

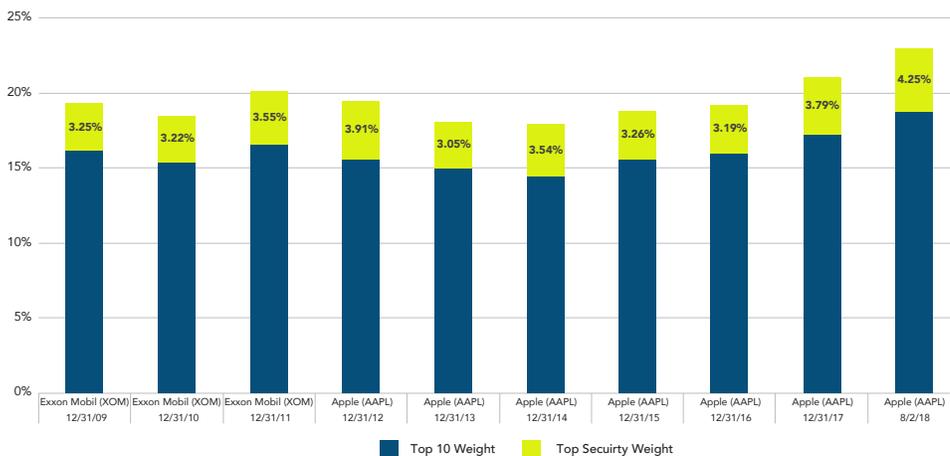
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Cap-weighted indices and the impact of these popular index weighting schemes is a relevant conversation in light of Apple (Ticker: AAPL) recently breaking the \$1T market cap barrier. The S&P 500 is a cap-weighted index based upon a company’s free float market capitalization. In other words, the more valuable the company, the greater the weight given to that company. However, companies with closely held shares (usually held by founders or their heirs) are weighted less than the overall market cap because those shares are not available to trade on the open market.

Take the example of Apple and Amazon (Ticker: AMZN). On July 31, 2018, Apple and Amazon had market caps of \$921B and \$867B, respectively. While that is roughly a 6% spread, Apple’s weight in the index was more than 30% greater because a larger percentage of its shares are freely traded. This impacts other companies as well such as Walmart (Ticker: WMT), Berkshire Hathaway (Ticker: BRK/A) and now Keurig Dr. Pepper (Ticker: KDP).

Another interesting topic surrounding the weighting scheme is how “top heavy” the index has become over the years and the impact of the top weighted company. After blowing through the \$1T mark, Apple was 4.25% of the S&P 500. If this holds through the end of the year, it would be the highest relative weight of a single security in the S&P 500 in the last 10 years. It is not just Apple whose relative value has increased against the rest of the index’s constituents. The top ten holdings have increased their relative value by 19% since 2010 as the weight has risen from 19.31% of the index to 22.97% of the index.

Weight of S&P 500 Top 10 Companies



While this is the largest single holding in recent memory, there are many companies which had greater relative valuations in the past. Microsoft (Ticker: MSFT), AT&T (Ticker: T), IBM (Ticker: IBM) and Exxon Mobil (Ticker: XOM) were all at least 4.9% of the index at one point over the past 40 years. While Apple and the Top 10 holdings of the index have grown recently, it is not historically unprecedented.

As the most valuable companies relative share of the index grows, serious questions should arise about whether or

not market cap weighted indices still deliver the security diversification investors sought when making allocation decisions. In order to combat the concentration of value in a small number of securities, investors should consider adding alternative weighting schemes (equal, style and/or factor weight especially) in order to further diversify passive allocations.

Sources:
Bloomberg
<https://www.cnbc.com/2018/08/02/apple-stock-has-most-influence-over-market-now-but-this-other-tech-na.html>

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