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Delta manages portfolios at TD Ameritrade and Schwab.  
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December 24, 2020

### Passive Expansion

In 1992, Vanguard launched its Total Stock Market Index (VITSMX) fund. At the end of its first year, it had \$512 million of assets. Today, assets exceed \$1 trillion. Passive mutual funds and Exchange Traded Funds (ETFs) now represent about half of the stock market. At the end of last year, there were roughly 6,970 ETFs and 7,945 mutual funds (not all of these funds are passive) versus roughly 3,670 public companies (U.S. stocks).

One may wonder, is the tail wagging the dog? Are passive index funds causing individual stocks to appreciate and depreciate in some manner that is not tied to company specific fundamentals?

Since S & P Dow Jones announced Tesla (TSLA) would be added to the S&P 500 index in mid-November until the day it was added this week (12/21), the stock advanced by ~70%. Passive S&P 500 index funds are required to buy Tesla. This was most evident on Friday, December 18 as volume spiked higher and the stock closed at \$695/share. The higher the stock rose, the larger the market cap, the bigger its share of the S&P 500 and the more passive index funds had to buy. This is a powerful feedback loop that is not tied to company fundamentals. The feedback loop works in both directions.



Tesla is 1.58% of the S&P 500 index, the seventh largest component, just ahead of Berkshire Hathaway. TSLA has a current Price/Earnings (P/E) multiple of 1,269x versus Berkshire's P/E of 25x. TSLA makes Amazon (AMZN) look cheap with its P/E of only 94x.

Tesla is a volatile stock. It has a beta of 2.15. This means that when the S&P 500 moves up or down by 1%, TSLA typically has moved up or down more than twice as much over the past five years. Its addition to the S&P 500 makes the index slightly more volatile. Passive funds helped turn TSLA into a "monster" stock that will have an outsized impact on the S&P 500. Viewed in this light, passive funds do not appear to be entirely passive.

The history of the Vanguard Total Stock Market Index (VITSX) suggests that over long-periods of time, passive investing has worked well as funds follow performance. In 1992, there were almost no passive index funds and zero exchange traded funds which were not invented until 1993. All ETFs combined did not reach \$1 trillion AUM until 2010. Today, ETF AUM is over \$4 trillion.

But now, with half of the stock market passively invested, the better opportunity may be in active investing. This may be especially true if passive investors cause the market to overshoot higher or lower. The depth of the next bear market may be exacerbated by passive selling pressure. Having an active manager help avoid a passive overshoot may be more important today than ever. Delta has expertise in mitigating the risk of major down markets. Combining the best-ideas and risk mitigated strategies may add robustness and safety to your portfolio.

Have a great holiday.

### **Let Us Help You Position for 2021 – Give Us a Call Today**

Give us a call or send an email if you would like to schedule an annual account review. If you do not currently have an investment account with Delta, we invite you to contact us to schedule your free portfolio review.

We have unique and sophisticated investment methods that seek to capture the stock market's gains while minimizing drawdowns in bear markets. If you would like to learn more about how we manage money, we invite you to give us a call at **(415) 249-6337**, visit [www.deltaim.com](http://www.deltaim.com) or email us at [info@deltaim.com](mailto:info@deltaim.com).



*"So where do you see yourself in five months?"*

## Delta Stock Market Dashboard

MARKET SENTIMENT IS

**BULLISH**

THIS WEEK'S NUMBER IS

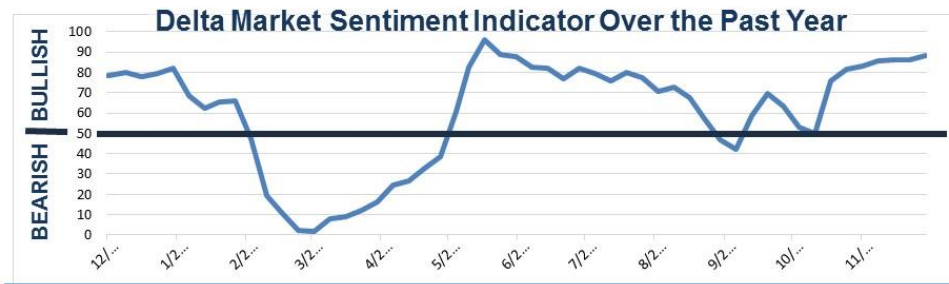
**88.3**

Our technical indicator increased  
from 86.3 to 88.3 this week

### INDICATOR STATISTICS

Consecutive Bullish Weeks:	12
Cycle Inception Date:	10/8/2020
Range:	58.6 – 88.3
Mean:	73.4
Bullish Weeks YTD:	36
Bearish Weeks YTD:	15
*S&P 500	7.5%
*DJIA	6.4%
*NASDAQ	12.3%

\* Percentage change during current cycle



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