# Diversification matters, now more than ever

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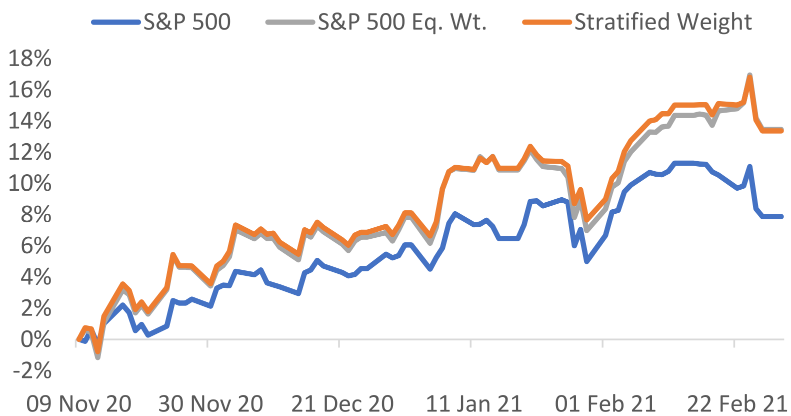
Since the first COVID-19 vaccines were announced, equity markets have rotated away from technology stocks into the rest of the market, as such diversified methodologies have outperformed (Exhibit 1).

Today, cap-weighted indices like the S&P 500 are more biased and concentrated towards mega cap technology stocks than they were in March 2000. Unlike the DotCom bubble, the risk this time may not be a tech collapse, but that the rest of the market is undervalued and underrepresented in investors' portfolios. Stratified Weight portfolios are designed to allocate more equally to sectors and industries to better capture the broad equity risk premium (Exhibit 2).

**Exhibit 1. Index performance since Pfizer Vaccine Announcement**

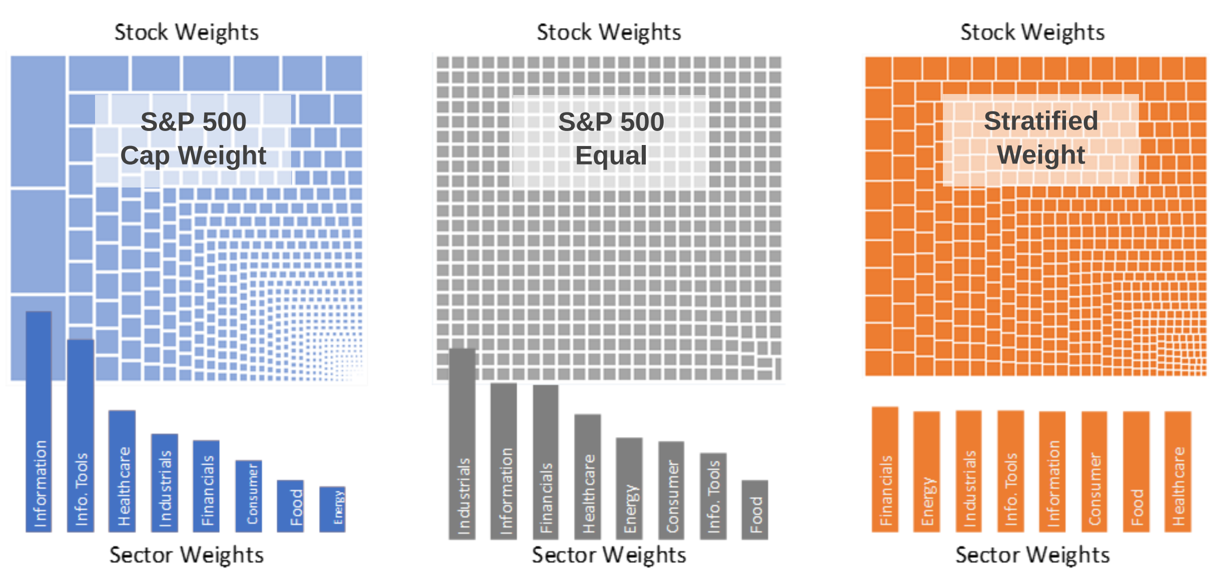



Performance since 11.9.2020

| | |
|---|---|
| Equal Weight 12.5% | Stratified Weight 12.5% |
| Cap Weight 7.9% | |

Source: S&P Dow Jones Indices, Syntax. Performance does not reflect fees or implementation costs.

**Exhibit 2. Better Beta: The Difference is Weighting**



## The largest companies have underperformed over the long-run

It's easy to believe that the largest companies today will remain at the top of the index indefinitely, but history is littered with top 10 companies whose current weights are a fraction of what they once were (Exhibit 3).

**Exhibit 3. The S&P 500's top 10 has changed considerably over the last three decades**

| 1990 | Weight 1990 | | Current |
|---|---|---|---|
| Exxon | 2.7% | ⇩ | 0.7% |
| General Electric | 2.5% | ⇩ | 0.3% |
| IBM | 2.3% | ⇩ | 0.3% |
| AT&T Corp. | 2.1% | ⇩ | 0.6% |
| Royal Dutch | 1.7% | | |
| Philip Morris | 1.6% | ⇩ | 0.4% |
| Merck & Co. | 1.3% | ⇩ | 0.6% |
| Bristol-Myers | 1.2% | ⇩ | 0.4% |
| Du Pont | 1.2% | ⇩ | 0.1% |
| Amoco | 1.2% | | |
| **Top 10** | **17.8%** | | |

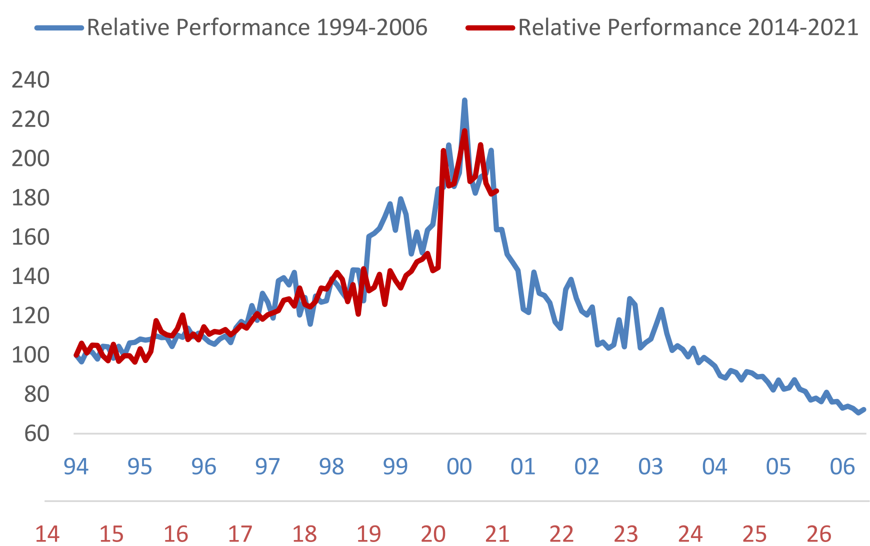
| 2000 | Weight 2000 | | Current |
|---|---|---|---|
| Microsoft | 4.9% | ⇧ | 5.4% |
| General Electric | 4.1% | ⇩ | 0.3% |
| Cisco Systems | 2.8% | ⇩ | 0.6% |
| Wal-Mart | 2.5% | ⇩ | 0.6% |
| Exxon Mobil | 2.3% | ⇩ | 0.7% |
| Intel | 2.2% | ⇩ | 0.8% |
| Lucent | 1.9% | | |
| IBM | 1.6% | ⇩ | 0.3% |
| Citigroup | 1.5% | ⇩ | 0.4% |
| America Online | 1.4% | | |
| **Top 10** | **25.2%** | | |

| 2010 | Weight 2010 | | Current |
|---|---|---|---|
| Exxon Mobil | 3.3% | ⇩ | 0.7% |
| Microsoft | 2.4% | ⇧ | 5.4% |
| Apple | 1.9% | ⇧ | 6.1% |
| Johnson & Joh. | 1.8% | ⇩ | 1.3% |
| Procter & Gam. | 1.8% | ⇩ | 0.9% |
| IBM | 1.7% | ⇩ | 0.3% |
| AT&T | 1.7% | ⇩ | 0.6% |
| Jpmorgan | 1.6% | ⇩ | 1.4% |
| General Electric | 1.6% | ⇩ | 0.3% |
| Chevron | 1.6% | ⇩ | 0.6% |
| **Top 10** | **19.3%** | | |

Source: S&P Dow Jones Indices, Syntax, Legal & General Investment Management America.

The ten largest companies in the S&P 500 currently account for 28.1%, a level higher than that seen during the heady days of the dotcom bubble (26.6% in March 2000). Anecdotally, the recent run-up in the 10 largest stocks matches the performance seen of the top 10 during the tech bubble. In the five years following the largest stocks underperformed by 63.8% (Exhibit 4).

**Exhibit 4. Performance of S&P 500 top 10 relative to S&P 500 Equal Weight Index**



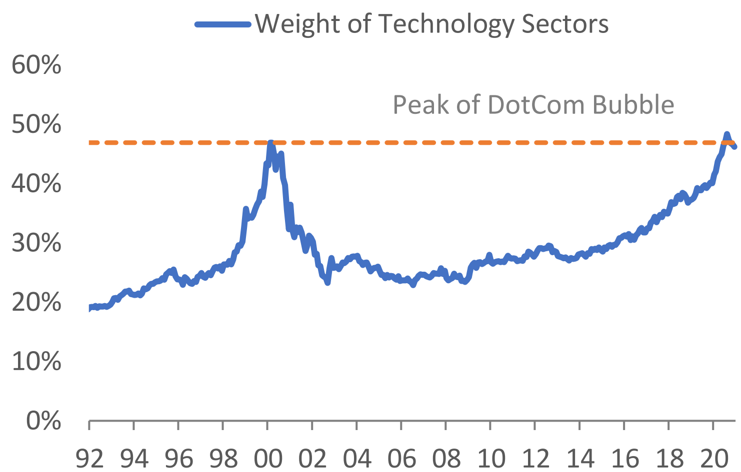

| 03/01/21 | Current |
|---|---|
| Apple | 6.1% |
| Microsoft | 5.4% |
| Amazon.com | 4.0% |
| Alphabet | 3.7% |
| Facebook | 1.9% |
| Tesla | 1.6% |
| Berkshire Hathaway | 1.5% |
| JP Morgan | 1.4% |
| Johnson & Johnson | 1.3% |
| Visa | 1.1% |
| **Top 10 in S&P 500** | **28.1%** |

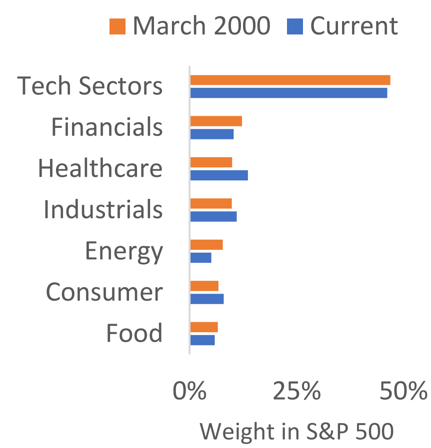
Source: Syntax, S&P Dow Jones Indices. Performance does not reflect fees or implementation costs as an investor cannot directly invest in an index.

## Sector weightings can cause a drag on the entire index

In cap-weighted strategies, risks are further compounded because the largest stocks share technology related business risks and therefore may correlate together on the downside. The weight of the Information and IT sectors combined is 46.2%, roughly the same level that we saw before the tech bubble burst. The other relative sector weights look eerily similar (Exhibit 5).

**Exhibit 5. S&P 500 sector composition looks similar to March 2000**

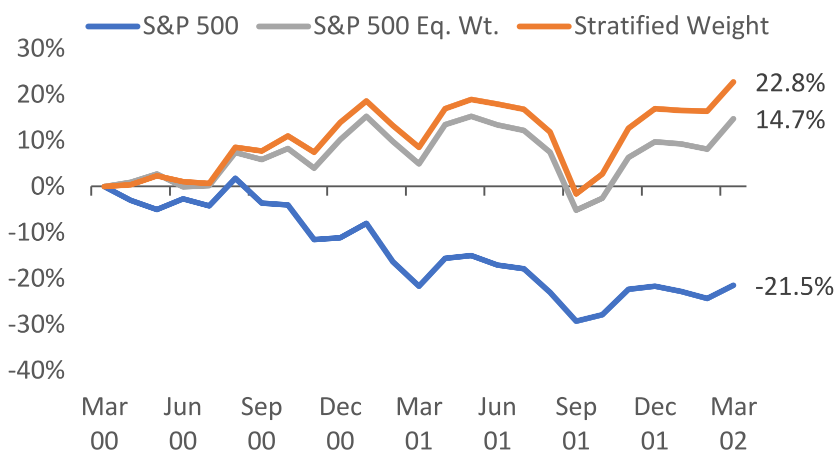


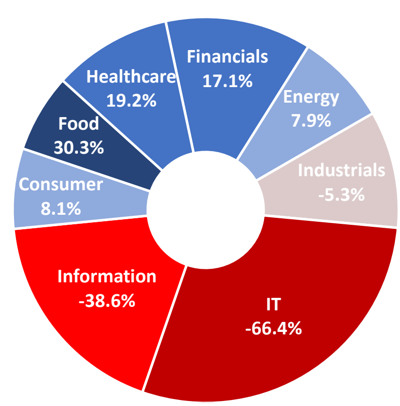

Source: Syntax, S&P Dow Jones Indices.

When the tech sectors collapsed in March 2000, they dragged the broad index down 21.5%, even though the non-tech sectors rose. An equal or stratified weight strategy would have better captured the broad equity risk premium, rising 14.7% and 22.8% respectively over the next two years (Exhibit 6).

**Exhibit 6. Concentrations cause a drag on index performance**




**S&P 500 Sector Composition and Performance**
(3.31.2000-3.31.2002)




Source: Syntax, S&P Dow Jones Indices. Total Return, S&P 500, S&P 500 Eq. Weight, and Stratified LargeCap Indices. Performance does not reflect fees or implementation costs as an investor cannot directly invest in an index. Please see important disclaimers regarding backtested data prior to inception.

## Cap Weight misses attractive opportunities outside Big Tech

Though valuations of Technology stocks have risen to above their historical averages, they remain well below their bubble multiples and a collapse in tech is therefore less likely than in 2000. However, due to Big Tech's oversized weight in the S&P 500, more attractively priced "old-economy" sectors like Industrials, Energy, Food and Consumer are under-represented in the index (Exhibit 7).

The Stratified LargeCap invests across the same universe of companies as the S&P 500 index but allocates weight across a broader range of industries and companies. With uncertainty remaining high amidst the new post-COVID paradigm, we believe that diversification matters, now more than ever.

**Exhibit 7. Comparison of different weighting methodologies for the S&P 500 universe**

**S&P 500 Universe**

| Cap Weight | Equal Weight | Stratified Weight |
|---|---|---|
| Stock Concentrations<br>Sector Biases | Diversified Stocks<br>Sector Biases | Diversified Stocks and<br>Diversified Sectors |
| Stock Concentration | Stock Concentration | Stock Concentration |
| Top 10 Weight = 28.1% | Top 10 Weight = 2.7% | Top 10 Weight = 7.2% |
| Top 50 Weight = 53.8% | Top 50 Weight = 12.4% | Top 50 Weight = 26.9% |
| Sector Biases | Sector Biases | Sector Biases |
| IT, Information<br>46.8% | Industrials, Financials<br>35.0% | Equal<br>Sector<br>Weights |
| Energy, Food<br>10.8% | Food, IT<br>15.0% | |
| Valuations | Valuations | Valuations |
| P/E ratio = 21.7x | P/E ratio = 20.2x | P/E ratio = 18.9x |
| P/B ratio = 4.23x | P/B ratio = 2.98x | P/B ratio = 2.94x |
| Dividend Yield = 1.94% | Dividend Yield = 2.12% | Dividend Yield = 2.23% |

Source: Bloomberg, Syntax. Data as at 3.2.2021, 12-month forward P/E ratio, 12-month trailing P/B ratio and Dividend Yield shown.

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