The Few and the Many

How a Select Group of Stocks are Driving Equity Market Performance

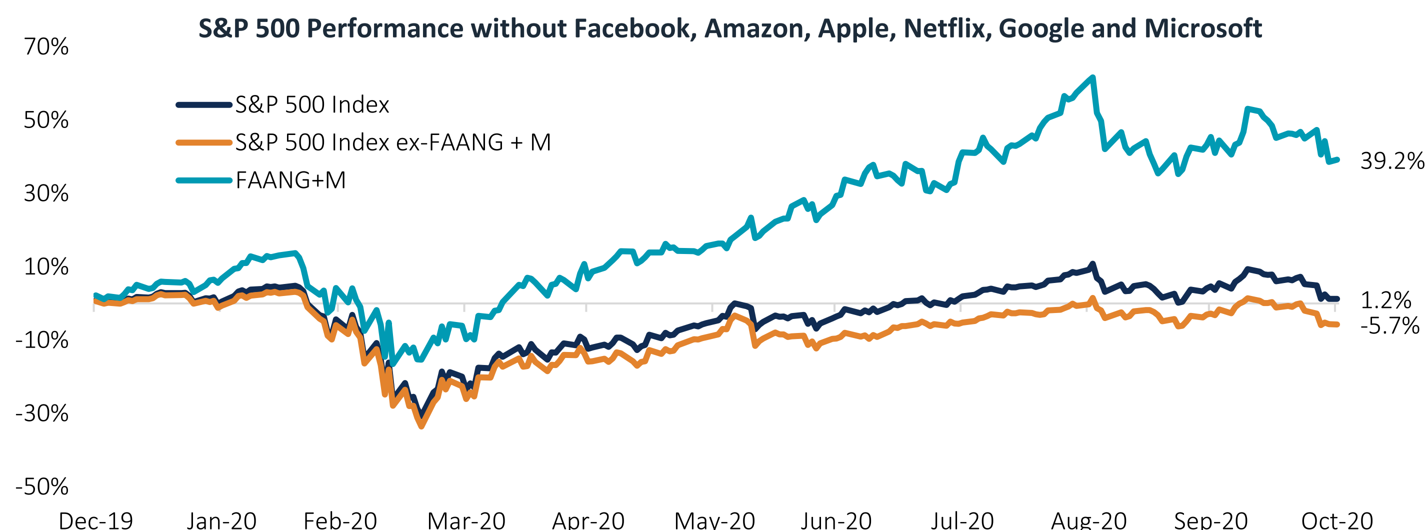
November 2020

In 1940, Britain faced a critical moment in its history. The islanders were desperately defending themselves against an onslaught from the German air force, the Luftwaffe, which was attempting to win dominance over the sky to clear a safe path for Hitler's army to cross the English Channel and launch a ground invasion. Britain's Royal Air Force (RAF), generally considered to be inferior to its German counterpart, played David to the Luftwaffe's Goliath. Despite taking heavy casualties, the RAF was able to hold its ground against the Germans. Winston Churchill had high praise for the pilots putting their lives on the line to defend their home country. Referencing the RAF pilots in a wartime speech, Churchill declared: "Never was so much owed by so many to so few".

Today, we are mired in a starkly different global crisis, and this time the high-flying heroes are in the stock market instead of the sky. Despite a worldwide pandemic, record job losses and the worst recession since World War II, global stock markets are in positive territory in 2020. A closer inspection of stock market returns indicates that a select few names are stepping up on behalf of the many, driving broad indices higher.

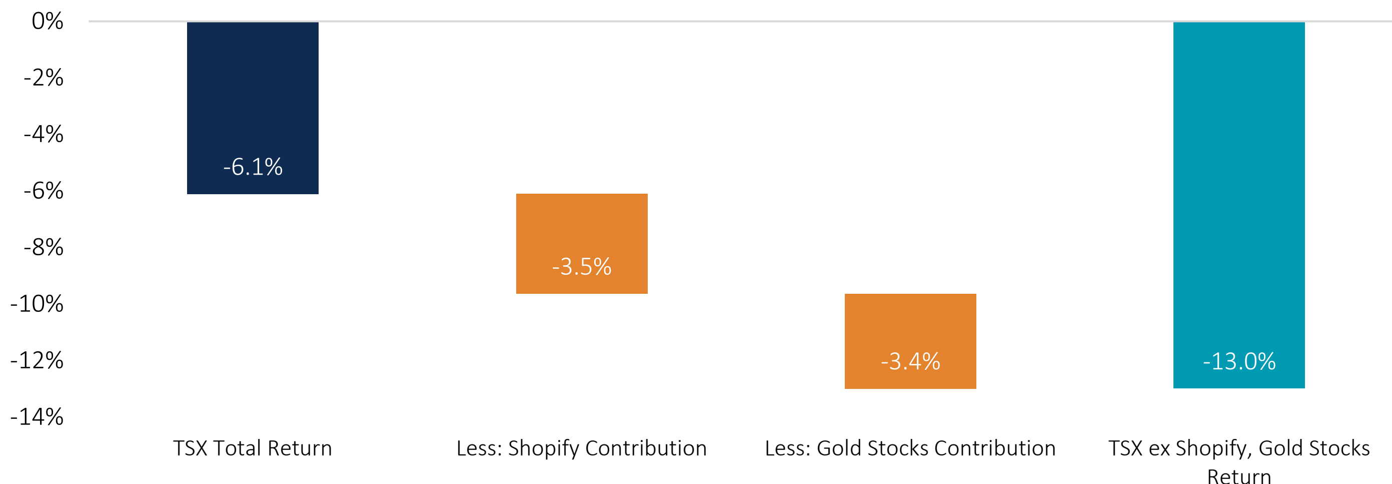
Narrow Leadership

A "narrow" stock market is one in which most of the return can be attributed to a small minority of constituents. Much of the return of the benchmark U.S. stock index, the S&P 500, has come from just six companies: Facebook, Inc., Amazon.com, Inc., Apple Inc., Netflix Inc., Alphabet Inc. (Google), and Microsoft Corp. (FAANG+M). These are some of the largest names in the index and are perceived to have more potential to benefit from a digital, remote economy. When we strip out the performance of these companies, the remaining 494 or so names in the S&P 500 Index are still down year-to-date. If you held just a portfolio of FAANG+M (proportional to their weights in the index), you would be up by almost 40% in 2020 alone.



Source: CI Global Asset Management, Bloomberg Finance L.P. As at October 31, 2020. Return calculations do not include dividends.

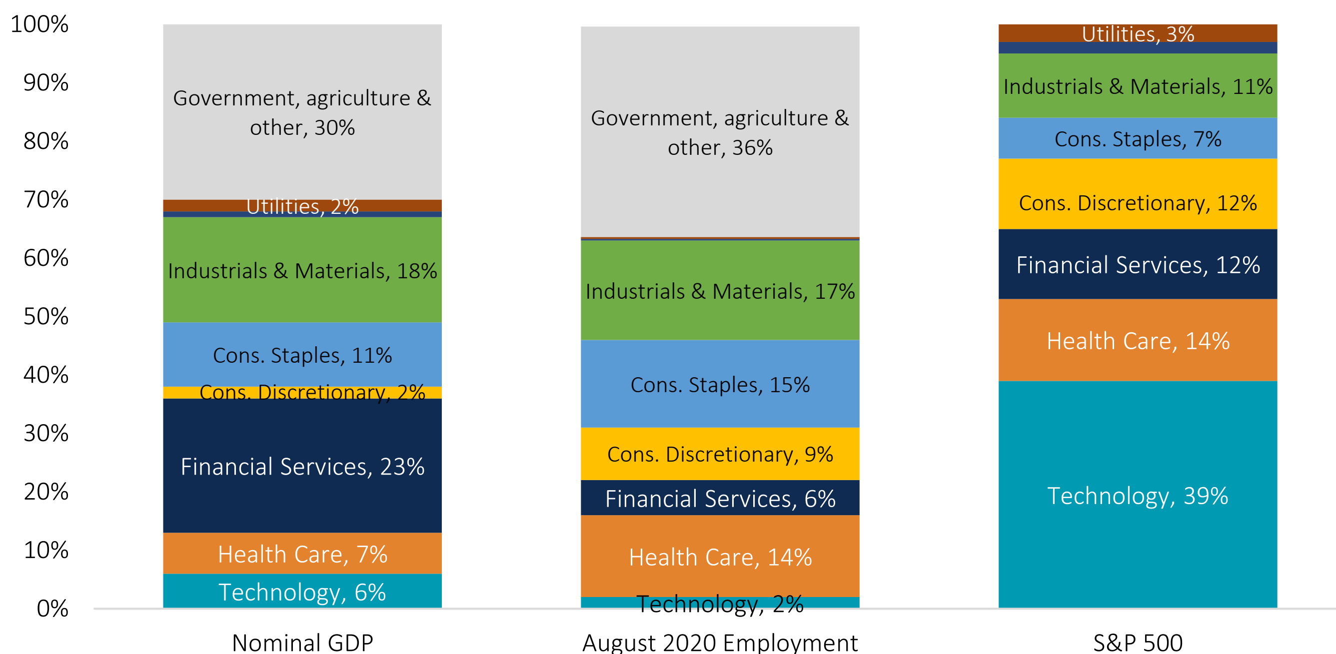
A similar analysis of the Canadian stock market shows that a narrow group of stocks is driving performance in our domestic benchmark index. Shopify, a Canadian e-commerce company expected to benefit from a shift to online shopping, has been the largest contributor to the S&P/TSX Composite so far in 2020. A group of gold miners have also had a strong year, benefiting from a surge in the price of the yellow metal that has made gold mining profitable again. When we remove the contribution from these few top performers, the S&P/TSX Composite is down by 13% this year.



Source: Bloomberg Finance L.P. As at October 31, 2020.

The Stock Market is not the Economy

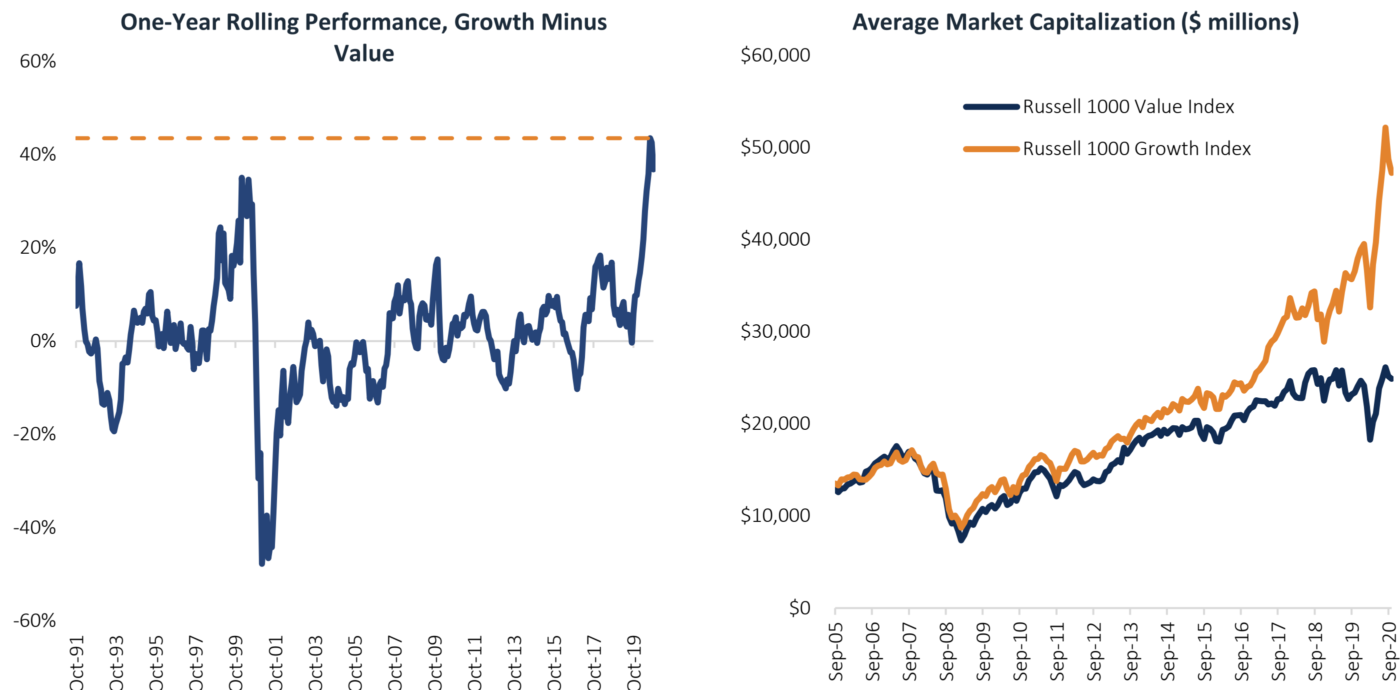
Investors often conflate the condition of the economy with that of the stock market; in reality, the stock market is a small subset of the broader economy. In the chart below, we compare the sector composition of gross domestic product (GDP), the labour force, and the benchmark stock index in the U.S. Technology makes up a whopping 39% of the stock market, but only 2% of all jobs and 6% of total output. Meanwhile, economically sensitive sectors like industrials, materials, consumer sectors, and financial services, which have been adversely impacted by COVID-19, make up a large portion of GDP.



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Standard & Poor's, J.P. Morgan Asset Management. Technology includes information technology and communication services. As at September 30, 2020.

Great Expectations

One side effect of the higher concentration in stock markets has been outperformance of growth stocks over value stocks. Growth equities are those that are expected to grow at a faster rate than the average stock in the future, while value equities are those that trade "on sale", or at a price below their intrinsic value. About 39% of the growth index is invested in FAANG+M stocks (as of October 31, 2020), which are expected to benefit more from sweeping lockdowns and a shift to working from home and e-commerce. On the other hand, the value index has only 1% in FAANG+M stocks and is composed primarily of "old economy" sectors that have been written off as relics of the past. As a result, the average market capitalization of growth companies is now approximately double that of the average value company. In addition, the outperformance of growth versus value investing set a record in the third quarter of 2020, surpassing the previous high set in the technology bubble of the early 2000's.



Source: Bloomberg Finance L.P. As at October 31, 2020. All figures are based on Russell 1000 style indices.

The Power of the Many

Looking under the hood, we can see that most companies in the stock market have been adversely impacted by the COVID-19 pandemic despite the year-to-date returns on benchmark indices. What catalysts would we expect to reverse this trend in favour of the many? A medical solution to COVID-19 could provide a tailwind for the languishing majority. Recently, positive news about vaccine development led to a rally in out-of-favour investment styles (value) and sectors (energy, financials, real estate).

In the short-term, it is not uncommon to see large performance divergences between individual stocks or investment styles within an index. However, these divergences are difficult to predict in advance or act on with conviction. Investors who chase the hottest trends of the recent past risk buying in too late and impairing future returns. In our view, the best investment outcomes are achieved by setting, and adhering to, a long-term investment plan that includes balanced exposure to different regions, investment styles and sectors.

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