INSIGHT

THE GREATEST WEALTH IS **YOUR PEACE OF MIND...**

BARNETT RAVENSCROFT
WEALTH MANAGEMENT

The old order changeth!

The old order changeth!

When one looks into the future it soon becomes apparent that a crystal ball would be useful. Unfortunately, they are in short supply. At times of uncertainty, such as this, it can be tempting to run 'what if' scenarios in our heads, such as 'perhaps I should move into tech stocks and pharmaceutical companies - as surely these sectors will do well' or to pick out specific companies that appear likely to thrive in the future. Two challenges exist. The first is that you won't be the first person to have thought this and these views in aggregate are already reflected in market prices. The second is that in making such concentrated bets you have a high chance of being wrong and missing out on the companies that actually end up driving future returns. Remember, 30 years ago Amazon did not exist.

To get a feel for what these concentration risks look like, academics are fortunate to be able to dig around in a vast bank of stock market data in the US, known as the CRSP database. One such study[1] reveals some surprising and useful findings using data from 1926 to 2015. Whilst investment wisdom and empirical evidence support the notion that stocks – in aggregate - outperform cash over longer periods of time, a forensic look at individual stock returns tells a very different story. Here are some of the insights that the paper provides:

- The median time that a stock is listed on the CRSP database is only seven years, during the period 1926 to 2015. That's not long.
- Just over 40% of all stocks have a holding period return that exceeds the return of cash (in this case one-month US Treasury bills) over the period that the stock was in the database. More than half deliver returns that are negative. The median lifetime return on any single stock was -3.7% p.a. That's not good.
- 26,000 stocks have appeared in the CRSP database since 1926, yet only 36 stocks survived the entire 90-year period. That's not many.
- US$32 trillion of wealth has been created since 1926 (to 2015), which has been generated entirely by the top 1,000 companies, representing less than 4% of the total number of companies listed over time. The top thirty firms (0.1% of all stocks) accounted for around 30% of the total stock market's wealth creation. That's pretty concentrated.

As the author states:

> *'Non-diversified portfolios are subject to the risk that they will fail to include the relatively few stocks that, ex-post, generate large cumulative returns. Indeed the results help to understand why active strategies, which tend to be poorly diversified, most often lead to underperformance.'*

At times like this – and in fact across all time periods – it makes enormous sense to remain highly diversified, as the risk of missing out on the next Exxon (the firm that has added most value to the US market ever), Apple or Amazon. Simply looking at the changing guard of the top ten US firms by revenues in 2000, 2010 and 2020 is revealing.

2000	**2010**	**2020**
General Motors Corporation	Wal-Mart Stores, Inc.	Wal-Mart Stores, Inc.
Wal-Mart Stores, Inc.	Exxon Mobil Corporation	Amazon.com
Exxon Mobil Corporation	Chevron Corporation	Exxon Mobil Corporation
Ford Motor Company	General Electric Company	Apple
General Electric Company	Bank of America Corporation	CVS Health
IBM	ConocoPhillips	Berkshire Hathaway
Citigroup, Inc.	AT&T Inc.	UnitedHealth Group
AT&T Corp.	Ford Motor Company	McKesson
Philip Morris	J.P. Morgan Chase & Co.	AT&T
The Boeing Company	Hewlett-Packard Company	AmerisourceBergen

In 2000 ranking	New in 2010	New in 2020

Figure 1: Top 10 US companies by revenue over time (2000, 2010, 2020)
Source: Fortune 500

Correctly picking which few companies are going to be driving stock market returns over the next decade or two will not be easy, or likely. Making sure that you own them can be achieved by owning a broadly diversified portfolio with many hundreds, if not thousands of companies in them. Missing out on these companies – perhaps that don’t even yet exist - could make all the difference between a good outcome and a very poor one. Remember, the old order changeth!

End notes

1. Bessembinder, H., (2017) Do Stocks Outperform Treasury Bills? WP Carey School of Business, Arizona State University.

Other notes and risk warnings

Use of Morningstar Direct© data

Risk warnings

This article is distributed for educational purposes only and must not be considered to be investment advice or an offer of any security for sale. The reference to any products is made only to make educational points and must, in no circumstances, be deemed to be any form of product recommendation.

This article contains the opinions of the author but not necessarily the Firm and does not represent a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable but is not guaranteed.

Past performance is not indicative of future results and no representation is made that the stated results will be replicated.

Errors and omissions excepted.

Barnett Ravenscroft Wealth Management is a trading name of Barnett Ravenscroft Financial Services Ltd which is authorised and regulated in the United Kingdom by the Financial Conduct Authority FRN: 225634 and registered in England and Wales under Company No. 04013532.

The registered office address of the Firm is 13 Portland Road, Edgbaston, Birmingham, B16 9HN

INSIGHT

The old order changeth!

BARNETT RAVENSCROFT WEALTH MANAGEMENT

Barnett Ravenscroft Wealth Management
13 Portland Road
Edgbaston
Birmingham
B16 9HN
UK

Tel: +44 (0)121 454 0910
Fax: +44 (0)121 410 5619
Email: info@brwm.co.uk
Web: www.brwm.co.uk