

OCTOBER 2017 COMMENTARY

U.S. markets as measured by the S&P 500 Index (“S&P 500”) and Dow Jones Industrial Average (“Dow”) were up 4.41% and 5.58%, respectively, for the quarter ended 9/30/17. On a total return basis, the S&P 500 has been positive for 18 of the past 19 quarters. Uncharacteristically low volatility in the markets continues to be the story in 2017. In fact, we have not witnessed a +/- 2.0% day for the S&P 500 year-to-date, which has not occurred in over a decade. Strong economic data, corporate earnings, and the expectations for tax reform have been the catalysts sending the markets higher. Although a short-term pullback could occur at any time, we think there are enough economic tailwinds out there to continue to drive corporate earnings higher.

One such tailwind has been the resurgence in international economies. Economic data abroad continues to come in strong, with no major economies in recession. S&P 500 companies generate more than half of their collective revenues overseas, so strength from major international economies is another net positive for many US companies. Not surprisingly, international markets continued their trend higher in the third quarter. International developed markets, as measured by the MSCI EAFE Index, were up 5.47%; emerging markets, as measured by the MSCI Emerging Markets Index, were up 8.01% for the quarter. Both indices are nearing their 2014 highs, which occurred before the rally in the U.S. dollar and the collapse in oil prices.

We want to highlight a benchmark change that will appear on your quarterly reports. The Investment Committee decided to change the U.S. Large Cap benchmark from the Dow to the S&P 100 Equal Weighted Index (“S&P Equal Weighted 100”). The Dow is a price-weighted index, meaning that companies with higher stock prices carry more weight in the benchmark (and vice versa). While the Dow is representative of blue chip companies, we feel its price-weighting model introduces the potential for results to be driven by the performance of a select few companies. A high-priced stock such as Boeing has nearly ten times (10x) more influence on the index than General Electric, even though General Electric is a larger company. To drive this point even further, Boeing’s year-to-date performance represents just over 20% of the Dow’s year-to-date performance (as of 10/11/17). Lastly, a price-weighted index, such as the Dow, assumes that investors hold an equal number of shares (not equal investment value), which is atypical of general portfolio construction.

During our benchmark evaluation, we also decided against using the S&P 500 as the benchmark for U.S. Large Cap stocks. The S&P 500 weights companies based on their market capitalization (shares outstanding times stock price). Market capitalization is a fancy way of stating the size of a business. For example, as of 10/11/2017, Apple has a market capitalization of \$808.62 billion and is considered the largest company in the world representing 3.7% of the value of the S&P 500. Technology-related companies currently represent the 5 largest positions in the S&P 500 (Apple, Alphabet, Microsoft, Facebook and Amazon).



In practice, here's how the size-weighted S&P 500 differs from the price-weighted Dow in the example above: The S&P 500 has more weight in General Electric than Boeing simply because General Electric has a higher market capitalization. Said another way, GE has more weight in the S&P 500 because it's a big company, but a very small weighting in the Dow due to its low stock price. We believe both approaches are flawed.

We believe the S&P Equal Weighted 100 is representative of the high quality, blue chip companies that make up our investment universe. The S&P Equal Weighted 100 also provides a more logical approach to weighting the constituents in the index. As stated in its name, each company has an equal weighting. The less publicized equal weighting is similar to the method we use to construct portfolios at Blue Chip Partners. We believe this change eliminates the biases due to share price or company size.

Sincerely,



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Data Source: Bloomberg LP, Morningstar, S&P Dow Jones Indices

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