

# Educational Series

## Article I



## U.S. EQUITY BENCHMARKS

### "WHAT ARE THEY"



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In the world of investments, benchmarks are used to compare and evaluate the performance of an investment portfolio. Generally, broad market indexes are used when benchmarking the performance of U.S. Stocks; commonly referred to as equities. The RHL Group regularly tracks four different U.S. equity indexes: The Dow Jones Industrial Average, The Standard and Poor's 500 Index, The Nasdaq Composite Index, and The Russell 3000 Index. It is important to note that, these four indices are *equity benchmarks*. Equities are only one, of the multiple types of asset classes that are typically held within a diversified investment portfolio.

#### The Dow

The Dow Jones Industrial Average (DJIA) is the oldest and most widely known equity index in the world. There are only 30 stocks in the DJIA but they represent 30 of the largest and most influential companies in the United States. These 30 companies represent roughly 25% of the valuation of the entire U.S. Stock Market.\* The DJIA is a price weighted average. Initially, the per share price of each company in the index was added together and the sum was divided by 30. However, stock splits and other events like spin-offs and acquisitions have made the calculation far more complicated. The key point to understand about the DJIA is that it primarily represents investor sentiment about large U.S. companies. While it is the most widely known index in the world, the DJIA is not a broad market index.

#### The S&P 500

The Standard and Poor's 500 stock index is a larger, broader index when compared to the DJIA. There are 500 company stocks in the S&P 500, representing roughly 80% of the total value of the U.S. stock markets. The S&P 500 is a market capitalization weighted index. Market capitalization or "market cap" is calculated by taking the current price of one share of stock and multiplying it by the total number of shares owned by shareholders; often referred to as "shares outstanding". It is important to note that companies with the largest market cap make up a larger percentage of the S&P 500 index. In fact, the 10 largest companies represent approximately 18.34% of the index. The key point in understanding the S&P 500 Index is that while it does represent a far wider cross-section of the U.S. equity market, The S&P 500 isn't a broad market index. The S&P 500 over-weights the largest market cap stocks. Therefore, significant changes in the market cap of those companies will have a greater impact, either positive or negative, on the index.

## The Nasdaq Composite Index

The Nasdaq Composite Index is a market capitalization weighted index of all stocks traded on the Nasdaq Stock Exchange. There are more than 3,100 stocks traded on the Nasdaq, including some companies from outside of the United States. Known primarily for technology stocks, which make up approximately 20% of the index, the Nasdaq also includes companies, both large and small, across all industries and sectors\*\*. The Nasdaq also provides access to stocks that are more speculative in nature. The Nasdaq is a good barometer for investor's comfort level with riskier, more volatile investments and the Nasdaq is also the best way to evaluate the overall health of the technology sector. However, while broad in nature, its specific focus on technology, limits the overall effectiveness of the Nasdaq as a broad market indicator.

## The Russell 3000 Index

The Russell 3000 Index, maintained by the Russell Investment Group, is a market capitalization Index that is intended to be a benchmark for the entire U.S. stock market. The Russell 3000 is comprised of 3000 small, medium and large-cap U.S. companies, all incorporated in the United States and actively traded on stock market exchanges. The Russell 3000 is the broadest U.S. stock market index and while it isn't known nearly as well as the big 3, it is widely considered to be the most accurate reflection of the overall health of the U.S. equity market. The Russell 3000 is reconstituted once every year and the underlying companies are ranked based on their current market capitalizations.

The DJIA, S&P 500, Nasdaq and Russell 3000 are the four primary indexes for benchmarking U.S. equity performance. While each benchmark is important in evaluating overall equity performance, many diversified investment portfolios often contain asset classes that are not specifically correlated to U.S. equities. There are benchmarks used to track international equities, fixed income, commodities, and even national currencies like the Euro and Pound. We will be writing more updates for our educational series later in the year.

*"I never invest in anything I don't understand"*

*-Warren Buffett*

*Series I*