KIM: Strength of largest stocks masked pain of average stock in 2015

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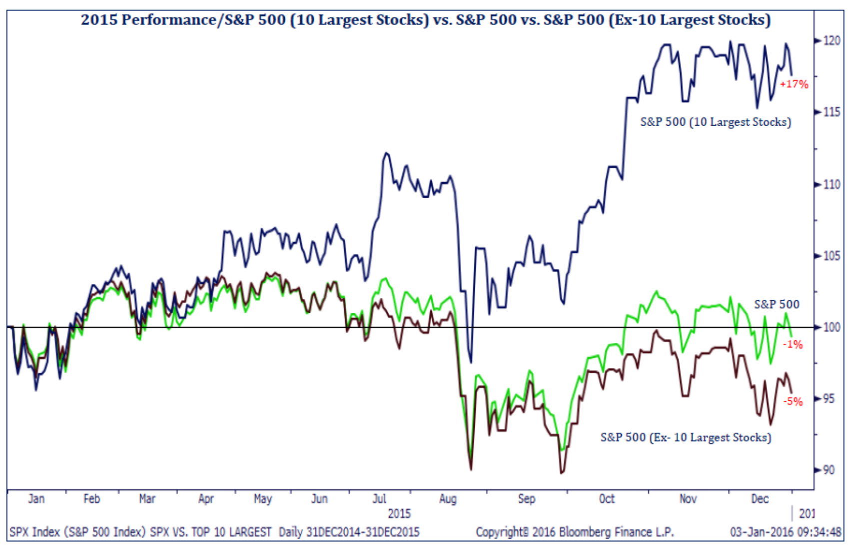
Although U.S. stocks recovered in the fourth quarter, 2015 was an extremely frustrating year for most investors. The major stock market indices showed flattish performance for the year, but only because the very largest-capitalization stocks did well.

In other words, the performance of the indices masked the fact the average stock struggled and misery was widespread in 2015.

One picture "paints a thousand words" of what happened in 2015. As background, the Standard and Poor's 500 Index (S&P 500—SPX) is a *capitalization-weighted* index. Recall a stock's "market capitalization" or "market cap" is simply the stock price multiplied by the number of shares.

So, if XYZ Corporation's stock is $50/share and there are 10 million shares outstanding, XYZ's market cap is $500 million. The S&P 500 contains 500 stocks, but the weighting of each stock in the index is determined by its market cap. This is why the S&P 500 (like most other indices) is *capitalization-weighted*.

The S&P 500 itself actually ***lost 15 points*** in 2015 (adding dividends led to a slight positive total return). According to our friends at Strategas Research Partners, the 10 largest market capitalization stocks (i.e. **2% of the 500 stocks**) have a **combined S&P 500 weighting of 18.8%.** As a group, those 10 stocks did very well in 2015 and accounted for 30.6 index points, or 304.8% of the S&P 500's points for the year.



The performance disparity between those 10 largest market capitalization stocks and the other 490 stocks in the S&P 500 can be seen in the graph below. The 10 largest stocks were up 17% in 2015. The S&P 500 was down 1% (price only). The S&P 500 without those 10 largest market capitalization stocks was down 5%. The upshot is if you did not own a significant amount of those 10 stocks, you sailed into a very stiff performance headwind in 2015.

We're not Pollyannas, but take some solace stocks faced a number of strong headwinds in 2015 without suffering even greater damage. Commodity prices continued to plunge (particularly oil), decimating earnings and freezing capital spending in the sector. Strength in the U.S. dollar and China's softening economy and weakening currency also hurt U.S. manufacturers. Finally, the Federal Reserve finally raised its target for short-term interest rates.

We don't know if and when the pressures noted above will abate and neither does anybody else. We can't control any of those things, so will continue to look for companies with solid business prospects, sound financial structures and strong, shareholder-oriented management teams whose stocks are selling at a significant discount to our evaluation of intrinsic value.
