S&P Dow Jones Indices

A Division of S&P Global

EDUCATION
Indexing 101

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Why Does the S&P 500® Matter to Australia?

The S&P 500 is regarded by many as the most well-known and most frequently used benchmark of U.S. large-cap equities. The index includes 500 leading companies and captures approximately 80% coverage of investable market capitalization in the U.S. equity market. As of year-end 2013, over USD 7 trillion was benchmarked to the S&P 500 alone, with indexed assets making up USD 1.9 trillion of this total.[1] Exchange traded products of the S&P 500 have been cross-listed in various markets across the globe, but what creates the international appetite for U.S. equities, especially the S&P 500?

In this paper, we will:

- Compare the S&P 500 to the leading large-cap equity benchmark in Australia
- Explore the significance of the S&P 500 in the global equity market
- Compare S&P 500 performance to that of active U.S. large-cap funds

COMPARISON OF THE S&P 500 AND THE S&P/ASX 200

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The S&P 500 and the S&P/ASX 200 are well-known, large-cap equity benchmarks in the U.S. and Australian markets. Both indices represent about 80% of the total market capitalization and comprise the largest and most-liquid stocks of their respective markets. However, they differ significantly due to the different economic landscapes and financial market developments they reflect.

The S&P 500 is highly diversified among sectors, with no single sector dominating more than 20% of the index. Information technology (I.T.) is the biggest sector, accounting for 19% of the index. The financials and healthcare sectors are the other two biggest sectors, representing 16% and 13% of the S&P 500, respectively. The S&P/ASX 200 is highly concentrated in the financials sector, which dominates 45% of the index. Materials is the second-biggest sector with a weight of 17%.

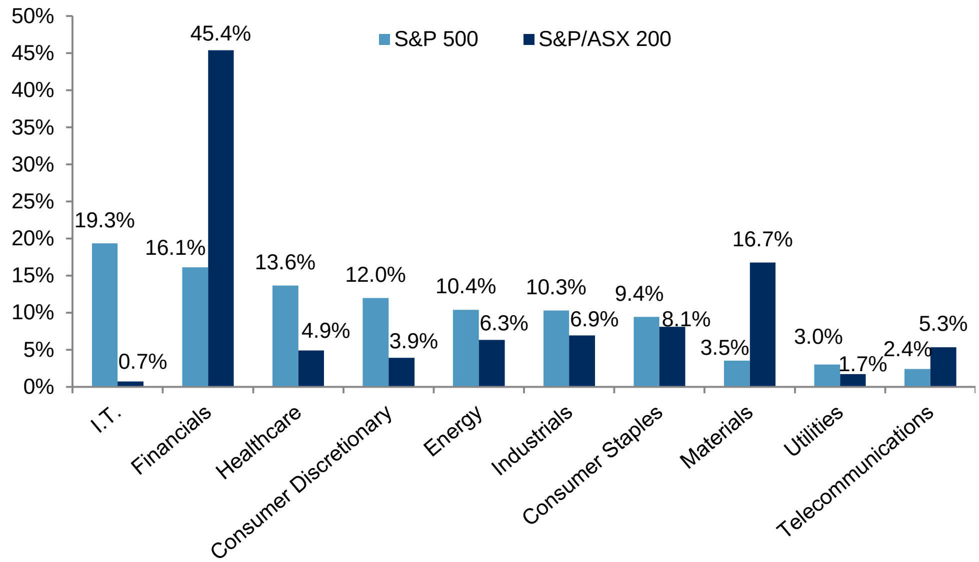
Compared to the S&P/ASX 200, the S&P 500 has significantly higher weighting in the I.T. and healthcare sectors. Some of the biggest I.T.

[1] Each year, S&P Dow Jones Indices conducts a survey to estimate the total assets directly linked to its indices. For the complete report, please see the "S&P DJI Annual Survey of Indexed Assets 2013."

names, such as Apple, Microsoft and Google, are global leaders in the tech hardware, software and internet services industries. These companies represent more than 30% of the S&P 500's I.T. sector and more than 22% of the S&P Global BMI's[2] I.T. sector. In the healthcare sector of the S&P 500, the three biggest companies are Johnson & Johnson, Pfizer and Merck, which are worldwide providers of healthcare and pharmaceutical products. These companies dominate more than 25% of the S&P 500's healthcare sector and around 14% of the S&P Global BMI's healthcare sector.

The S&P 500 is highly liquid and almost all index members have an average daily value traded above USD 20 million, whereas in the S&P/ASX 200, only 38 stocks are have an average daily value traded above USD 20 million.

Exhibit 1: Sector Weighting of the S&P 500 Versus the S&P/ASX 200



Source: S&P Dow Jones Indices LLC. Data as of Aug. 31, 2014. Chart is provided for illustrative purposes.

Compared to the S&P/ASX 200, the S&P 500 has much higher stock diversification and its members are significantly more liquid. The 10 largest S&P 500 stocks represent only 18% of the index and the largest stock, Apple, has a weight of just 3.5%. In contrast, the 10 largest stocks in the S&P/ASX 200 dominate 55% of the index and the largest stock, Commonwealth Bank Australia, carries a stock weight as high as 9.5%. The S&P 500 is highly liquid and almost all index members have an average daily value traded above USD 20 million, whereas in the S&P/ASX 200, only 38 stocks have an average daily value traded above USD 20 million.

[2] The S&P Global BMI (Broad Market Index), which includes more than 10,000 global investable stocks, is designed to measure the performance of the global equity market.

Exhibit 2: Top 10 Index Members in the S&P 500 and the S&P/ASX 200

S&P 500 STOCKS	WEIGHT (%)	S&P/ASX 200 STOCKS	WEIGHT (%)
Apple Inc.	3.5	Commonwealth Bank Australia	9.5
Exxon Mobil Corp.	2.4	BHP Billiton Ltd.	8.5
Microsoft Corp.	1.9	Westpac Banking Corp.	7.8
Johnson & Johnson	1.6	ANZ Banking Group	6.6
General Electric Co.	1.5	National Australia Bank Ltd.	5.9
Wells Fargo & Co.	1.4	Telstra Corp Ltd.	5.0
Chevron Corp.	1.4	Wesfarmers Ltd.	3.7
Berkshire Hathaway Inc. B	1.4	Woolworths Ltd.	3.3
Procter & Gamble	1.3	CSL Ltd.	2.6
JP Morgan Chase & Co.	1.3	Woodside Petroleum Ltd.	2.2
Total weight of top 10 stocks	17.6	Total weight of top 10 stocks	55.1

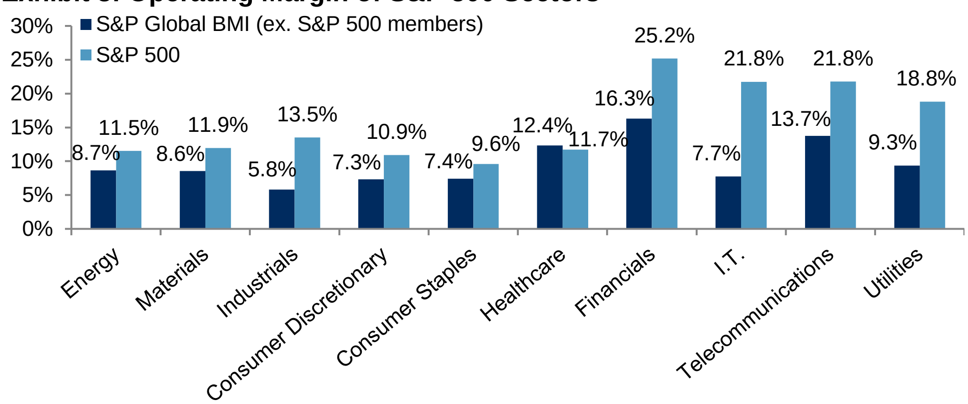
Source: S&P Dow Jones Indices LLC. Data as of Aug. 31, 2014. Table is provided for illustrative purposes. Past performance is no guarantee of future results.

SIGNIFICANCE OF THE S&P 500 IN THE GLOBAL EQUITY MARKET

Because many S&P 500 members are global industry leaders and produce in large quantities, they usually have higher negotiation power with suppliers, which can lower their operating costs.

Because many stocks in the S&P 500 are leading global companies, they represent a significant part of global equity market capitalization, revenue and earnings. S&P 500 companies represent 37% of the total market capitalization of the S&P Global BMI. Among the 100 largest stocks in the S&P Global BMI, 61 of them are S&P 500 members. In 2013, the S&P 500 generated more than 22% of corporate revenue and 31% of corporate earnings for the S&P Global BMI. We have also observed that in most sectors, S&P 500 companies have delivered higher operating margins than their global sector peers, especially in the I.T. sector, with a spread of 14%.

Exhibit 3: Operating Margin of S&P 500 Sectors



Source: S&P Dow Jones Indices LLC, Worldscope, Factset. Data as of Aug. 31, 2014. Figures based on company reported operating income and revenue in FY2013. Chart is provided for illustrative purposes. Past performance is no guarantee of future results.

Because many S&P 500 members are global industry leaders and produce in large quantities, they usually have higher negotiation power with suppliers, which can lower their operating costs. On the other hand, the brand power of these companies helps them to sell their products at premium prices and maintain higher margins.[3] Based on the Best Global Brand 2013 report published by the worldwide brand consultant Interbrand, 53 out of the top 100 global brands are members or are owned by members of the S&P 500.[4] These brands scored well on the valuation-based competitive strength of the brand, the role the brand plays in the purchase decision and the financial performance of the branded products or services. Apple, Google, Coca-Cola, IBM, Microsoft, GE, McDonald's and Intel are 8 of the top 10 global brands.

The S&P 500 outperformed more than 60% of active U.S. large-cap funds in the past one-year period ending June 2014.

Exhibit 4: Global Brands in the S&P 500

GLOBAL RANKING	BRAND	COMPANY/PARENT COMPANY IN THE S&P 500	GLOBAL RANKING	BRAND	COMPANY/PARENT COMPANY IN THE S&P 500
1	Apple	Apple Inc.	19	Amazon	Amazon.com Inc.
2	Google	Google Inc.	22	Pepsi	PepsiCo Inc.
3	Coca-Cola	Coca-Cola Co.	23	American Express	American Express Co.
4	IBM	Intl Business Machines Corp.	24	Nike	NIKE Inc.
5	Microsoft	Microsoft Corp.	27	UPS	United Parcel Service Inc.
6	GE	General Electric Co.	28	eBay	eBay Inc.
7	McDonald's	McDonald's Corp.	29	Pampers	Procter & Gamble
9	Intel	Intel Corp.	30	Kellogg	Kellogg Co.
13	Disney	Walt Disney Co.	33	JPMorgan	JPMorgan Chase & Co.
14	Cisco	Cisco Systems Inc.	41	Accenture	Accenture Plc.
15	HP	Hewlett-Packard Co.	42	Ford	Ford Motor Co.
16	Gillette	Procter & Gamble	44	Goldman Sachs	Goldman Sachs Group Inc.
18	Oracle	Oracle Corp.	48	Citigroup	Citigroup Inc.
50	Colgate	Colgate-Palmolive Co.	80	John Deere	Deere & Co.
52	Facebook	Facebook Inc.	81	Johnson & Johnson	Johnson & Johnson
53	Heinz	Berkshire Hathaway*	85	Duracell	Procter & Gamble
58	Caterpillar	Caterpillar Inc.	86	Jack Daniel's	Brown-Forman Corp.
62	Xerox	Xerox Corp.	87	AVON	Avon Products
66	KFC	Yum! Brands Inc.	88	Ralph Lauren	Ralph Lauren Corp.
69	Sprite	Coca-Cola Co.	89	Chevrolet	General Motors Company
70	Discovery	Discovery Communications Inc.	90	Kleenex	Kimberly-Clark
71	Morgan Stanley	Morgan Stanley	91	Starbucks	Starbucks Corp.
74	VISA	Visa Inc.	94	Pizza Hut	Yum! Brands Inc.
75	Tiffany	Tiffany & Co.	96	Harley-Davidson	Harley-Davidson Inc.
76	3M	3M Co.	97	Mastercard	Mastercard Inc.
78	MTV	Viacom Inc.	100	GAP	Gap Inc.
79	Adobe	Adobe Systems Inc.			

Source: S&P Dow Jones Indices LLC, Interbrand (www.interbrand.com/en/best-global-brands/2013/top-100-list-view.aspx). Table is provided for illustrative purposes.

[3] For more details, please see the article "America's Most Profitable Products" by Thomas C. Frohlich and Alexander E.M. Hess.

[4] For methodology and complete list of the 100 best global brands, please see www.interbrand.com/en/best-global-brands/2013/Best-Global-Brands-2013.aspx.

PERFORMANCE OF THE S&P 500 VERSUS ACTIVE U.S. LARGE-CAP FUNDS

Investing in the U.S. equity market can be done via the use of active fund managers or index-linked products, which track the returns of the underlying index. Twice a year, S&P Dow Jones Indices releases the SPIVA® Scorecard, which tracks the number of actively managed mutual funds that beat their comparable benchmarks over different timeframes.[5]

The mid-year 2014 SPIVA U.S. Scorecard showed that the S&P 500 outperformed more than 60% of active U.S. large-cap funds in the past one-year period ending June 2014. Performance of active U.S. large-cap funds looks even more unfavorable for longer investment periods, as 85% and 87% of them underperformed the S&P 500 over the three- and five-year periods, respectively. The returns of the S&P 500 also exceed the average returns of active U.S. large-cap funds on both an equal- and asset-weighted basis. This result indicates index-based investing may be a viable complement or substitute to actively managed investments in the U.S. equity market.

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Exhibit 5: Annualized Performance of Active U.S. Large-Cap Funds and the S&P 500; Percentage of Active U.S. Large-Cap Funds Outperformed by the S&P 500

CATEGORY	1-YEAR (%)	3-YEAR (%)	5-YEAR (%)
S&P 500	24.62	16.58	18.83
Active U.S. Large-Cap Funds (Equal-Weighted Average)	23.69	14.48	16.99
Active U.S. Large-Cap Funds (Asset-Weighted Average)	24.16	15.1	17.34
Percentage of Active U.S. Large-Cap Funds Outperformed by the S&P 500	**59.78**	**84.94**	**86.94**

Source: S&P Dow Jones Indices LLC. Data as of June 2014, as reported in the SPIVA U.S. Scorecard Mid-Year 2014. Past performance is no guarantee of future results. Table is provided for illustrative purposes. It is not possible to invest directly in an index, and index performance returns do not reflect the expenses an investor would pay to replicate the index.

CONCLUSION

The S&P 500 and the S&P/ASX 200 are well-known, large-cap equity benchmarks in the U.S. and Australian markets, and both of them comprise the largest and most-liquid stocks of their respective markets. However, apart from having higher weightings in the I.T. and healthcare sectors, the S&P 500 has much higher stock diversification and its members are significantly more liquid compared to the S&P/ASX 200.

The members of the S&P 500 are not only the largest companies in the U.S., but many of them are leading global companies that represent a significant share of global equity market capitalization, revenue and earnings. These companies delivered higher operating margins than their global peers in most sectors in 2013, and more than half of the top brands across the globe are members or are owned by members of the S&P 500.

[5] For the complete analysis on U.S. active funds versus S&P U.S benchmark returns, please see www.spindices.com/documents/spiva/spiva-us-mid-year-2014.pdf.

Additionally, the majority of active U.S. large-cap funds were outperformed by the S&P 500 over one-, three- and five-year periods, indicating that index-based investing may be a viable complement or substitute to actively managed investments in the U.S. equity market.

All of these factors drive international appetite for the S&P 500, and as a result, there has been an increasing number of S&P 500 exchange traded products listed in various markets across the globe.

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