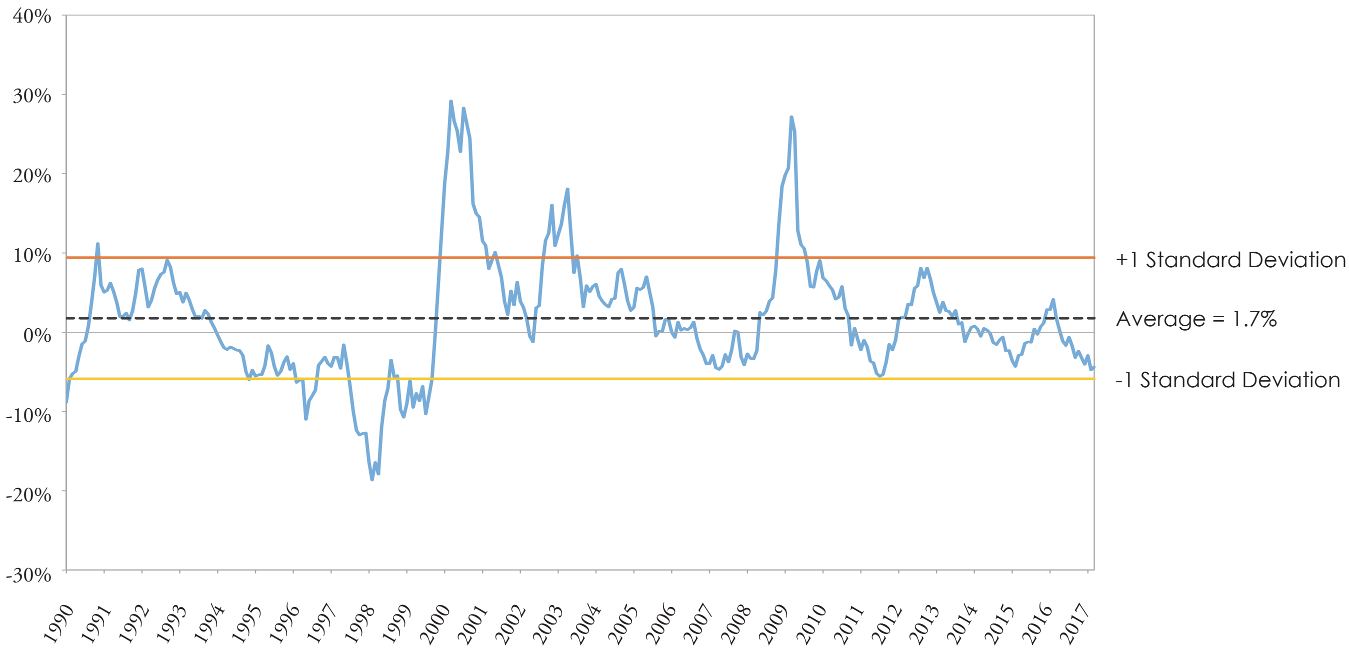
Market Update

While stocks have struggled thus far in 2018, one trend that has remained in place is the outperformance of larger capitalization stocks vs. medium- and small-cap issues. However, that trend is showing signs of being overextended, and good opportunities may be presenting themselves today for investors willing to depart from capitalization-weighted benchmarks.

The chart below shows the difference in trailing 12-month returns between the capitalization-weighted S&P 500 Index and the same S&P 500 Index calculated on an equal-weighted basis. Over rolling 12-month periods since 12/31/90, the equal-weighted S&P 500 Index has outperformed the cap-weighted version by an average of 1.7% per year. However, there are shorter-term periods where the cap-weighted benchmark does better. Over the twelve months ending 2/28/18 the cap-weighted S&P 500 gained 17.1%, while the same Index equal-weighted gained only 12.7%, a difference of -4.4%.

ROLLING 12-MONTH RELATIVE RETURNS

S&P 500 Equal Weighted Minus S&P 500 Cap Weighted



Data from 12/31/90–12/31/17

Source: Bloomberg, Standard & Poor's

As shown on the chart, this difference in return is approaching one full standard deviation away from the average, which has historically marked an environment where the equal-weighted Index begins to outperform. The exception to this rule was 1999 and early 2000, where the equal-weighted S&P 500 continued to underperform the cap-weighted Index due to the Tech "bubble" of the late 1990s. Even so, the equal-weighted Index recovered with a vengeance when the tech bubble burst and outperformed the cap-weighted Index for five straight years thereafter.

We believe that the equal-weighted S&P 500 is poised to resume its long-term trend of outperformance of the cap-weighted Index. While it's impossible to time this shift in market leadership, we believe that our portfolio discipline of equal weighting, combined with a focus on identifying reasonably priced growth companies, should perform relatively well in such an environment.

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