JOPPA MILL ADVISORS LTD.

WHAT DOES ALL THE JARGON REALLY MEAN?

August, 2023

Many clients, when speaking with their Financial Advisor, simply nod in agreement as their trusted advisor rattles off a string of intelligent sounding acronyms or short-hand references in response to a simple question, " What do you think of the market?" So, to help with the translation, here is a short guide to many of the frequently used terms… and what your Advisor is actually saying. Now you can judge their narrative for yourself.

***What is "The Market*"** – Okay, let's define what we are talking about. Keeping this at a high level, in terms of the stock market, there are three main Indices:

The **Dow Jones Industrial Average -**First calculated on May 26, 1896, the DJIA includes only 30 large companies. It is price-weighted, unlike stock indices which use market capitalization, meaning the individual stock weights in the Index are predicated on their share price. (Higher priced stocks have a higher weighting).

The **Standard and Poor's 500**, or simply the **S&P 500**, tracks the stock performance of 500 of the largest companies listed on stock exchanges in the United States. The S&P 500 index is a capitalization-weighted index. As, *and* of 8/1/2023, the 10 largest stocks in the index based on their total market value (in descending order) were: *Apple, Microsoft, Amazon, Nvidia, Alphabet Class A, Tesla, Meta, Alphabet Class C, Berkshire Hathaway, United Health Group*. Combined, these 10 stocks represent 30.65% of the Index, with the Top 5 stocks accounting for 22.29% of the Index.[i]

The **Nasdaq Composite Index** was launched on Feb. 5, 1971. It also uses a market capitalization weighting methodology. The Nasdaq Composite Index includes all equity securities listed on the Nasdaq. The Nasdaq Composite includes the stocks of companies headquartered in the U.S. International companies that are listed on the Nasdaq are also included in the index, which is in contrast to the S&P 500 Index and the Dow Jones Industrial Average (DJIA) and is often seen as a stand-in for the technology sector, due to its heavy weighting in tech companies (55%, compared to the S&P 500's 28.3% tech weighting).[ii]

What does "Market Cap" mean; what are Small-Cap (or Mid-Cap) stocks; and why does it matter?

Market capitalization refers to the total value of a company. Market capitalization is calculated by multiplying the number of shares outstanding times the market price. Apple [AAPL] recently became the first company to cross the $3.0 trillion dollar market cap threshold. While there is no exact metric, broadly speaking market capitalization categories break down as follows:

Mega Cap	Over $200 billion
Large Cap	$10 billion to $200 billion
Mid Cap	$2 billion to $10 billion
Small Cap	$250 million to $2 billion
Micro Cap	Less than $250 million[iii]

In general, **larger capitalization** companies' business tend to be more established with more stable revenues, profits and cashflows. Companies that pay a dividend tend to be in this category. While considered more stable, their growth prospects may be somewhat lower because they are larger nd may have exploited the majority of their exponential growth stage of innovation in their industry.

Mid-cap companies often are well along the growth path to profitability with a proven business model. While they may be thought of as more established than small-cap companies, nevertheless, they face the challenge of disrupting larger, well-funded companies to realize their potential.

Smaller capitalization companies are seen as the more innovative, higher-growth potential. They are typically younger, with riskier, perhaps unproven, business models, including companies that are not yet profitable or experiencing negative cashflow.

Confused yet? Each of these capitalization categories is further bifurcated by "**Value**" and "**Growth**" metrics. The main difference between growth and value stocks is that value stocks are companies whom investors think are undervalued by the market either on the basis of earnings growth potential or their assets are worth more than the market value of the company. Growth stocks are companies that investors think will deliver better-than-average returns through the growth of sales and revenues. (A discussion of what sort of metrics are applied will be deferred for another day. Suffice it to say they are numerous!)

Why does any of this matter?

As one might expect, there is a relationship to how the economy is doing and stock prices, although it is far from linear or immediate! Certain sectors are deemed to be more economically sensitive; others more interest rate sensitive; and still others that are likely to be more resilient in the face of a weak economy (so called "defensive sectors".) For example, when the economy is booming, things like Industrials, Financials, Energy, and Information Technology generally perform better than other sectors such as Consumer Staples (think Proctor & Gamble, Kraft Heinz and Mondelez.) Conversely, when interest rates are rising, high growth companies, whose earnings are far in the future, and Financials, whose cost of funds is increasing typically sell-off while Consumer Staples stocks tend to be more resilient. Regardless of the economy, consumers always need to purchase essentials such as household goods, food, soap, etc.

Depending upon the outlook for the economy and for interest rates, certain sectors tend to lead the charge or lag behind. Applying this to our "matrix" of the market:

- During strong economic growth periods, when Industrials, Information Technology and Consumer discretionary stocks are doing well, a rising tide lifts all boats!
- Large Cap companies enjoy growing revenues and profits, while Small Cap stocks, who have greater capital needs to expand their business also tend to do well.
- This is an environment that benefits Growth stocks.

On the other hand, when economic growth is slowing with the potential for job losses to rise, Growth hits the brakes and Value stocks tend to outperform (i.e., traditional Healthcare stocks as compared to Biotech names.)

It is important to realize that the Large, Mid, and Small cap Indices have vastly different sector weightings that can lead to materially different sector exposures, and therefore, investment returns. Let's compare several of the largest sectors in each capitalization-oriented index:

	S&P 500	S&P Mid-Cap 400	S&P Small Cap 600
Information Technology	28%	14%	20%
Healthcare	14%	9%	11%
Financials	12%	14%	20%
Consumer Discretionary	11%	14%	15%
Communications Services	9%	2%	1%
Industrials	8%	19%	15%
Consumer Staples	7%	4%	4%

Note that I have added shading to denote the tendency for each of these sectors to be considered "Value (green) or "Growth" (yellow). Healthcare and Communication Services are considered to contain elements of both attributes, referred to as a "blend" Note, these are generalizations only! Exceptions always exist!

To summarize the implications for your portfolio, during periods of strong economic growth and low interest rates, the larger weightings to Information Technology in the S&P 500 and to Information Technology and Industrials in the Small- and Mid-Cap Index would benefit your portfolio.

In a rising rate/slowing economy scenario, the large weightings in Information Technology, Financials, and Industrials in the Small-Cap Index would be detrimental.

So, the next time your Financial Professional starts telling you how your portfolio is positioned, see if their narrative is consistent with the portfolio's positions. No one can predict the markets, but one can incorporate specific exposures to sectors or market capitalizations that are consistent with your investment objectives, providing important diversification benefits.

---

[i] https://www.usatoday.com/money/blueprint/investing/s-and-p-companies-by-weight/
[ii] https://www.investopedia.com/terms/n/nasdaqcompositeindex.asp.
https://www.usbank.com/investing/financial-perspectives/market-news/investing-in-tech-stocks.html
[iii] https://www.finra.org/investors/insights/market-cap#:~:text=large%2Dcap%3A%20market%20value%20between,of%20less%20than%20%24250%20million.