weighted posted the higher average return at 13.3% versus 10.6% for cap-weighted. Cap-weighted has dominated since late 2021, showing the out-performance of large-cap, tech stocks during this period.

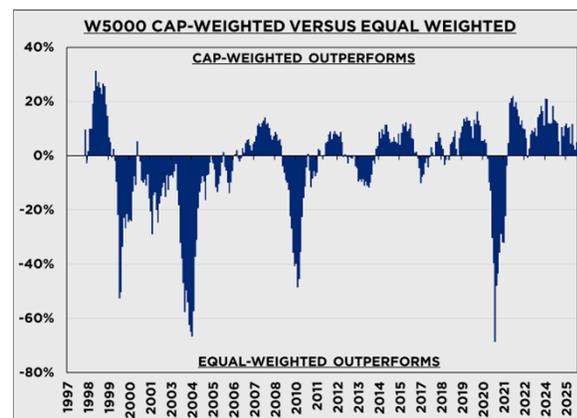
The return differences between cap-weighted and equal-weighted indexes certainly reflect the returns and weightings of individual stocks in each index format. **Table I** shows the 5 largest stocks in each fund along with their weightings and sector representation. The cap-weighted picture offers no surprises with the 5 largest stocks representing 29% of the index. With one exception, the 5 stocks are in the tech sector, and that exception has much to do with the tech sector. Each of the top 5 stocks in the equal-weighted index is in the tech sector but there are no overlaps with top 5 holdings in the cap-weighted index. It is easy to see how format can change the return outcome of different indexes for the same market.

Fear of loss from investing in higher risk assets looms large among most investors. Past market drawdowns (a measure of decline from prior high levels) provide a good perspective of loss potential if an adequate period for analysis is available. Such is the case for the Wilshire 5000 as shown in **Chart II**. Over the past 56 years, the Wilshire 5000 has posted some notable drawdowns, largest of which was -51% in the bear market of the Great Recession. Over the course of 56 years, drawdowns of -20% or greater have occurred a little more than once a year. The good news is that the index recovered fully from each drawdown.

## INVESTMENT IMPLICATIONS

Much creativity has gone into efforts to improve return experiences from investing in different structures of indexes representing the same market. If, for example, a particular index structure purports to reduce drawdowns consistently, investors could be well-served. Material changes (e.g., outright elimination of certain sectors such as energy) could warrant that the index so changed no longer is representative of the market being measured. Investors and advisors who serve them must understand these differences and that an expanded breadth of investment choices is not necessarily a benefit.

**CHART I**



**TABLE I**

<b>WILSHIRE 5000 5-LARGEST HOLDINGS</b>			
<b>CAP-WEIGHTED</b>			
STOCK	%	SECTOR	
Nvidia	8.4%	Technology	
Apple	6.9%	Technology	
Microsoft	6.6%	Technology	
Amazon	4.2%	Consumer Cyclical	
Broadcom	2.9%	Technology	
<b>Total</b>	<b>29.0%</b>		
<b>EQUAL-WEIGHTED</b>			
STOCK	%	SECTOR	
Warner Bros. Discovery	0.4%	Technology	
Western Digital	0.3%	Technology	
Advanced Micro Devices	0.3%	Technology	
Micron Technology	0.3%	Technology	
Intel	0.3%	Technology	
<b>Total</b>	<b>1.6%</b>		

**CHART II**

