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COMMENTARY

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Should America's tech giants be broken up? Is the American economy too concentrated? These are questions that have become increasingly asked in the financial, as well as political media, as the "FAANG stocks" aka Facebook, Apple, Amazon, Netflix, and Google grow faster than the broader economy, disrupt "traditional" businesses, and become a larger percentage of total stock market total capitalization. In fact, these companies plus Microsoft, account for almost 100 percent of the year to date price return of the S&P 500 index through June. In addition to technology, many other industries have been increasingly consolidated, from banking to telecom. For the sake of brevity, we will refrain on opining on the various arguments for or against breaking up corporate behemoths, but believe it is instructive to study the past to get clues on the history of market concentration and the impact on future returns.

2018	
Apple Inc	3.9%
Microsoft Corp	3.4%
Alphabet	3.1%
Amazon.com Inc	3.0%
Facebook	1.7%
JPMorgan Chase & Co	1.6%
Berkshire Hathaway	1.6%
Johnson & Johnson	1.5%
Exxon Mobil	1.4%
Bank of America	1.2%
	22.6%

So how big are the corporate leaders of today as compared to the rest of the economy? A good way to measure this is to compute how much of the value of the S&P 500 is occupied by the top 10 largest firms. As of today, these largest 10 companies make up 22.6% of the S&P 500. Almost a quarter of the value of the S&P! This may seem large at first glance, but how does this compare to previous decades? Below, we can see at the turn of the last 4 decades, this measure has fluctuated between 20% and 26%. In that context, it seems that the current market concentration is right in the middle of recent historical averages.

1980		1990		2000		2010	
IBM	4.3%	IBM	3.0%	General Electric	4.1%	Exxon Mobil	3.1%
AT&T Corp	3.9%	Exxon Corp	2.9%	Exxon Mobil	2.6%	Apple Inc	2.5%
Exxon Corp	3.8%	General Electric	2.3%	Pfizer	2.5%	Microsoft	3.1%
Standard Oil, Ind	2.5%	Phillip Morris	2.2%	Citigroup	2.5%	Berkshire Hathaway	3.0%
Schlumberger	2.4%	Royal Dutch Petrol	1.9%	Cisco Systems	2.4%	General Electric	1.7%
Shell Oil	1.9%	Bristol-Myers Squibb	1.6%	Wal-Mart Stores	2.0%	Wal-Mart Stores	1.6%
Mobil Corp	1.9%	Merck & Co	1.6%	Microsoft	2.0%	Google Inc	1.6%
Standard Oil, CA	1.8%	Wal-Mart Stores	1.6%	AIG	2.0%	Chevron Corp	1.5%
Atlantic Richfield	1.6%	AT&T Corp	1.5%	Merck & Co	1.9%	IBM	1.4%
General Electric	1.5%	Coca-Cola Co	1.4%	Intel	1.7%	Procter & Gamble	1.2%
	25.6%		20.0%		23.5%		20.8%

Source: S&P Dow Indices, Ben Carlson

Within the technology industry itself, the presence of seemingly invincible players is not a new phenomenon either. While it remains successful to this day, IBM was once so dominant in technology that it constituted 6% of the S&P 500 (compared to Apple currently less than 4%), and even more amazingly over 70% of the market capitalization of the top 100 technology firms in 1985 (according to *The Economist*). Since that time, the industry has seen remarkable transformations from the mass adoption of the PC through the 80s, the rise of the internet through the 90s, the ubiquity of the mobile phone in the 2000s, and more recently, the power of social networks in the last decade. Throughout this period, IBM has reinvented itself many times, but was unable to maintain its relative dominance in the sector. Importantly, its relative decline has not had negative ramifications for the broader economy or the stock market in general (and shareholders that bought in 1985 would still have a +800% return if they still held the shares today). While there is no doubt that the importance and power of the technology sector has never been higher, the continuous innovation and disruption that defines the industry ensures that the stalwarts of today will need to execute flawlessly to remain the stalwarts of tomorrow. This is even more true for companies with rich valuation multiples, in which cases more of their market value is based on future rather than present earnings. Amazon is where it is today because of Amazon Web Services, not because it sold the most books. Netflix is where it is today because of its streaming service, not because it sends the most DVDs through the mail. In order to maintain their positions near the top, they will need to have the prescience to continuously pivot to the next big thing, as they did with cloud computing and streaming video.

What are some of the key takeaways from this data as investors?

- Concentration and size amongst the top firms is not unusual as compared to historical averages, nor is it unusual to see one industry dominate from time-to-time (energy in 1980)
- Across the decades, many corporate titans remain central to daily life in America (Exxon, AT&T) while others fade from the scene due to acquisition or troubled business models (Atlantic Richfield, AIG). Size is not necessarily a handicap nor an advantage on its own
- Size can provide advantages such as economies of scale and creation of well known brands, as well as disadvantages such as difficulty of maintaining growth rates from a larger and larger base
- While most of the firms displayed remain healthy many years later, their inclusion often marks a top in sentiment. Once you have reached the mountaintop as a firm, valuation at purchase becomes a much larger driver of returns when growth inevitably slows. Cisco has grown EPS by over 300% since 2000 but stockholders have still lost money because the company traded at over 200x earnings at its peak

Our view remains that the concentration of firms does not strike us as a worry or risk to the overall economy, and that size remains only one data point in determining whether a company is an attractive investment opportunity. Revenue growth, underlying profitability of the business model, industry and structural tailwinds, honest and capable management, and a fair valuation are all key factors in driving our investment decision making. We will continue to watch these innovative companies closely to determine if they are a fit for client portfolios, as well as monitor the fundamental performance of other “mega cap” holdings.