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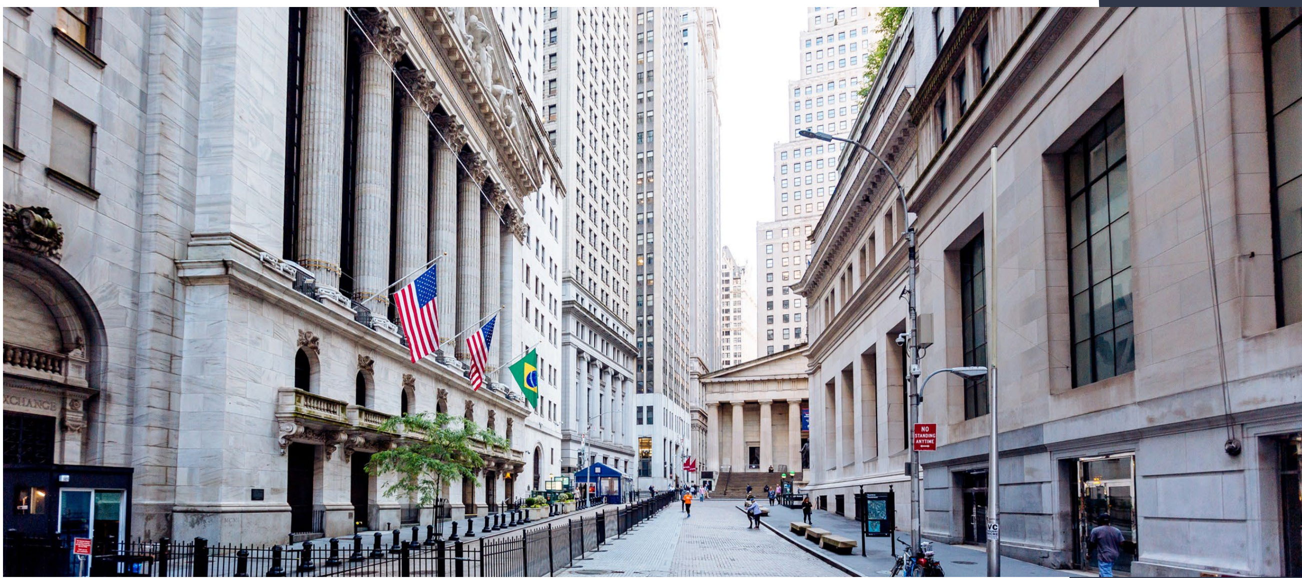
We Can Be Heroes



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Last week, the US chip-designer Nvidia became the largest company in the world, based on market capitalisation. It only maintained this status for one day - hence the reference to David Bowie's song Heroes - before ceding the crown back to Microsoft, which itself has been swapping positions with Apple for a while.

In gaining the top spot, Nvidia became just the twelfth company in the last century to be the biggest in the US stock market. It is a select group and includes, in addition to Microsoft and Apple, some well-known names such as the phone company AT&T, oil giant Exxon, large manufacturers General Motors and General Electric, supermarket Walmart and the chemical company DuPont (although today it describes itself as a provider of technology-based materials and solutions).

One of the pioneers of computer technology, IBM, was once the top dog, but now fails to make it into the top 50. An interesting reflection on how the world used to be is encapsulated in the presence of Philip Morris on the list. The maker of Marlboro cigarettes is just behind IBM these days in terms of size, although its focus has shifted to "working to deliver a smoke-free future and evolving its portfolio [...] to include products outside of the tobacco and nicotine sector". Such is corporate evolution, even if the name on the door stays the same.

The one I haven't mentioned so far is Cisco Systems, a technology company responsible for providing a lot of the "plumbing" for the internet capex boom in the late 1990s and early 2000s. It reached its peak coincident with that of the technology bubble in late March 2000. I'm not sure exactly how many days it held the number one slot, but suffice to say, its shares had already lost a third of their peak value before the end of May and bottomed out in October 2003 having lost 89%. Word has it that some of the kit they sold is still sitting under the ground having never been used! Its share price remains more than 40% below its peak, and, because it hasn't paid out a huge amount of dividends, it can't even claim to be in positive territory on a total return basis.

One initial observation on these companies is the migration of the winners towards technology (although, to be fair, cars and landline phone networks could have been deemed to be the "high tech" industries of their era). It seems improbable that we will once again see a maker of low/no-tech "stuff" leading the pack given the way the world and consumption patterns are developing. The current main contender might be Warren Buffett's Berkshire Hathaway, but it is a conglomerate, whose biggest economic interests are its insurance business and its stake in Apple.

Another is Eli Lilly, the pharmaceutical company. Its recent run of form, with the shares roughly doubling in the last year, comes on the back of its appetite suppressing drugs, a boom that has also been exploited by Novo Nordisk in Europe. Just outside the current top 10 is Tesla. It is best known for manufacturing electric cars (and the sometimes erratic behaviour of its Chief Executive, Elon Musk), but bulls of the stock point more towards its vast bank of data related to autonomous driving and its potential to be the software company behind fully self-driving vehicles.

Away from the United States, the main contender (and erstwhile world's largest company) is Saudi Aramco, the petrostate's oil company, which is now partially listed, but with just a 2.5% free float. It would rank 7th in the S&P 500 today, sandwiched between Amazon and Meta. Unfortunately, the circumstances in which Aramco could become the world's biggest company again would probably be unappetising for investors. They might include a big spike up in the oil price, possibly as the result of some major geopolitical upset and a substantial derating for the companies currently ahead of it.

To be clear, none of this commentary on individual companies constitutes an investment recommendation, because I am forbidden from making those.

Related to Nvidia's success has been a burgeoning debate about the concentration of leadership in the US (and by extension global) equity market. I have written plenty about the exceptionalism of the Magnificent 7 stocks (Microsoft, Apple, Nvidia, Alphabet, Amazon, Meta and Tesla) in previous commentaries, and I note that Bloomberg has listed a new sub-index created by UBS called the S&P 500 ex-Magnificent 7. This serves to illustrate the performance difference between the two groups.

If we look at the pecking order year-to-date, we see the Mag 7 on top with a total return of 35% (!). The S&P 500 (of which the Mag 7 comprises 32%) is +15.4%, while the S&P 500 ex-Mag 7 is + 8.6%. But I also note that the equal-weighted S&P 500 (in which every stock has a weight of 0.2% whatever its size) is +5.5%, which tells me that there are few other companies helping with the heavy lifting. These are Eli Lilly (+52%), Broadcom (another Artificial Intelligence-related name, +49%), Walmart (at last, an "old-school" supermarket, +30%) and even the venerable bank, JP Morgan (+17%).

This spurs a different conversation. Are the top 10 (and a few more) stocks in the US becoming too influential? The top 10 account for about 37% of the S&P 500 market capitalisation. This, in fact, compares to around 50% in the UK, but the contribution to world indices is much bigger in the US. Indeed, Microsoft, Apple and Nvidia are all individually larger than the whole of the UK stock market! Does that lead to less diversification in portfolios as more money crowds into index funds, driving up the biggest constituents? There is no doubt that the portfolio risk of an individual stock "blowing up" is rising. There is also further risk in the fact that many of these companies are involved in the development of AI, and so their performance is becoming more correlated. Perhaps if one slips up, they all do.

In that case, it would be incumbent upon the "rest" to provide a counterbalance in portfolios. That certainly didn't happen in 2000, when the S&P 500 fell 50% from its peak to the trough in 2003, although there were plenty of shares that went up during the period, especially some of the more boring "old economy" stocks that were judged to represent no more than the "opportunity cost" of investing in the go-go stuff. However, we continue to point out that today's market leaders are far more profitable than those of 2000 and that they are far more embedded in our daily lives than they were back then. Furthermore, for all the talk of higher valuations, they are nowhere near as egregious as then either. And we haven't found sufficient academic evidence to suggest that market concentration per se is bound to lead to an immediate reversal. Where would you draw the line anyway?

That's not to say there won't be some disappointments ahead, but we struggle to see the bottom falling out of this group of leaders in the absence of some extraordinary shock. We can see them pausing for breath at some point and acknowledge that they can't keep rerating higher forever, a factor that has been at least partly responsible for the latest run of performance. Maybe if that pause comes at a time when the interest rate environment is becoming more benign, we could see a resurgence in smaller companies and other value stocks.

My stock response when asked about our attitude towards AI is that it is a potentially world-changing development, and we are definitely not going to bet against it – and thank goodness we have not.

Economic Commentary

FTSE 100 weekly winners

Flutter Entertainment Plc	8.9%
Hargreaves Lansdown plc	7.8%
Phoenix Group Holdings plc	7.4%
ITV PLC	6.1%
Abrdn plc	5.8%
St. James's Place Plc	5.4%
JD Sports Fashion Plc	4.4%

FTSE 100 weekly losers

Ocado Group PLC	-12.8%
Berkeley Group Holdings plc	-6.0%
Persimmon Plc	-4.5%
Melrose Industries PLC	-4.4%
British Land Company PLC	-3.2%
Barratt Developments PLC	-3.0%
Ferguson Plc	-2.9%

FTSE 100 index, past 12 months

EuroStoxx 600 index, past 12 months

S&P 500 index, past 12 months

All data shown in GBP.

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