Is the S&P 500 a True Reflection of the U.S. Economy?

The S&P 500 has officially closed out weekly trading at new all-time highs. It is now up nearly 8% for the year. We have watched this “broad” index battle to pass February highs over the past several weeks. It follows the tech-focused Nasdaq, which did so earlier in the summer and has continued to plow higher on an almost daily basis. The Dow Jones lags and is still well below its February highs.

So, why is it that the Dow is so out of line compared to the other two well-known gauges of stock market performance? The reason is very simple - and a bit concerning. I touched on it last week and will provide a little more insight this week. Each of these indices are market cap weighted, which means bigger companies make up a relatively larger share of the index price performance. Currently, the S&P 500 and Nasdaq contain all the big-name tech companies. These include Apple, Microsoft, Nextflix, Facebook, Amazon and more. The Dow, however, only contains Apple and Microsoft. It is this sliver of the economy that has resulted in the incredible rally we have seen in the stock market over the past five months. It is not the “stock market” that has performed so well, but rather a very few huge companies that account for the daily cheering on CNBC. That is what is concerning. The traditional bellwethers of the U.S. economy, many of which make up the old and stodgy Dow Jones 30, are not doing nearly as well. Unfortunately, these companies are a much better reflection of what is going on in the real economy as opposed to the tech sector alone, and big tech in particular. It is for this reason I have suggested that we need to see increased participation by other sectors and industries for the broad market to continue higher. While it may be argued that technology *is* the new economy and nothing else matters, let us not forget that same argument was made during the high times of the tech bubble in 1998-2000. We all know how that ended. Eventually, it comes home to roost that all of the other companies out there employ many people and their businesses have been financed by many banks. At some point the weakness elsewhere reaches an inflection point, income recedes, loans dry up, and people stop buying new iPhones and ordering clothes on Amazon Prime. Be cautious when people say it’s different this time.

Last week’s market commentary can be found here.

G. Chadd Mason
CEO, The Cabana Group

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