October 2007 *MoneyMinute* – What is the S&P 500?

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The S&P 500 is one of the most commonly used benchmarks for the overall U.S. stock market. Many consider it to be *the* definition of the market. But just what is the S&P 500, and why should anyone care?

First off, S&P stands for Standard & Poor's, a financial services company owned by McGraw Hill that rates stocks and bonds according to their risk profiles. Standard & Poor's began in 1923 with an index of 233 companies. The present form of the Standard & Poor's 500 Index (S&P 500) came into being in 1957.

As the name suggests, the Standard & Poor's 500 Index consists of 500 companies from a diverse range of industries. Contrary to a popular misconception, the S&P 500 is not a simple list of the largest 500 companies by market capitalization or by revenues. Rather, it is 500 of the most widely held U.S.-based common stocks, chosen by the S&P Index Committee for market size, liquidity, and sector representation. "Leading companies in leading industries" is the guiding principal for S&P 500 inclusion.

How It Is Measured

The S&P 500 is a "market-capitalization" weighted index. (Think of market cap as the value of all shares of a single company.) In effect each dollar of market value is one "vote."

Strengths

The S&P 500 represents approximately 75% of the value of all U.S. publicly traded companies. Part of the index's popularity is due to its close association with the largest mutual fund in the world, the Vanguard 500 Index Fund.

Weaknesses

Because the index gives more weight to larger companies, it tends to reflect the price movement of a fairly small number of stocks. Plus, the index is composed only of U.S.-based companies. Foreign companies are not included.

The top 10 companies in the S&P 500 now account for 20% of the benchmark, and the 50-biggest companies make up almost half the index. Thus it is skewed toward very large U.S. companies. If Exxon had a bad day, the index could take a big hit, even if every one of the bottom 100 companies went up that day. The market cap of Exxon is greater than the combined market cap of the bottom 100 companies within the S&P 500 index.

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Top 10 Companies in the S&P 500				
Company	Float Adjusted Market Cap ($ Million)	Index Weight	Sector Weight	GICS® Sector
Exxon Mobil Corp.	513,362	3.81%	32.62%	Energy
General Electric	424,192	3.15%	27.36%	Industrials
AT&T Inc.	258,048	1.92%	51.10%	Telecommunication Services
Microsoft Corp.	237,534	1.76%	10.90%	Information Technology
Citigroup Inc.	232,162	1.72%	8.70%	Financials
Bank of America Corp.	223,066	1.66%	8.36%	Financials
Procter & Gamble	219,514	1.63%	17.13%	Consumer Staples
Cisco Systems	201,669	1.50%	9.25%	Information Technology
Chevron Corp.	199,485	1.48%	12.67%	Energy
Johnson & Johnson	190,169	1.41%	12.13%	Health Care

Data: Standard & Poor's Inc. (As of 9/30/07)

Recent Performance and Summary:
The value (price reported on Google finance or Yahoo finance) of the S&P 500 index has risen 12.3% annually since Dec 31, 2002, thru Sept 30, 2007. However this understates the true total return of the index because it does not include dividends.

Here is chart showing the returns since Dec 31, 2002, for VFINX (an inexpensive way to purchase the S&P 500):

Portfolio Description	Annual Return 2003	Annual Return 2004	Annual Return 2005	Annual Return 2006	Tot Ret YTD 9-30-07	Cumulative	Annualized
Vanguard 500 Index	28.5%	10.7%	4.8%	15.6%	9.1%	88.0%	14.2%

As you can see, the S&P 500 index has returned 14.2% since 2003. Compare this to the 12.3% shown on popular web sites or reported on CNBC. The media underreport the S&P 500 performance because they do not include dividends.

Not too many of us would complain about a return of 14.2%. However, those were only good years. Now let's look at the period since 2000 and you will see the risk of putting all your eggs in one (U.S. large cap) basket.

Portfolio Description	Annual Return 2000	Annual Return 2001	Annual Return 2002	Annual Return 2003	Annual Return 2004	Annual Return 2005	Annual Return 2006	Tot Ret YTD 9-30-07	Cumulative	Annualized
Vanguard 500 Index	-9.1%	-12.0%	-22.2%	28.5%	10.7%	4.8%	15.6%	9.1%	17.1%	2.1%

The bear market of 2000-2002 severely impacted the annualized returns. If you started investing at the beginning of 2000, it took until sometime late in 2006 before you broke even. In other

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words, it took nearly seven years for the index to fully recover and go on to show a profit.

We do not consider the S&P 500 to be a diversified portfolio. At ICM we use the S&P 500 to represent one asset class (large U.S. companies) within a diversified portfolio of 4-10 asset classes. For example, the Growth benchmark we use here at ICM includes small stocks and international stocks along with large U.S. stocks.

Portfolio Description	Annual Return 2000	Annual Return 2001	Annual Return 2002	Annual Return 2003	Annual Return 2004	Annual Return 2005	Annual Return 2006	Tot Ret YTD 9-30-07	Cumulative	Annualized
Growth Benchmark	-9.4%	-11.4%	-20.4%	33.3%	13.9%	6.9%	18.2%	9.7%	34.5%	3.9%

Growth benchmark consists of 65% weighting in the Vanguard 500 Index, 15% weighting in the Russell 2000 Index iShares, and 20% weighting in the Vanguard Total Int'l Stock Index.

Using the benchmark, your same investment made in 2000 would have fully recovered during 2005, about one year sooner. The annualized return of the benchmark from 2000 to 9-30-07 is about 85% higher than the S&P 500.

The tables above are looking at the results for portfolios that hold only stocks (equities). Most of you have some allocation to bonds, which help to buffer the downs. The S&P 500 is a small part of most portfolios at ICM for reasons of risk and diversification. The next time the media talks about how the S&P 500 index is performing, remember that they are not talking about a diversified portfolio and they're not talking about *your* money.

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