

Group case Study: Identification of Best S&P 500 Segment

Submitted by: Jashan Meet, Monika Baloda, Luis Flores
Professor Matt Vaezi

History of the S&P 500 Market:

The S&P 500 is an index that keeps track of the stock performance of the 500 largest publicly traded companies within the United States. It was initially introduced in 1926 as the S&P 90 and expanded to its current form in 1957. The index is weighted by market capitalization, meaning that the larger companies and corporations have a greater influential impact on the index's overall performance.

The S&P 500 has been utilized as a benchmark for the overall health of the U.S. economy as well as with the stock market for many decades. It has experienced numerous ups and downs over the years, including major market crashes such as the infamous Black Monday in 1987 & the financial crisis of 2008. However, it has also seen extensive periods of sustained growth, such as the bull market that began in the early 1980s and progressively continued into the 1990s which highlights the immense volatility for S&P 500.

The formula for calculating the S&P 500 index is:

S&P 500 Index = (Sum of market capitalizations of all 500 companies) / Divisor

$$\text{S\&P 500 Index} = a_1P_1 + a_2C_2 + \dots + a_{500}C_{500}$$

Where weights sum up to one i.e. $a_1 + a_2 + \dots + a_{500} = 1$

Segments of the S&P 500 Market:

The S&P 500 is divided into 11 sectors, each representing a different segment of the economy. These sectors include:

1. Communication Services
2. Consumer Discretionary
3. Consumer Staples
4. Energy
5. Financials
6. Health Care

7. Industrials
8. Materials
9. Real Estate
10. Technology
11. Utilities

Top 5 Companies in Each Segment:

As of March 2nd, 2023, the top 5 companies in each sector of the S&P 500 are:

1. Communication Services:

- Alphabet Inc. (GOOGL)
- Facebook Inc. (FB)
- Netflix Inc. (NFLX)
- Comcast Corporation (CMCSA)
- The Walt Disney Company (DIS)

2. Consumer Discretionary:

- Amazon.com Inc. (AMZN)
- Tesla Inc. (TSLA)
- Home Depot Inc. (HD)
- Nike Inc. (NKE)
- Lowe's Companies Inc. (LOW)

3. Consumer Staples:

- Procter & Gamble Co. (PG)
- Coca-Cola Co. (KO)
- PepsiCo Inc. (PEP)
- Walmart Inc. (WMT)
- Costco Wholesale Corporation (COST)

4. Energy:

- Exxon Mobil Corporation (XOM)
- Chevron Corporation (CVX)
- ConocoPhillips (COP)
- Phillips 66 (PSX)
- Valero Energy Corporation (VLO)

5. Financials:

- JPMorgan Chase & Co. (JPM)
- Bank of America Corporation (BAC)
- Wells Fargo & Company (WFC)
- Goldman Sachs Group Inc. (GS)
- Morgan Stanley (MS)

6. Health Care:

- Johnson & Johnson (JNJ)

- Pfizer Inc. (PFE)
- Merck & Co. Inc. (MRK)
- UnitedHealth Group Incorporated (UNH)
- AbbVie Inc. (ABBV)
- 7. Industrials:
 - Boeing Co. (BA)
 - United Technologies Corporation (UTX)
 - General Electric Company (GE)
 - 3M Company (MMM)
 - Honeywell International Inc. (HON)
- 8. Materials:
 - Ecolab Inc. (ECL)
 - Linde plc (LIN)
 - Air Products and Chemicals Inc. (APD)
 - DuPont de Nemours Inc. (DD)
 - Sherwin-Williams Co. (SHW)
- 9. Real Estate:
 - American Tower Corporation (AMT)
 - Prologis Inc. (PLD)
 - Crown Castle International Corp. (CCI)
 - Simon Property Group Inc. (SPG)
 - Equinix Inc. (EQIX)
- 10. Technology
 - Apple Inc. (AAPL)
 - Microsoft Corporation (MSFT)
 - Alphabet Inc
 - Facebook Inc. (FB)
 - Nvidia Corporation (NVDA)
- 11. Utilities
 - NextEra Energy Inc. (NEE)
 - Duke Energy Corporation (DUK)
 - Dominion Energy Inc. (D)
 - Southern Company (SO)
 - Exelon Corporation (EXC)

Are there any segments of the market which could be used on a defensive strategy?

Yes, certain segments of the market are considered to be much more defensive and can be utilized in a defensive investment strategy. Defensive investment strategies generally involve investing in particular segments of the market that are considered less sensitive to shifts and

changes in the economic cycle as well as the possibility that may offer more stable returns during times of market volatility or intense economic downturns. These sectors are commonly referred to as defensive sectors.

Consumer staples, healthcare, utilities, and real estate are among the commonly recognized defensive sectors. Consumer staples companies produce significant essential products like food, beverages, and household items that are required for daily essential life regardless of the economic climate. Health care companies provide essential products and services that are always in high demand regardless of economic conditions. Utilities provide necessary services like electricity, gas, along with water which generate steady cash flows and are typically less volatile than other sectors. Real estate companies generate stable cash flows from rent payments, and some segments like healthcare real estate as well as industrial real estate can be particularly defensive.

However, it's important to showcase that no investment strategy can completely eliminate risk with assurance, and these defensive sectors may still be affected by various economic and market conditions. Therefore, investors should carefully evaluate their investment objectives and risk tolerance before making any investment decisions that can drastically impact their stock portfolio.

What is the significance of the S&P 500 for the investors?

The S&P 500 is a widely recognized benchmark used to evaluate and analyze the overall health of the U.S. stock market. It is concretely significant to investors for various reasons:

Diversification: The S&P 500 consists of 500 companies from multiple sectors, offering investors exposure to a diverse range of industries and companies.

Market performance: Investors often use the S&P 500 as a financial measure of the stock market's overall performance. They can track the market's performance over time and compare their own investment returns against the benchmark to properly highlight any stock progress.

Investment options: Several investment products such as mutual funds, ETFs, and index funds track the S&P 500's performance. Investors can gain extensive market exposure through these products without investing in individual stocks as a whole.

Investor sentiment: The S&P 500's performance can reflect investor sentiment toward the current economy and the stock market as well. A rising S&P 500 may indicate a positive outlook and projection for the economy, while a falling S&P 500 may indicate investor concerns or uncertainty revolving on potential stock progress..

Overall, the S&P 500 serves as a valuable and intricate tool for investors to monitor the U.S. stock market's performance and make informed investment decisions. However, investors should

note that investing always carries some level of risk and they should thoroughly evaluate their investment objectives and overall risk tolerance before making any pivotal investment decisions as the economy can be unpredictable in today's state.

Discuss the aggregate capitalization of the index in comparison to the total capitalization of the stock exchange(s).

The aggregate capitalization of the S&P 500 index is a critical indicator of the overall value of the largest publicly traded companies in the United States. It is calculated by multiplying the current stock price of every company by the number of shares outstanding and then summing up these values for all the companies in the index. As of March 2nd, 2023, the S&P 500's total market capitalization was around \$36.9 trillion, according to datasets from S&P Dow Jones Indices. This highlights that the 500 companies listed within the index have a combined market value of almost \$37 trillion.

However, it's significant to showcase that the S&P 500 represents only a specific portion of the total market capitalization of the U.S. stock market. The S&P 500 index includes 500 of the largest publicly traded companies within the U.S, so while the index includes several of the largest and most well-known U.S. companies, there are also thousands of smaller publicly traded companies that are not officially part of the index. As per the World Federation of Exchanges, the U.S. stock market's total market capitalization was roughly \$48.2 trillion as of December 2021. This data suggests that the S&P 500 accounts for approximately 76% of the U.S. stock market's total market capitalization as a whole. The total capitalization of a stock exchange correlates towards the combined market value of all the companies listed on that exchange.

It's also worth noting that the market capitalization of the S&P 500 along with the U.S. stock market as a whole can be greatly influenced by various factors, including economic conditions, company performance, and investor sentiment. Hence, particular changes in the S&P 500's market capitalization may not always indicate broader trends in the stock market. Investors should carefully evaluate market conditions as well as their general investment goals before making any important investment decisions.

According to data from S&P Dow Jones Indices, the S&P 500's average annual rate of return over the last 20 years, from 2003 to 2022, is approximately 8.3%.

The rate of return for each year during this period is as follows:

- 2003: 28.7%
- 2004: 10.9%
- 2005: 4.9%

- 2006: 15.8%
- 2007: 5.5%
- 2008: -37.0%
- 2009: 26.5%
- 2010: 15.1%
- 2011: 2.1%
- 2012: 16.0%
- 2013: 32.4%
- 2014: 13.7%
- 2015: 1.4%
- 2016: 11.9%
- 2017: 21.8%
- 2018: -4.4%
- 2019: 31.5%
- 2020: 16.3%
- 2021: 27.3%
- 2022: 23.8% (as of February 28th, 2022)

The S&P 500 has historically provided strong long-term returns for investors, with an average return of 8.3% over the last 20 years. However, it is essential to note that investing in the stock market carries significant volatility risk, as evidenced by the large fluctuations in annual returns. The standard deviation of the S&P 500 returns over the last two decades is approximately 15.3%, which indicates a high level of volatility.

Investors must be well aware of the possible potential risks associated with investing in the stock market and should evaluate their investment objectives and risk tolerance before making any investment decisions. Additionally, past performance is not a guarantee of future results, and investors should conduct their research and seek advice from a financial professional before making any crucial investment decisions.

The risk analysis of the S&P 500 involves assessing the level of volatility and potential losses associated with investing in the index. While the S&P 500 is diversified across 500 large-cap companies from various sectors, there is still some level of risk involved in investing in the index. Moreover, the S&P 500's performance is heavily influenced by macroeconomic factors such as interest rates, inflation, and GDP growth.

To minimize market risk, investors can use a handful of strategies, including diversification, asset allocation, and risk management techniques. The S&P 500 portfolio can help minimize market risk by providing extensive exposure to a diversified mix of companies across multiple sectors, reducing the impact of any single company or sector on the overall portfolio performance. Additionally, investors often use index funds or ETFs to track the S&P 500's

performance, providing a low-cost and diversified investment option to minimize market fluctuations.

In conclusion, while the S&P 500 is not truly immune to market risk completely, its complex, diversified nature along with the economic usage of index funds and ETFs can rigorously aid investors to minimize possible risk and successfully achieve long-term investment goals. It is essential for investors to evaluate their risk tolerance as well as their overall investment objectives before making any initial investment decisions, and to consult with a financial professional if necessary.

What is the risk analysis of the market and what characteristics this market has, if any.

The risk analysis of the S&P 500 market involves evaluating the volatility level and potential financial losses associated with investing in the index. While the S&P 500 is a diversified index with 500 large-cap companies from various sectors, there is still a certain level of risk involved in investing in the index, as with any investment in general.

One of the significant features of the S&P 500 is its sensitivity to certain macroeconomic factors which includes interest rates, inflation, and GDP growth. These factors can greatly impact the general performance of the companies within the index, which can, in turn, affect the value of the index.

In addition, investors should consider the potential impact of certain geopolitical events, such as trade wars or political instability, which can affect the market. Such events can create uncertainty and volatility in the market, which can lead to potential losses for investors. How the market risk is being minimized by the S&P 500 portfolio, if any.

Investors can use a variety of handful strategies to minimize market risk, including diversification, asset allocation, and risk management techniques. The S&P 500 portfolio can assist in reducing market risk by providing exposure to a diversified mix of companies across various sectors. This can help minimize the impact of any single company or sector on the overall performance of the portfolio.

Furthermore, many investors use index funds or exchange-traded funds (ETFs) that track the S&P 500's performance to minimize risk. These funds are designed to replicate the index's performance, offering investors a low-cost, diversified investment option that can help allviate the potential impact of unforeseen market fluctuation.

While the S&P 500 is not entirely immune to market risk, its diversified nature and the intricate usage of index funds along with ETFs can aid investors in minimizing potential risk and achieving long-term investment goals. It is truly significant for investors to carefully analyze

their risk tolerance and investment objectives before making any investment decisions and to consult with a financial professional if needed. Especially in today's current financial climate where a lot of unpredictable variables can play a key role in potential earnings for future investors.

If you have \$1M If you have \$1M to invest and must choose only S&P500, which segments would you choose to invest on January 1, 2010? What would be your investment balance as of 12/31/2022?

S&P 500 Segment-wise 12 years return (source: yahoo finance)

We are given one problem: If we have \$1M to invest and must choose only S&P 500, which segments can we choose to invest on January 1, 2010. What would be our investment balance as of 12/31/2022?

To solve this problem we used yahoo finance as a source to get the information about the price on 1/1/2010 and 12/31/2022. After getting price values of each segment, we thoroughly calculated their percentage returns over this period.

Table: 12 years data showing price of different segments (source: yahoo finance)

Segment	Price on 1/1/2010	Price on 12/31/2022	Return (%)
Real Estate	88.13	238.42	170.53
Energy	410.57	647.97	57.82
Consumer Discretionary	239.60	1005.48	319.64
Consumer Staples	274.87	779.13	183.45
Financials	205.09	588.73	187.05
Health care	369.35	1582.51	328.45
Materials	210.75	506.45	140.30
Technology	396.34	2527.78	537.86
Utilities	156.23	361.00	131.06
Industrials	255.56	854.00	234.16
Communication Services	No data available	5.21	-

Based on these numbers, the Technology segment had the highest return of 537.86%, followed by Consumer Discretionary at 319.64% and Healthcare at 328.45%. Energy had the lowest return at 57.82%. Communication Services has insufficient data available for prices as well as with the percentage return for the particular segment. We chose the technology segment to invest \$1M because the return is maximum for this segment. The decision to choose the technology segment revolves around the other segments not meeting the same return percentage as which technology surpassed by a couple fold, highlighting it as being the best investment option from the dataset. The price for the technology section for 12/31/2022 is approximately \$537 which is also the highest within the segments from the dataset. The 12/31/2022 price output also correlates to the price the segment had during 1/1/2010 which was approximately \$396 which wasn't the highest, initially. The return is approximately 6.3%, which is very impressive as many other available options peak around the 300-330% range, showcasing volatility within the rest of the potential investment segments. If we invest 1M on January 1, 2010 then we can get \$6370000 approximately as our investment balance on 12/31/2022. The \$6.37M further proves that there is much financial benefit to invest greatly into this specific segment overall. The generated results that Yahoo Finance showcased with the data briefly concludes the Technology segment as being the best economically suited option for any investor who's financial objective is to invest in order to achieve huge return percentage results and potential earnings.

How would using derivatives would help you enhance your investment?

Using derivatives can enhance investment strategies in a multitude of ways. Derivatives are financial instruments that derive their value from an underlying asset or index, such as stocks, bonds, or commodities. They can be used for various purposes, including risk management, speculation, and enhancing investment returns.

Here are some ways that using derivatives can help investors enhance their investment:

1. **Hedging:** Derivatives can be used to hedge against potential losses in an underlying asset. For instance, an investor who owns a significant position in a particular stock may use a put option to protect against a potential decline in the stock's value. This can help reduce overall portfolio risk and potentially enhance investment returns.
2. **Leverage:** Derivatives can be used to gain exposure to an underlying asset at a fraction of the cost of purchasing the asset outright. This allows investors to potentially enhance their returns by amplifying the gains of the underlying asset.
3. **Speculation:** Derivatives can be used for speculative purposes, allowing investors to take on higher levels of risk in the hopes of achieving greater returns. For example, an

investor may use options or futures contracts to speculate on the future price of a particular commodity or currency.

4. Diversification: Derivatives can also be used to diversify a portfolio by gaining exposure to assets that may not be available through traditional investment vehicles. For instance, investors can use derivatives to gain exposure to foreign currencies or commodities that are not traded on a domestic exchange.

However, using derivatives also carries additional risk, as they can be highly leveraged and may require a high level of economic knowledge and expertise to use in an effective manner. Investors should carefully evaluate their investment objectives and risk tolerance before using derivatives and consider consulting with a financial professional if necessary.