Cue the Camouflage

The S&P 500 is up 6.5% this year. That's a total return number, and given what is going on out there, it's pretty impressive. On December 31, 2019, if someone had told you a once-in-a-century world-wide pandemic would grind global economies to a coordinated halt, you probably wouldn't have guessed the market would be up.[1]

Europe is not doing nearly as well. Why not? Well, there are a few reasons, but one of the biggest is it doesn't have Facebook, Apple, Amazon, Microsoft, and Google. The MSCI Europe is down nearly 11%. Europe doesn't have the FAAMGs.

And the US is doing well because it does.[i]

In his Irrelevant Investor blog, Michael Batnick of Ritholtz Wealth had a nice post[2] about how large-cap names in the S&P 500 were much closer to their 52-week highs than small-cap names. It got us thinking about the size effect, and the relative impact (or not) of performance of each size decile, and the influence (or not) of the constituents within them; specifically these tech winners that sit in the decile of the largest cap names.

To help illuminate it all, we went back to the beginning of the year, and broke the S&P constituents into ten deciles, from smallest to largest market caps. We then further broke the largest five securities out of the top (10^{th}) size decile into their own group. This new 11^{th} group consisted of Apple, Microsoft, Amazon, Google, and Facebook.

We walked each decile forward to see how each group has performed YTD.

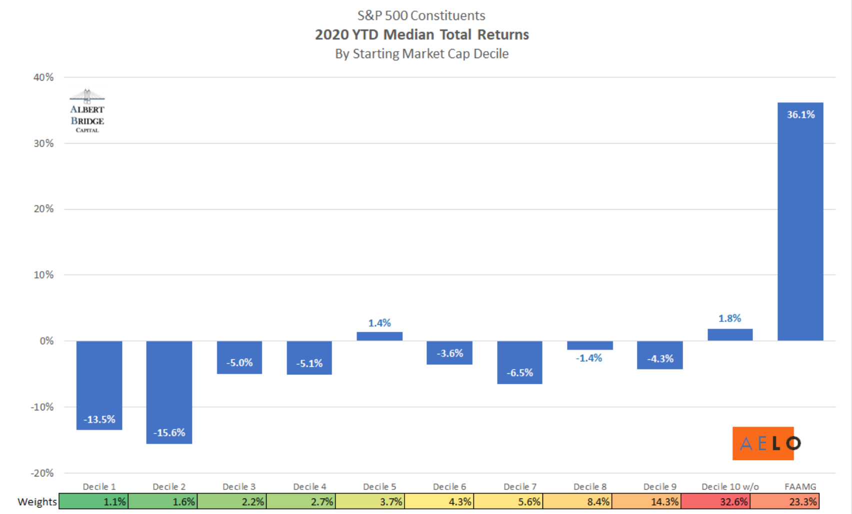
The results were astounding.

	Decile 1	Decile 2	Decile 3	Decile 4	Decile 5	Decile 6	Decile 7	Decile 8	Decile 9	Decile 10 w/o	FAAMG
Weights	1.1%	1.6%	2.2%	2.7%	3.7%	4.3%	5.6%	8.4%	14.3%	32.6%	23.3%
Low Cap	$4,374	$9,423	$12,253	$14,697	$19,097	$23,593	$30,082	$43,165	$63,127	$121,960	$584,719
Avg. Cap	$7,572	$10,725	$13,594	$16,783	$21,335	$26,758	$35,740	$50,500	$84,961	$211,087	$969,862
Median	$7,717	$10,785	$13,625	$16,769	$21,445	$26,523	$36,092	$49,525	$78,581	$184,628	$925,564
High Cap	$0	$12,234	$14,649	$19,049	$23,412	$30,069	$42,981	$62,609	$121,296	$540,917	$1,246,923

[1] *As of Friday, August 21, 2020*
[2] *https://theirrelevantinvestor.com/2020/08/20/the-other-94/*

I mean, we knew that the winners had really been winning, and by all accounts, they are all tremendous, game-changing, high-quality businesses. However these FAAMGs are not just outperforming the other 495 securities in the index, they are *slaughtering* them.[ii]

And it isn't an average-effect thing. Here is the same data using median market caps.



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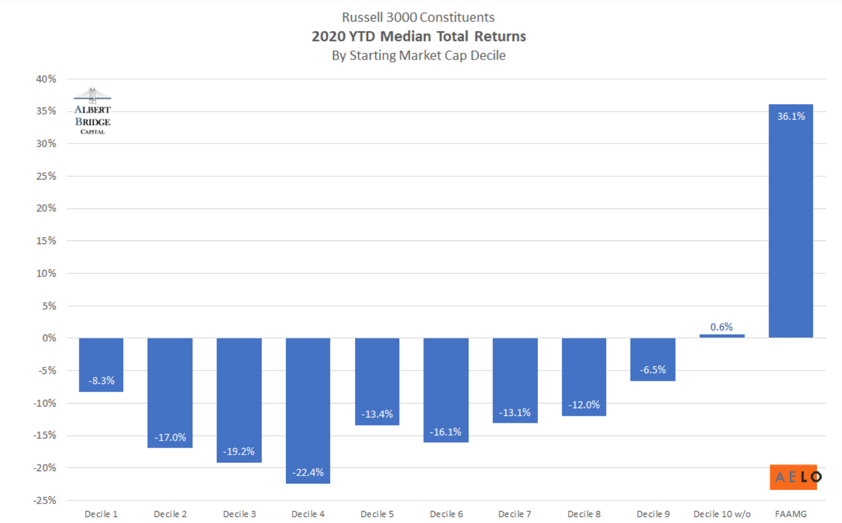
We also observed the relative underperformance of the smallest size deciles. But given that the very smallest company in the S&P 500 started the year with a $4.4 billion cap, we thought we'd do a deeper dive into the Russell 3000 to see what the FAAMG and size effect looked like as we moved into proper small and micro-cap land.

This one blew us away too.



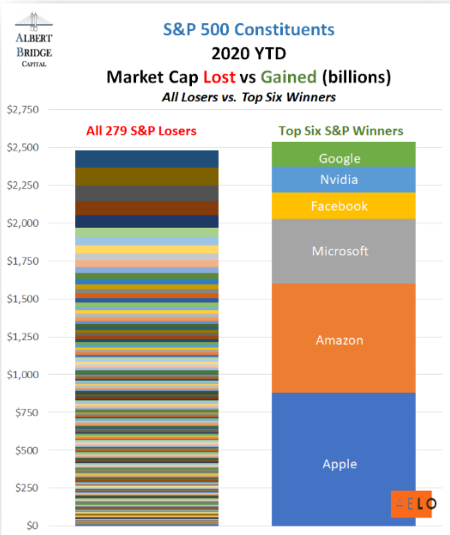
	Decile 1	Decile 2	Decile 3	Decile 4	Decile 5	Decile 6	Decile 7	Decile 8	Decile 9	Decile 10 w/o	FAAMG
Low Cap	$12	$242	$426	$743	$1,172	$1,880	$2,853	$4,613	$8,796	$21,766	$584,719
Avg. Cap	$167	$330	$569	$927	$1,495	$2,332	$3,643	$6,355	$13,580	$71,803	$969,862
Median	$174	$329	$563	$913	$1,481	$2,329	$3,621	$6,215	$12,978	$43,748	$925,564
High Cap	$241	$425	$741	$1,170	$1,868	$2,851	$4,613	$8,770	$21,680	$540,917	$1,246,923

Not only do the FAAMGs dominate the Russell 3000, the "size effect" started recovering a bit as we moved below a billion in market cap. We didn't expect that.

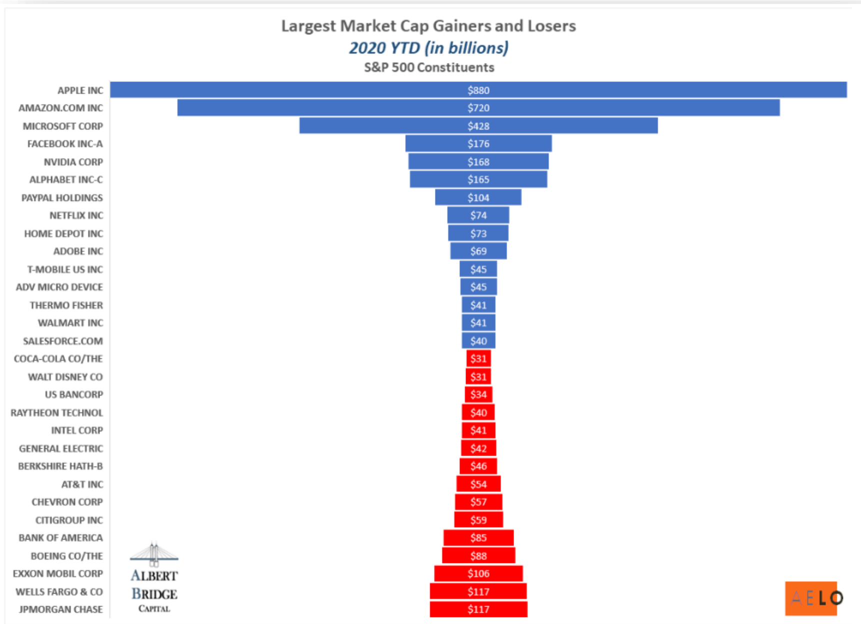
However, back to these tech winners, the really interesting part for the Russell is that the FAAMGs carry a 19% benchmark weight in this index (we wouldn't have guessed that before thinking about it). In other words, the 2995/3000 securities in the Russell that weren't FAAMGs were broadly awful, but for the 0.17% of the securities that represented 19% of the index, business was good.

And even in the S&P, these five FAAMGs dominate the index. They capture a 23% index weight. The bottom decile of 50 S&P 500 companies only has a 1% weight, in aggregate.

So far YTD, there are 279 stocks in the S&P 500 that are down. Not just down in relative terms, but absolutely down. Between them, they've lost $2.5 trillion in market cap. But if we look at the top six winners – the FAAMGs plus Nvidia – they have *gained more than* $2.5 trillion in market cap.

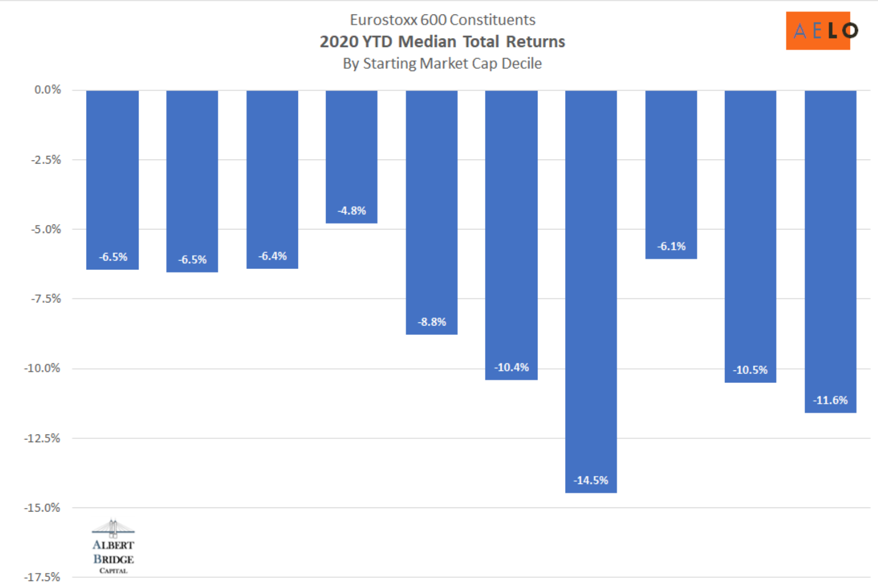


And even if we compare to the 15 major market-cap losers (JP Morgan, Wells Fargo, Exxon, Boeing, BofA, Citi, Chevron, AT&T, Berkshire Hathaway et al), we can see that the 15 largest winners captured much more market cap than the big losers lost.



Back in our world (Europe, that is) we don't have the FAAMGs. It's almost an out-of-sample test to see how stock markets did if Facebook, Amazon, Apple, Microsoft, and Google weren't in them.

And guess what, they didn't do well.

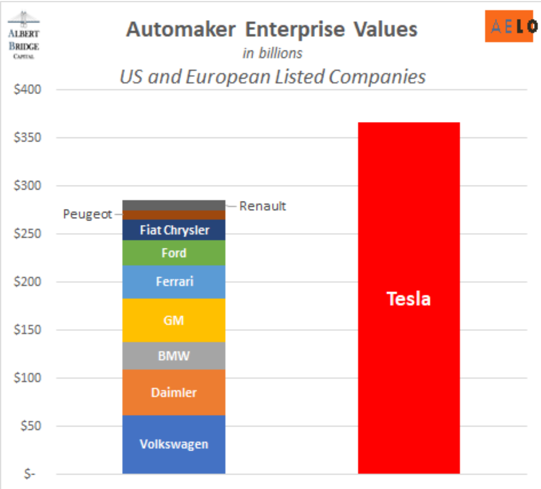


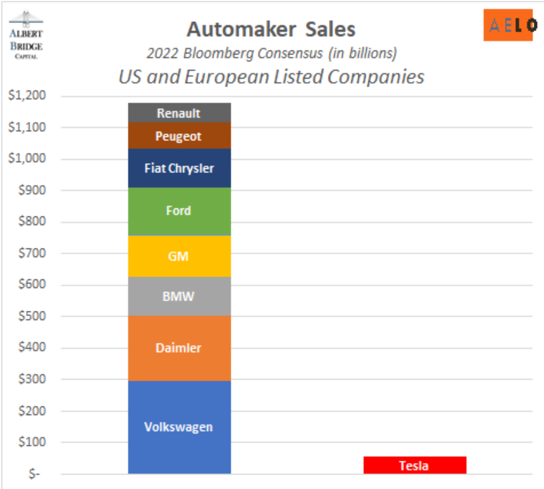
	Decile 1	Decile 2	Decile 3	Decile 4	Decile 5	Decile 6	Decile 7	Decile 8	Decile 9	Decile 10
Low Cap	$1,753	$3,775	$5,212	$6,681	$8,218	$10,658	$13,682	$19,902	$28,424	$49,624
Avg. Cap	$3,045	$4,542	$5,946	$7,410	$9,258	$11,895	$16,068	$23,484	$37,073	$106,652
Median	$3,160	$4,605	$5,941	$7,478	$9,184	$11,904	$15,902	$23,081	$35,184	$85,714
High Cap	$3,743	$5,188	$6,674	$8,194	$10,506	$13,634	$19,435	$28,339	$49,510	$322,109

We aren't advocating that we all need to go out and buy FAAMG stocks (or Nvidia, or Tesla, or Netflix or whoever) to make up for all the losers, nor are we advocating that those holding these winners should necessarily reduce their exposure. We are just highlighting how important these few names have been when it comes to the performance of global stock markets. The magnitude of their effect has even surprised us.

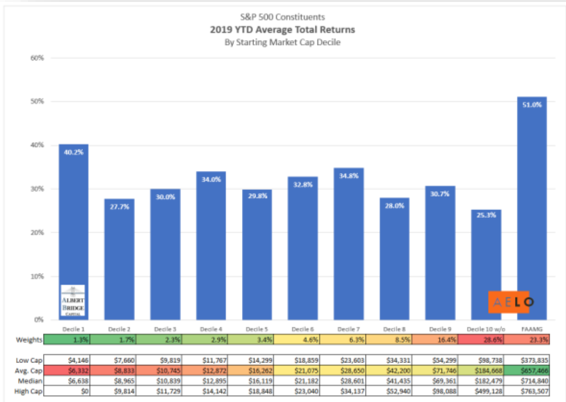
End Notes

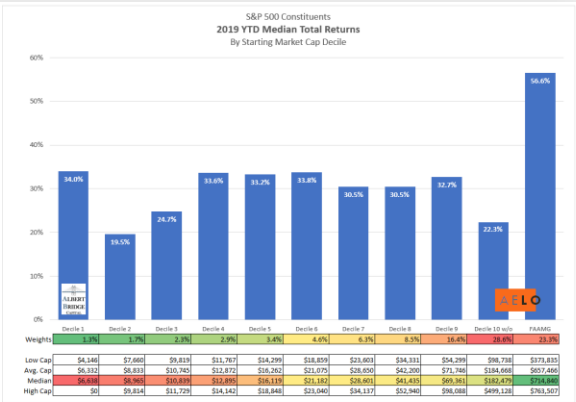
[i] *The US has Tesla too, which has gained >$300 billion in market cap here in 2020, which is even more than Facebook, Google, or Nvidia; but we don't count it in this analysis because it is not (yet) in the S&P 500 Index. Why not? Well, because the S&P needs the company to be profitable for four quarters to include it in the benchmark. Imagine that? Imagine getting to a $390 billion market cap and still not yet qualifying for entry? With this last print, they actually have finally shown four straight quarters of profitability (thank you emission credits!), but in the meantime the exclusion from the index hasn't gotten in the way of them grabbing quite a lot of market cap too.*





[ii] *As we all know, these FAAMGs have been crushing it for some time. We did the same analysis (average and median) on 2019 total returns by size decile. Here you see the FAAMGs beating the other groups as well, but perhaps we didn't feel or notice it as easily given that all size deciles, and the market generally, had such a good year.*





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