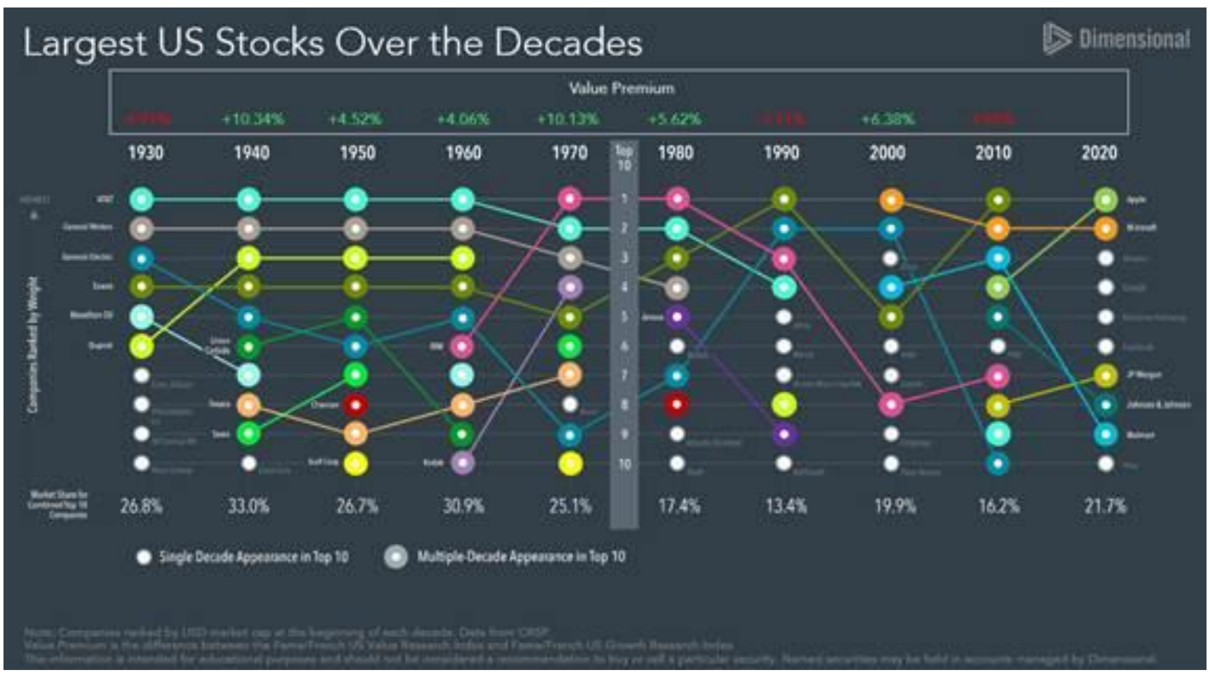
Client question of the month: Large technology stocks continue to dominate the market, is this a new normal? Should I change my investment approach to target these large stocks atop the market?

- The top 5 stocks in the S&P 500 Index – Apple, Amazon, Microsoft, Alphabet, and Facebook – have had an extraordinary run of returns. Year-to-date through August, the S&P 500 index has returned 10% – with those five stocks returning 49% while the remaining stocks in the index have had a return of -3%1.
- Many have wondered if we can expect these stocks to continue to exhibit strong performance going forward. Looking at the companies who have been at the top of the market in the past can provide helpful insights to inform our expectations for the future.

Exhibit 1



Note: Companies ranked by USD market cap at the beginning of each decade. Data from CRSP. Value premium is the difference between the Fama/French us Value research index and the Fama/French US Growth research index.

- ✓ This information is intended for educational purposes and should not be considered a recommendation to buy or sell a particular security. Named securities may be held in accounts managed by Dimensional.
- ✓ **Fama/French US Value Research Index:** Provided by Fama/French from CRSP securities data. Includes the lower 30% in price-to-book of NYSE securities (plus NYSE Amex equivalents since July 1962 and Nasdaq equivalents since 1973).
- ✓ Fama/French US Growth Research Index: Info by Fama/French from CRSP securities data. Includes the higher 30% in price-to-book of NYSE securities (NYSE Amex equivalents since July 1962 and Nasdaq equivalents sin ce1973

- Exhibit 1 shows a breakdown of the largest US stocks by decade going back to the 1930s. One key takeaway from this visual is that we have seen persistence at the top of the market for some companies. AT&T was among the top two for six straight decades beginning in 1930. General Motors and General Electric ranked in the top 10 for more than 50 years. IBM and Exxon were also mainstays in the second half of the 20th century. Hence, concentration of the stock market in a few large companies such as Apple, Amazon, Microsoft, Alphabet, and Facebook in recent years is not unprecedented.

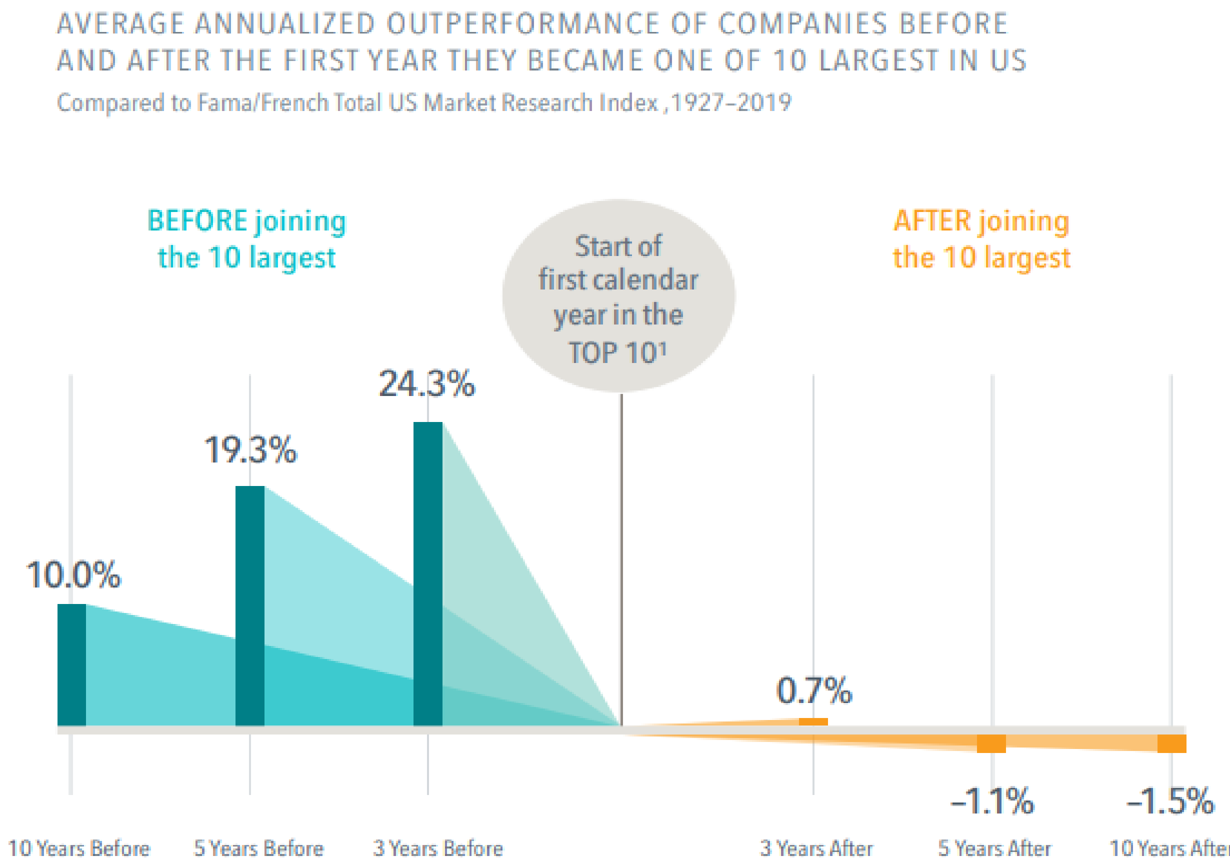
- It is also not unprecedented for disruptors to be at the top of the market. While the definition of "high-tech" is constantly evolving, firms dominating the market have often been highly innovative. Dupont, inventor of Teflon and Nylon, two household items that many individuals use daily, was at the top of the stock market for several decades after these two seminal inventions. AT&T is another company that spent a number of years dominating, as they brought the first mobile telephone service to the market. GM did the same, with innovations such as the electric car starter, airbags, and the automatic transmission. So, while the companies dominating the market are highly innovative with the products they offer today, this is something we've seen before.

- A third takeaway from this chart is to address the perception that growth stocks currently atop the market may be an issue for the value premium going forward. Through time we have experienced stocks from different industries and sectors dominating the market, but investors should find confidence in the persistence of the value premium through a number of market environments. As shown at the top of the chart in Exhibit 1, in six of nine decades we have experienced positive value premiums and over the full period (1927 – 2019) we observe an annualized value premium of 3.2%.

- When contemplating making a change to their investment approach, investors should remember that any expectations about the future operational performance of a firm are already reflected in its current price. While positive developments for the company that exceed current expectations may lead to further appreciation of its stock price, those unexpected changes are not predictable.

- Exhibit 2 illustrates this and may cause investors to think twice about chasing the biggest stocks.

Exhibit 2



- [1] Ten Largest companies by market capitalization.
- In USD. Source: Dimensional, using data from CRSP. Includes all US common stocks excluding REITs. Largest stocks identified at the end of each calendar year by sorting eligible US stocks on market capitalization. Market is represented by the Fama/French Total US Market Research Index. Annualized Excess Return is the difference in annualized compound returns between the stock and the market over the 3-, 5-, and 10-year periods, before and after each stocks' initial year-end classification in the top 10. 3-, 5-, and 10-annualized returns are computed for companies with return data available for the entire 3-, 5-, and 10-year periods respectively. The number of firms included in measuring excess returns prior (subsequent) to becoming a top 10 stock consists of 38 (53) for 3-year, 37 (52) for 5-year, and 29 (47) for 10-year. Returns are measured as of the start of the first calendar year after stocks join the top 10. Market defined as Fama/French US Total Market Research Index. Average annualized outperformance of companies before and after the first year they became one of the 10 largest in the US by market capitalization.
- Fama/French Total US Market Research Index: The value-weighed US market index is constructed every month, using all issues listed on the NYSE, AMEX, or Nasdaq with available outstanding shares and valid prices for that month and the month before. Exclusions: American Depositary Receipts. Sources: CRSP for value-weighted US market return. Rebalancing: Monthly. Dividends: Reinvested in the paying company until the portfolio is rebalanced. Returns are measured as of the start of the first calendar year after stocks join the top 10. Market defined as Fama/French US Total Market Research Index. Average annualized outperformance of companies before and after the first year they became one of the 10 largest in the US by market capitalization.
- Past performance is no guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

- From 1927 to 2019, the average annualized return for these stocks over the three years prior to joining the Top 10 was nearly 25% higher than the market. In the three years after, the edge was less than 1% (see exhibit 2). Five years after joining the Top 10, these stocks were, on average, underperforming the market. Extend the time frame out to 10 years and the gap was even wider – a stark turnaround from their earlier advantage.

- This chart is illustrative of the concept that once a company is large and dominant, sure, it may stay at the top of the market, but this does not necessarily mean it is also a great investment. Rather than chasing the performance of today's top companies, we want to ensure we are well positioned to capture the returns of tomorrow's top companies. While it remains impossible to systematically predict which large companies will outperform the stock market, we can focus on controlling what we can by having broadly diversified portfolios that provides exposure to a vast array of companies and sectors.

If you have any questions about this article or want to discuss your family finances, investment portfolio, or financial planning advice, please call on me anytime at my number (215) 325-1595 or you can click here to schedule a meeting.

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About the advisor: Jeff Broadhurst is a wealth manager at Broadhurst Financial Advisors, Inc. He focuses on providing wealth management solutions to business owners and family stewards in the Philadelphia area. Together with his partners, he helps affluent clients address their five biggest concerns:

1. Preserving their wealth
2. Mitigating taxes
3. Taking care of their heirs
4. Ensuring their assets are not unjustly taken
5. Charitable giving.

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