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COPYCAT PORTFOLIO BENCHMARKING—THE CASE AGAINST THE S&P 500

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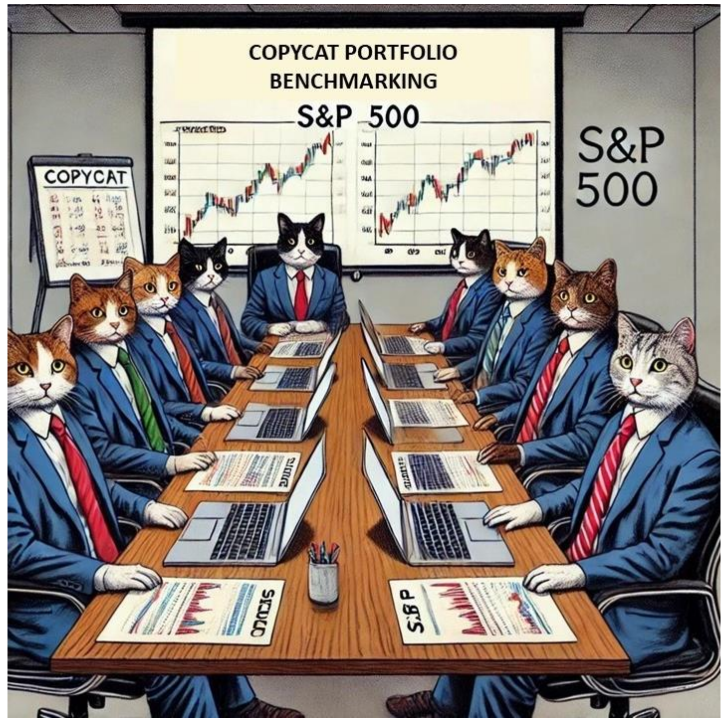

It's a massive 'Me-Too' movement: Envious investors, devoted 'Bogle-heads', and even hard-nosed institutional overseers champion using the S&P 500 as the benchmark of choice. And why not? In recent years, the index has outperformed, embarrassing scores of managers and investors.

So, all aboard then?!

Not so fast!

Representing nearly 80% of the US and 48% of the global stock market capitalization, the S&P 500 stands as the titan of benchmarks. Yet, alongside its impressive fair-weather performance the index has often resembled the Titanic—inevitably on a collision course with the next investment iceberg, as illustrated below:

S&P 500—Derailing Bear Market Exposure

The S&P 500 has been at the forefront of every major bear market, including the devastating drawdowns of 2008+ (-58%), 2000+ (-51%), 1974+ (-50%), 1937+ (-54%), and 1929+ (-86%). It has also endured generational-length downturns, such as the Great Depression (1929-1942), the Great Stagflation (1966-1982), and, more recently, the Lost Decade (2000-2009). These prolonged declines have derailed countless portfolios and left investors with a sense of financial trauma. Tracking the S&P 500 virtually guarantees significant portfolio losses when the next bear market inevitably arrives.

S&P 500—Narrow Focus and Periods of Relative Underperformance

The S&P 500 is only a US-focused, Large-cap, Growth-Oriented Index and is prone to long periods of underperformance relative to other assets. Consider these striking examples:

> From 2000 to 2008, the S&P 500 declined by -4.5%, while international equities gained +36.5%.
>
> Between 2000 and 2013, the S&P 500 grew just +64%, as Small Caps soared by +289%—ouch!
>
> Since 2000 Gold has outperformed the S&P 500 by a ratio of 1.48 : 1—quite embarrassing!

While the S&P 500 has dominated many asset classes in recent years, such trends are cyclical and mean-reverting, and it's unwise to be stuck on one side of them.

S&P 500—Unsustainable Shortfall Risk

Most importantly, and with apologies to Warren Buffett, far from being a racing horse, a portfolio is a workhorse designed to pay bills and meet funding goals on defined schedules. In this context, the S&P 500 falls short on sustainability:

Analyzing all rolling 30-year periods since 1900 (i.e. 1900-1929, 1901-1930, …,1995-2024), an S&P 500-tracking portfolio registers a 13% shortfall rate—the probability of prematurely running out of money—under a standard schedule of 5% annual inflation-adjusted disbursements. This significantly exceeds the desirable threshold of 5%.

For those who think rejecting the S&P 500 is merely sour grapes over an 'unbeatable' index, it's worth noting that there are many ways to outpace it. For example, since its introduction in 1985, the Nasdaq 100 has outpaced the S&P 500 by an annualized margin of +13.56% vs. +10.13%.

Data: YCharts, Bloomberg.

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the index proportionate to its market value. The Nasdaq 100 index is an unmanaged group of the 100 biggest companies listed on the NASDAQ Composite Index. The list is update quarterly and companies on this index are typically representative of technology-related industries, such as computer hardware and software products, telecommunications, biotechnology, and retail/wholesale trade.