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QUARTERLY PERSPECTIVE

The Illusion of Diversification

by Will Williams
Chairman, President & CEO

For most of my nearly 40-year career in the investment industry, the default barometer for U.S. stock market performance has been the S&P 500 Index. Originally developed in 1923 by the Standard Statistics Company, it was made up of 233 companies. It was later revised in 1957 to include what were considered at the time the 500 leading U.S. companies, with a total market capitalization of $172 billion. Fast forward to today, the S&P 500 now has a market capitalization of over $48 trillion and represents approximately 80% of the total market capitalization of publicly traded companies in the U.S. (S&P Global).

Market Capitalization-Weighted vs. Equal-Weighted

From the very beginning, Standard & Poor's adopted a "free float framework" to calculate the performance of the S&P 500. For each company included in the Index, S&P would determine the market capitalization of that company by multiplying the stock price by the number of outstanding shares available for public trading—what is called "free float." (These shares exclude restricted shares held by company insiders that are not available for public trading.) To illustrate, let's use Home Depot as an example. Home Depot has 989.7 million "free float" shares, which is roughly 98.3% of their total shares outstanding. On June 28, Home Depot's closing price was $334.24 per share. S&P's (*Price x Shares*) calculation equals a market value of $330.8 billion.

The market capitalization of the S&P 500 Index is calculated by totaling the market capitalizations of all 503 constituent companies. These figures are calculated daily, and S&P allows market forces to dictate each company's percentage weighting instead of periodically rebalancing back to pre-set target amounts.

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Chart 1: S&P 500 Market Cap Weighted | % Top Ten Holdings (01/31/97 to 06/30/24)

S&P 500 Top 10: March 2000	
Microsoft	4.4
Cisco	4.2
General Electric	4.0
Intel	3.5
AT&T	3.2
Oracle	2.9
Pfizer	2.8
Verizon	2.5
Time Warner	2.2
Exxon Mobil	2.1
% of Total	**31.9**

S&P 500 Top 10: June 2024	
Microsoft	7.2
NVIDIA	6.6
Apple	6.6
Alphabet	4.3
Amazon	3.9
Meta	2.4
Berkshire Hathaway	1.6
Eli Lilly	1.6
Broadcom	1.5
JP Morgan	1.3
% of Total	**37.0**

June-24

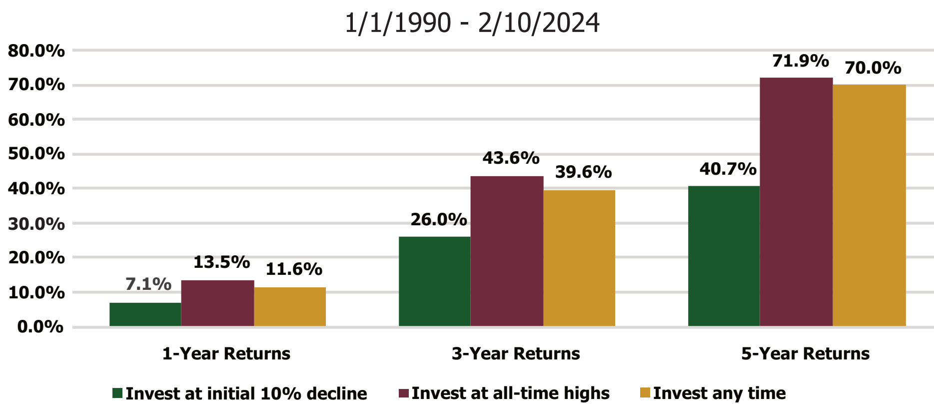
Y-axis: 10.00, 12.00, 14.00, 16.00, 18.00, 20.00, 22.00, 24.00, 26.00, 28.00, 30.00, 32.00, 34.00, 36.00, 38.00, 40.00
X-axis: '97, '99, '01, '03, '05, '07, '09, '11, '13, '16, '18, '20, '22, '24

Source: FactSet

Higher and Higher

by Brian Christensen, CFA®
Senior Vice President & CIO

When the stock market is trading at or near all-time highs, investors tend to become more cautious about committing additional cash to stocks. The data suggests that investors continue to hold large cash balances on the sidelines. Money market fund balances now exceed $6 trillion, having increased nearly $1 trillion in just the last two years. With money market rates averaging 5% compared to the days of near-zero interest rates, the incentive to invest in the stock market has decreased meaningfully. But is waiting for a correction the best strategy?

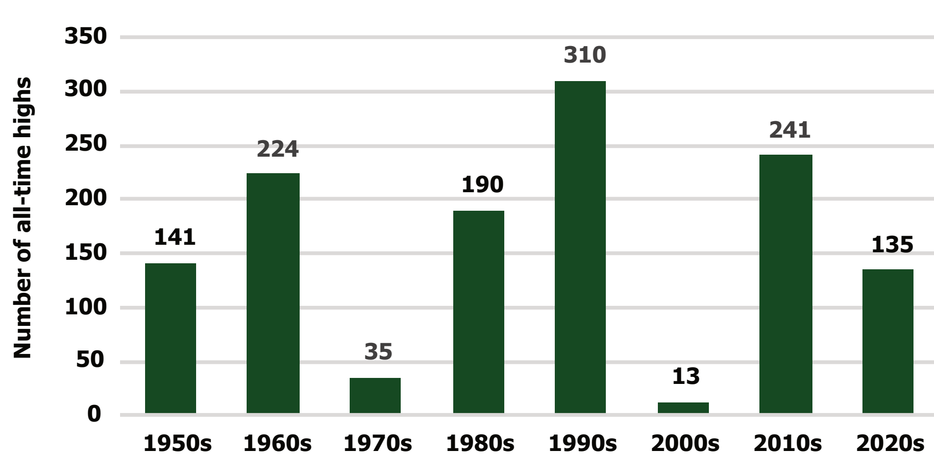


All-time highs are nothing new to the market (see Chart 1). Since 1950, the S&P 500 index has set over 1,200 all-time highs, averaging more than seventeen each year. At the time of this newsletter's publication, the S&P has already hit 135 all-time highs this decade, with predictions of more to come.

An investor's urge to try to time markets has proven to be a poor strategy. Cumulative return data since 1990 (see Chart 2) indicates that when investors wait for a 10% market decline following an all-time high, they experience trailing returns. In fact, not only will their returns trail the investments made at all-time market highs, but they will also trail returns on investments made *at any other time.*

Historically, market highs have been followed by above-average returns—not sell-offs. In a recent market commentary, UBS Global Wealth Management highlighted that 60% of the time in the past 60 years, the S&P 500 Index has traded within 5% of an all-time high. Moreover, since 1960, the Index has seen an average return of 11.7% in the 12 months following an all-time high. Stocks generally set new all-time highs when the economy is strong and supports corporate earnings growth. Such is the case today: Corporate earnings are forecasted to grow 10-12% annually through 2026 (FactSet).

Investors may be tempted to retreat in response to daily news about geopolitical unrest and the upcoming election. But the business environment remains robust for corporate America. Your financial plan and goals are long-term focused and designed to weather market volatility whenever it may arrive. The only way to manage volatile markets is to Stick to the Plan.



DVI continues to build our team, and we are always on the lookout for talented investment professionals. To view our open positions or learn more about careers at DVI, we invite you to scan this QR code or visit: www.dviinc.com/join-team.

Financial Planning: Your Roadmap to Peace of Mind

by Mike Flaherty, CFP®
Senior Relationship Manager

Embarking on a cross-country family road trip without a destination programmed into a GPS or routes marked on a map might seem thrillingly spontaneous. You assume that as long as you're making progress in a general direction, you'll eventually make it to all the sites you've dreamed of seeing. While this approach may tick off a few bucket list items, a lack of planning could also lead to missed opportunities and unexpected delays. Conversely, a well-thought-out plan ensures you make it to all the landmarks and reach your final destination on time.

This analogy mirrors how many people approach financial planning. Shockingly, a 2023 Charles Schwab & Co. survey found that nearly two-thirds of Americans lack any financial plan: They're navigating life's financial road trip without directions, hoping to stumble upon success through sheer luck. In contrast, the same survey found that for those who do have a plan, 92% feel confident they'll reach their financial goals. They navigate with purpose and confidence because they have a responsive financial plan managed with trusted advisors.

At DVI, our Relationship Managers specialize in crafting tailored financial plans. These comprehensive blueprints clarify current financial standings, outline short- and long-term goals, and account for unexpected financial traffic jams and roadblocks. Each client's needs differ, so financial planning at DVI is also a *process*. Sometimes, plans need to address concrete, basic financial needs (budgeting and cash flow, paying off debt, or contributing more toward retirement, for example). More elaborate financial plans can also guide clients through multifaceted, long-term approaches (tax efficiency, estate planning, or wealth transfer strategies, for example).

It's a common misconception that formal financial planning is an expensive, complicated, or invasive process that only makes sense for people with extreme wealth. Like a well-planned road trip with GPS navigation, a comprehensive financial plan is essential for everyone's journey to financial security, guiding people with precision toward life's milestones and ensuring their dreams are realized.

Financial Plans: The DVI Way

The financial planning process may initially seem daunting, involving discussions about assets, liabilities, income, and expenses. It's true that these conversations require transparency, but know that your Relationship Manager appreciates the invitation to engage in this important work with you and values your trust and confidence. Not only are DVI Relationship Managers bound to the fiduciary duties entailed by our industry credentials as Certified Financial Planners (CFP®), we also adhere to DVI's core tenet to always do the right thing for *you*, our valued clients.

Beyond financial data, we delve into your vision for the future—your timeline for achieving goals, plans to support loved ones, and aspirations for your legacy. We explore your risk tolerance and how it influences your financial decisions. This holistic approach allows us to tailor strategies that align with your unique circumstances and dreams, whether it's funding education, purchasing a home, or traveling the globe.

Once a financial plan is established, it becomes our dynamic tool for ongoing discussions and adjustments. Together, we monitor progress, anticipate obstacles, and adapt strategies in response to life's changes or new opportunities.

In essence, financial planning is not just about reaching a final destination; it's about empowering you to make informed decisions at every stage of life while enjoying the sites along the way.

By partnering with DVI to create your financial plan, you gain a dedicated team committed to your financial success, ensuring you navigate life's financial highways with confidence and clarity.

To better understand our clients' financial priorities and vision for the future, DVI Relationship Managers engage in ongoing conversations about topics like:

What is the timeline you have in mind to achieve some of your bigger financial goals?

Are there any upcoming life events or changes on the horizon that may impact your financial goals?

How do you define your risk tolerance, and what are the factors that impact the level of risk you're willing to take on?

Are you hoping that you'll be able to financially support family members or other dependents in the future?

What is your vision for your legacy? How do you hope to pass on assets or want your estate handled?

Comprehensive financial planning is an ancillary service for our valued clients. If you want to know more about creating or updating your financial plan, please reach out to your Relationship Manager by email or by calling (309) 685-0033.

THE ILLUSION OF DIVERSIFICATION ...continued from page 1

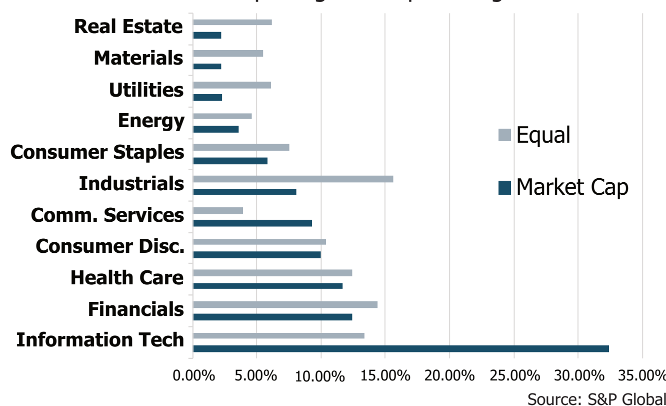
In 2003, S&P introduced an equal-weighted index with the same companies as the market cap-weighted index, but they incorporated two guidelines: First, each company is limited to 0.20% of the total. Second, the companies' weights are rebalanced quarterly to maintain this original target (S&P Global). Despite a lack of research to confirm, I suspect S&P undertook this initiative to address the statistical anomalies that arose from the dotcom bubble bursting in March of 2000. At that time, as is the case today, a handful of stocks represented nearly a third of the market cap weighting of the entire S&P 500 Index, and most of those companies were specific to the information technology sector. Following the burst of the dotcom bubble, the S&P 500 Index performed more like a proxy for large capitalization technology companies rather than as a diversified common stock portfolio.

The Statistical Difference

Due to their significantly different construction methodologies, these two S&P 500 Indices exhibit dramatic differences. In the market cap-weighted index, a handful of stocks can rise to prominence and substantially influence overall performance as shown in Chart 1. Today, just ten companies make up nearly 40% of the index, while a mere five of those companies—less than 1% of the index's total constituents—represent 28.6%. This is in stark contrast to the 2.3% weighting of the top ten holdings in the equal-weighted index.

As Chart 2 shows, the weightings of the eleven economic sectors that comprise the two indices are also significantly different. In the market cap-weighted index, company valuations drive index weights. In the equal-weighted index, the number of companies in each economic sector affects the allocation percentage. The industrial sector is a good example that illustrates

Chart 2: Sector Weightings



this point. This sector has the most companies in the S&P 500 with 78, but it only represents 8% of the market cap-weighted index since most of these 78 companies have relatively modest market valuations. GE Aerospace, the General Electric spin-off, has the largest valuation within the sector, yet its total market capitalization of $178 billion is less than one-tenth the size of Amazon.

On the opposite end of the spectrum, the information technology sector has a similar number of companies (67) to the industrial sector yet represents over 32% of the market cap-weighted index. It is astonishing that three companies alone—Microsoft, Apple, and Nvidia—represent nearly *$10 trillion* in market capitalization!

Chart 3: S&P 500 Eleven Sectors

Sector	# of Companies	Top 3 Largest Companies by Market Cap
Real Estate	31	Prologis, American Tower, Equinix
Materials	28	Linde, Sherwin Williams, Freeport-McMoran
Utilities	31	NextEra Energy, Southern Company, Duke Energy
Energy	22	Exxon Mobil, Chevron, ConocoPhillips
Consumer Staples	38	Walmart, Proctor & Gamble, Costco
Industrials	78	GE Aerospace, Caterpillar, Uber Tech
Communication Services	22	Alphabet, Meta Platforms, Netflix
Consumer Discretionary	52	Amazon, Tesla, Home Depot
Health Care	63	Eli Lilly, UnitedHealth, Johnson & Johnson
Financials	71	Berkshire Hathaway, JP Morgan, Visa
Information Tech	67	Microsoft, Apple, Nvidia

Source: S&P Global, FactSet

The Fiduciary Dilemma

Historically, most fiduciaries have relied on the market capitalization-weighted S&P 500 Index as the proper performance benchmark for U.S. large company stock strategies. With the current market backdrop, I believe we need to further examine the rationale for using the market cap index as the default index. As a fiduciary, guided by prudent expert standards, would you realistically advocate for the outsized concentration of specific companies that exists in the market cap index today? Would you be willing to wager a third of your chips on one economic sector?

At DVI, we genuinely try to understand the implications of adopting age-old industry standards that may not be widely understood or discussed outside the halls of investment management firms. As fiduciaries, we ask ourselves: Are we gauging performance properly? Do we understand the required risks inherent in portfolio construction that would be needed to meet or exceed the investment performance of this benchmark?

Beyond the hypothetical, my personal concern lies with the billions upon billions of dollars invested passively in the market cap-weighted S&P 500 Index. Many of these unsuspecting investors are under the illusion that they have invested in a diversified U.S. common stock portfolio. In contrast, the equal-weighted index meets the definition of a diversified equity portfolio with a built-in mechanism that corrects the dramatic tilts occurring within a cap-weighted index during speculative market environments.

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