How the Mighty Have Fallen

The Fortune 500, a list of the biggest U.S. companies ranked by revenues, has been around since 1955. That means there have currently been 59 annual Fortune 500 lists. And do you know how many unique companies have occupied the #1 ranking on that list over those 59 years? Three.

That's right—just three different companies have qualified as the largest U.S. company over the last six decades: General Motors, Exxon Mobil, and Wal-Mart.

But we investors know that it's not really revenues that matter, right? What we care about as owners of these companies is not necessarily how much money we take in by selling our widgets; we care about how much money is left over at the end of the day after selling our widgets and then paying our suppliers, employees, and the tax man. And then, based on those bottom line profits, we investors decide how much each company is worth, and we as a group assign it a certain value which we call its market cap.

So one should not at all be surprised to learn that a similar list of the biggest U.S. companies, ranked not by revenues but by market cap, shows a much higher level of turnover

Welcome to the Club, Apple

The most recent annual list of the ten biggest U.S. companies by market cap should have some fairly familiar names to all of us:

1. Apple
2. Exxon Mobil
3. Microsoft
4. GE
5. IBM
6. Chevron
7. Johnson & Johnson
8. AT&T
9. Procter & Gamble
10. Pfizer

While the Fortune 500 leadership seems to rotate between just three different companies, with its first-ever first place finish in 2012 Apple became the sixth company to lead the market cap list. Our market cap data goes back just 33 years, though, so 6 leaders in 33 years represents a turnover rate three and a half times as fast as the Fortune 500 revenue leaders.

Which suggests that either the stock market is faster to recognize the changes in the economic dynamics of publicly traded companies, or it is a much more fickle decider of value than a simple accounting-based list, or both.

Oldies but Goodies

Perusing the list of the companies which at one time populated the list of the top ten market caps over the last 33 years, we see that some of the companies were absorbed by some of their still-larger competitors: Mobil Oil, Atlantic Richfield, BellSouth.

We see also that some businesses were just not built to last, or were not able to continue to compete in an ever-changing world: Sears, duPont, Philip Morris, Eastman Kodak. Can you believe Kodak was not long ago one of the ten largest U.S. stocks by market cap?!

And then we also see that some businesses were simply mis-understood and therefore mis-valued by the market on a gargantuan scale: in 1999, the top ten list included Cisco, Lucent, and—ack!—America Online.

Many Shall Be Restored

While the title of this article comes from the Christian Bible, there is another related quotation that comes to mind from the investing Bible, which is also known as Security Analysis by Benjamin Graham and David Dodd. At the beginning of that book, the authors cite the ancient Roman poet Horace, who said, "Many shall be restored that now are fallen, and many shall fall that now are in honor."

In the oldest list of the bunch, the one from 1980, a full seven of the top ten companies by market cap were in the oil business. By 1995, five of the top ten were in consumer-related businesses. And the latest list, the one shown above, seems to be a pretty even mix of oil stocks, consumer-related businesses, and telecom/technology names.

In other words, the stock market—which is well-known for its sometimes vicious short-term cycles—seems to move in longer-term cycles as well. It is our job, as investors, to try to recognize those cycles (e.g., the move from physical to digital film, or the reduction in the prevalence of smoking) and then position our portfolios accordingly.

If You Can't Beat 'Em, Join 'Em

If we sum up the market caps for all ten companies on the list back in the early 1980s, we come up with a number between $200 and $250 billion. Compare that to the market cap for our most recent #10 company, Pfizer, which clocked in at $186 billion all by itself: Pfizer today is just about as big as the entire group of the ten largest companies were 33 years ago.

If you do that same math for the most recent list—that is, taking Pfizer's $186 billion and adding in all the rest right on up to Apple's $498 billion—you come up with an aggregate market cap of just over $2.5 trillion, or about 11 times as big as the corresponding number from 1980.

While a number 11 times bigger may seem like a large increase, on an annualized basis it only works out to 7.7%. Plus, we are still nearly 20% below the largest-ever aggregate market cap for the ten largest companies. That record was, of course, set in the year 1999, when the aggregate market cap reached $3.1 trillion. That year, Microsoft was valued at just over $600 billion, still a record no other company has achieved in the ensuing 13 years.

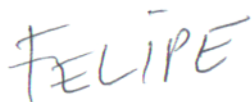
Let's look again at that figure of 7.7%, the average annual amount by which the top ten market caps have grown over the last 33 years. If we compare that ten-company figure to the annual advance of the market overall, as judged by the S&P 500, we get a nearly identical result.

Which leads to the question…. which would you rather do? Try to anticipate the future profits of the individual companies, paying attention to the advances and declines in their economic fortunes, and actively manage a portfolio based around your analysis? Or would it be more appealing to buy the entire market, mentally sit back, and take advantage of the upward trend of the stock market as a whole, allowing you to let your mind attend to other matters?

There is no right answer for everyone. Each of us will choose a different tack, depending on our temperament and the time we have in our schedule to be able to devote to the endeavor.

Choose Your Own Adventure

Today's stock market darlings could be tomorrow's dogs, and today's unloved enterprise could be next year's belle of the ball. While we would never advocate for such rapid portfolio turnover as would qualify as "day trading," we would also advise against employing a "buy and forget" strategy. The prudent investor should plot one of two courses: either build a portfolio of individual stocks, being always vigilant to stay abreast of the shifting sands of stock market sentiment, or simply buy a broad-based market index fund and hang on for the ride.



Felipe Garcia, CFA
Chief Investment Officer
INKWELL CAPITAL LLC

Aaron Byrd, CFA
President
INKWELL CAPITAL LLC