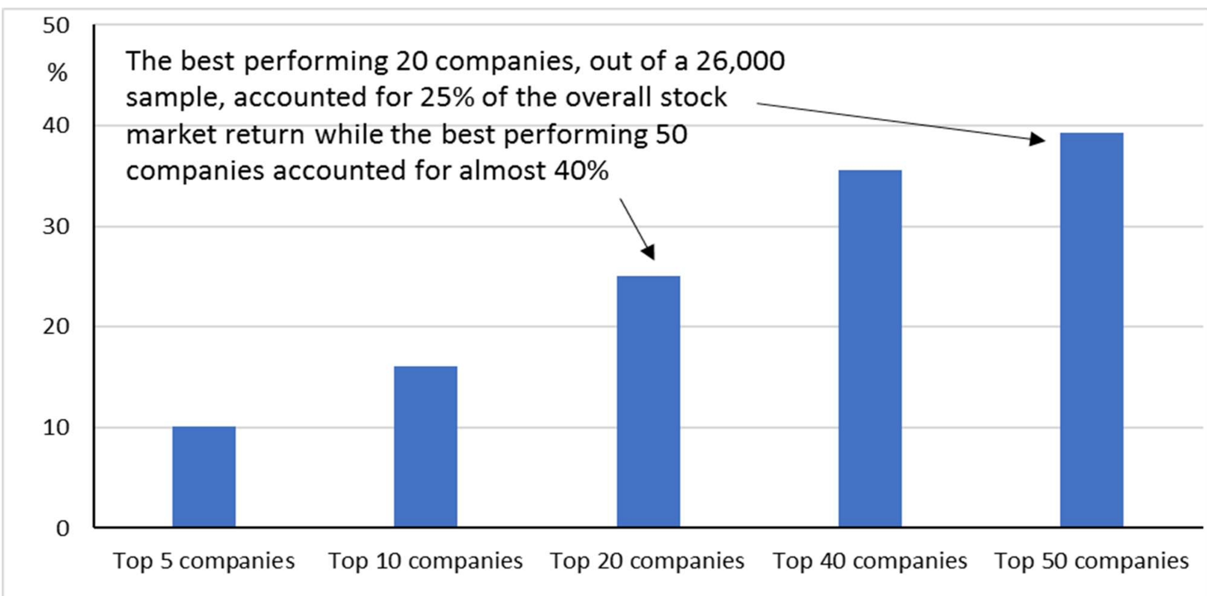
“SUPER” STOCKS TURBO CHARGE THE STOCK MARKET

In a paper entitled “Do Stocks Outperform Treasury Bills”[1] first drafted in 2017 and then revised and published in 2018, Professor Bessembinder, Professor of Finance at Arizona State University, analysed the performance of 26,000 US stocks from 1926 to 2016. He assumed that once bought the stocks were held for the full period, unless they were forced into bankruptcy or were taken over.

The Findings

His findings gave much food for thought. His analysis showed that just four per cent of the sample companies were responsible for creating the entire $34.82 trillion of wealth created over the period. In this analysis they will be referred to as “Super” stocks. The chart below shows the cumulative return over the period of the top 50 performing stocks.

Chart 1. “Super” Stocks Percentage Contribution to Overall US Stock Market Returns 1926-2016



Source: Bessembinder, Hendrik, Do Stocks Outperform T-Bills?, Journal of Financial Economics, vol.129, 3 in https://ssrn.com/abstract=2900447, pgs 51-52.

Even more strikingly the top five “Super” stocks created just over 10 per cent of the wealth. Subsequently, this study was updated to include data up to December 2019.[2]

[1] Bessembinder, Hendrik, Do Stocks Outperform Treasury Bills?, Journal Of Financial Economics, Vol.129, 3 in https://ssrn.com/abstract=2900447 p. 1-53

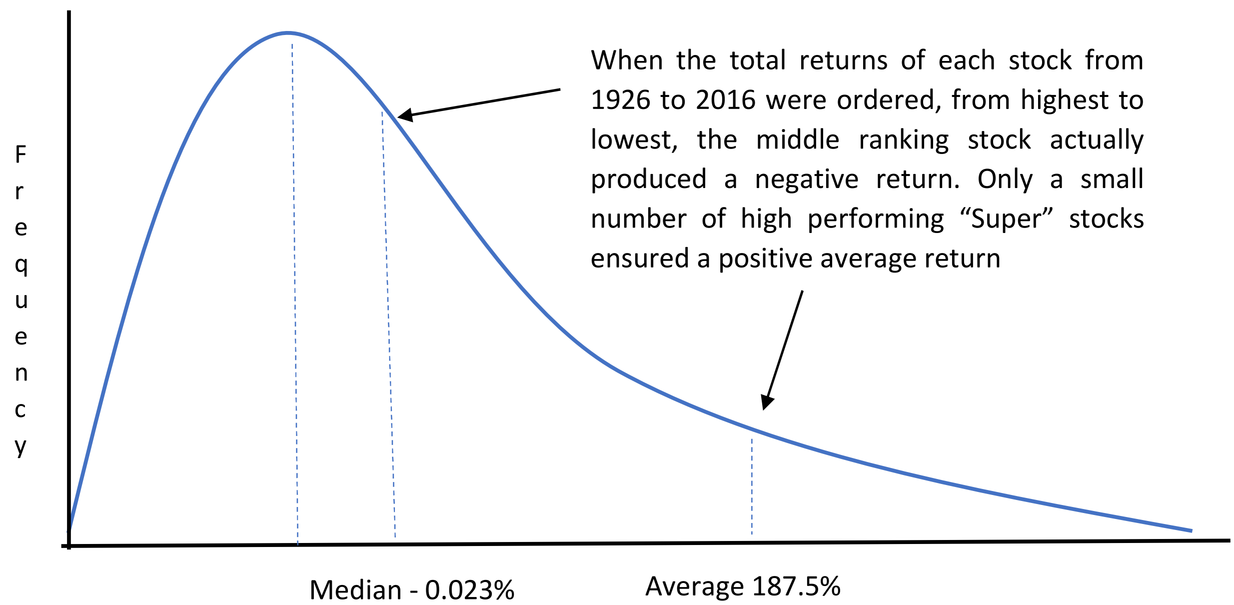
[2] Bessembinder, Hendrik, Wealth Creation in the US Public Stock Markets 1926-2019, Feb 13,2020 at https://ssrn,com/abstract=3537838

By then stock market wealth creation had increased to $47.38 trillion with 5 “Super” stocks accounting for 22% of the wealth creation.

The Meaning of This

In statistical terms this means that, there is a large positive skew of the distribution of returns. The chart below shows the distribution of returns from Bessembinder’s research.

Chart 2: The Distribution of US Stock Market Returns 1926-2016



Source: Source: Bessembinder, Hendrik, Do Stocks Outperform T-Bills?, Journal of Financial Economics, vol.129, 3 in https://ssrn.com/abstract=2900447, p44.

In the analysis, the average return between 1926 and 2016 was 187.4705%, however the median return over the same period was a small loss of 0.0229%. This means that the positive returns over the period were created by a surprisingly small percentage of stocks. Just four per cent were responsible for the 187% return, with a huge number producing negative returns.

The Characteristics of “Super” Stocks

It is interesting to consider the characteristics of the “Super” stocks that have been so instrumental in creating wealth for investors. The majority had founders with “big dreams”, had access to large markets which were often global, with barriers to entry and, once established paid regular, and increasing, dividends. It is equally true for the wealth creators in the sample to the end of 2019.

The Findings Extend to Other Markets

The obvious question is whether the US market is unique in having such a small group of "Super" stocks producing the returns. It seems not. In July 2019 Bessembinder[3] and his team published further research which looked at the performance of 62,000 stocks globally between 1990 and 2018. This showed that less than 1 per cent of all equities created all the market returns over the period. In this instance just four "super stocks" together produced 8% of the shareholder wealth globally.

The Implications

As this article has highlighted, stock market wealth creation arises from a small percentage of stocks which produce positive multi-period returns. The main characteristics of these companies are that they have large and growing markets with strong barriers to entry.

When constructing portfolios for our clients we aim to identify these "Super" stocks by looking for companies which have exposure to growth markets, barriers to entry, a clear strategy and a strong management team. We then aim to hold them over a number of years. In this way, we are able to create portfolios which produce a good return for our clients. For the returns generated by our equity portfolios please see the Growth strategy fact sheet on the website *(please note: past performance may not be replicated in the future*).

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[3] Bessembinder, Hendrik and Chen, Te Feng and Choi, Goeun and Wei, Kuo-Chiang, Do Global Stocks Outperform US Treasury Bills?, July 5,2019, https:///ssrn.com/abstract=3415739