JAG CAPITAL MANAGEMENT LLC

JAG Team Insights

JAG Growth Equity Thematic Insights: Q4 2024

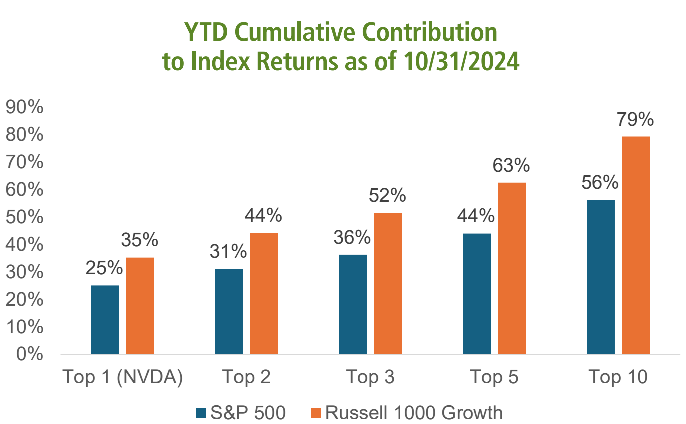
Total reading time = 2 minutes

How to Invest in Concentrated Markets

In our previous Insights pieces, we've explored key market themes, including the emergence of **Generative AI** and the growing impact of **GLP-1 drugs** on healthcare and consumer products. In this write-up, we will discuss a topic that has been garnering considerable attention – market returns being driven by a relatively small number of high-performing stocks - and the implications of this on portfolio management.

Nvidia (NVDA) is the best example in recent history, with the stock accounting for approximately one quarter of S&P 500 gains in 2024 on the back of rapidly rising AI demand (Figure 1). Beyond Nvidia, market breadth remains narrow, with the Top 10 stocks collectively accounting for over half of the S&P 500's gains. These numbers become even more skewed when looking at growth-oriented indices with greater concentration. For example, within the Russell 1000 Growth Index, just 10 stocks are responsible for nearly 80% of the year-to-date returns.

Figure 1: Top Contributors

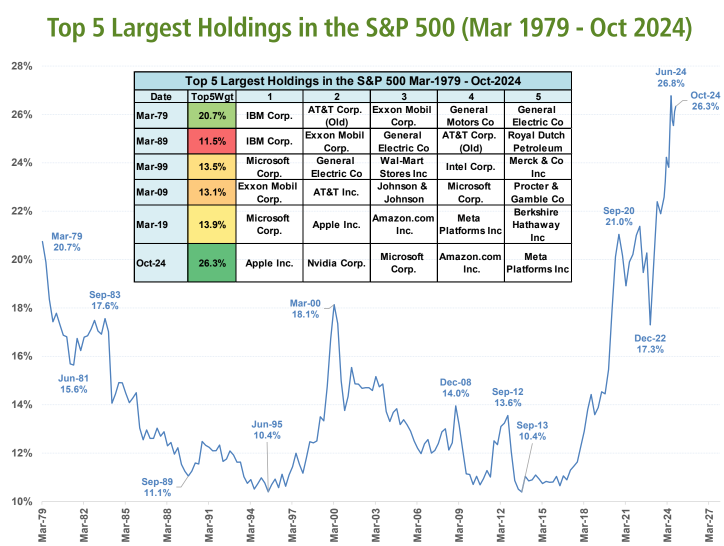


Source: JAG Capital Management Research, FactSet as of 10/31/2024

While Nvidia's performance this year is an outlier, history has shown that it is not unusual for a handful of stocks to drive the majority of shareholder returns. Hendrik Bessembinder, a finance professor at Arizona State University, examined the performance of 28,114 individual stocks from 1926 to 2022. He uses Net Shareholder Wealth Creation (SWC) as a key metric to evaluate a stock's performance, which measures the wealth a stock generates above the returns of 1-month Treasury Bills (T-Bills) since its public listing.

Bessembinder's findings are striking. First, only 41.4% of stocks outperformed the 1-month T-Bill, meaning most stocks failed to beat this modest benchmark. Second, a few well-performing stocks have had an outsized impact on shareholder returns, with Apple (AAPL) alone responsible for nearly 5% of the total SWC during Bessembinder's analysis period. This means that Apple has accounted for $2.7 trillion of the total $55.1 trillion of wealth created by the stock market since 1922. Finally, while market concentration has varied over time, Bessembinder also notes it has been rising steadily since 2016 (Figure 2).

Figure 2: Top 5 Combined Weights in S&P 500



Top 5 Largest Holdings in the S&P 500 Mar-1979 - Oct-2024

Date	Top5Wgt	1	2	3	4	5
Mar-79	20.7%	IBM Corp.	AT&T Corp. (Old)	Exxon Mobil Corp.	General Motors Co	General Electric Co
Mar-89	11.5%	IBM Corp.	Exxon Mobil Corp.	General Electric Co	AT&T Corp. (Old)	Royal Dutch Petroleum
Mar-99	13.5%	Microsoft Corp.	General Electric Co	Wal-Mart Stores Inc	Intel Corp.	Merck & Co Inc
Mar-09	13.1%	Exxon Mobil Corp.	AT&T Inc.	Johnson & Johnson	Microsoft Corp.	Procter & Gamble Co
Mar-19	13.9%	Microsoft Corp.	Apple Inc.	Amazon.com Inc.	Meta Platforms Inc	Berkshire Hathaway Inc
Oct-24	26.3%	Apple Inc.	Nvidia Corp.	Microsoft Corp.	Amazon.com Inc.	Meta Platforms Inc

Source: JAG Capital Management Research, FactSet as of 10/31/2024

What conclusions should investors draw from Bessembinder's findings? We believe there are two primary takeaways.

First, active investors should be flexible and have clear and repeatable sell disciplines. Regardless of the investor's pedigree and conviction level, earning attractive long-term returns in the stock market can be challenging. The data shows that 58.6% of all stocks underperformed 1-month T-Bills since being listed, and the percentage of stocks underperforming benchmarks like the S&P 500 Index is much higher. Portfolio managers should be willing to recognize their mistakes early and divest from the underperforming positions as there is a high likelihood the stock could continue to underperform.

Second, we believe the research is supportive of the philosophy made famous by legendary investor Peter Lynch of "letting your winners run." As noted earlier, Apple alone contributed ~5% to SWC, while the top five (Apple, Microsoft, Exxon, Alphabet, Amazon) accounted for 14.1% of SWC. The reason that these companies have been so successful is that they have been able to repeatedly identify large market opportunities and consistently outexecute challengers. Tying this back to our previous themes, Bessembinder's research suggests it is reasonably likely that a select few companies will generate an overwhelming share of the value that is ultimately created by AI and GLP-1s. It is our belief that investors who can identify these long-term winners early are most likely to achieve superior returns over the years to come.

Bessembinder's findings also bring up an interesting question regarding active versus passive investing. On the one hand, during concentrated market regimes, top-performing stocks often represent a large portion of an index, allowing passive investors to gain exposure to high-impact stocks without having to pick them individually. Furthermore, owning a broad index of stocks provides some certainty that an investor will have some exposure to the largest wealth creating companies of the future. On the other hand, the study also highlights that passive investing/indexing will inevitably provide a sizeable exposure to many stocks that tend to underperform markets. This could create big opportunities for active investors who can successfully identify a relatively small number of long-term compounders while avoiding the long-term "losers." Although we at JAG appreciate the simplicity and effectiveness of passive investing, we are unapologetically active investors. Our focused and active approach to equity investing is embedded with a time-tested sell discipline, while also offering our clients the potential to participate in the growth of the elite wealth-creating companies available in the markets.

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Disclosures

About JAG

JAG Capital Management (JAG) actively invests for institutions and individuals in highly selective, customizable, and nimble equity and fixed income strategies. JAG is a boutique, independent, employee-owned investment management firm in St. Louis.

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