NAPATREE CAPITAL

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THIRTEEN DIGITS

For the first time in the history of the stock market, there are public companies valued at more than one trillion dollars. Yes, one trillion. At the time of this writing (1/31/20), four technology behemoths, Apple (AAPL), Microsoft (MSFT), Alphabet (GOOG), and Amazon (AMZN) have market capitalizations of $1.35 trillion, $1.295 trillion, and each $1 trillion respectively.

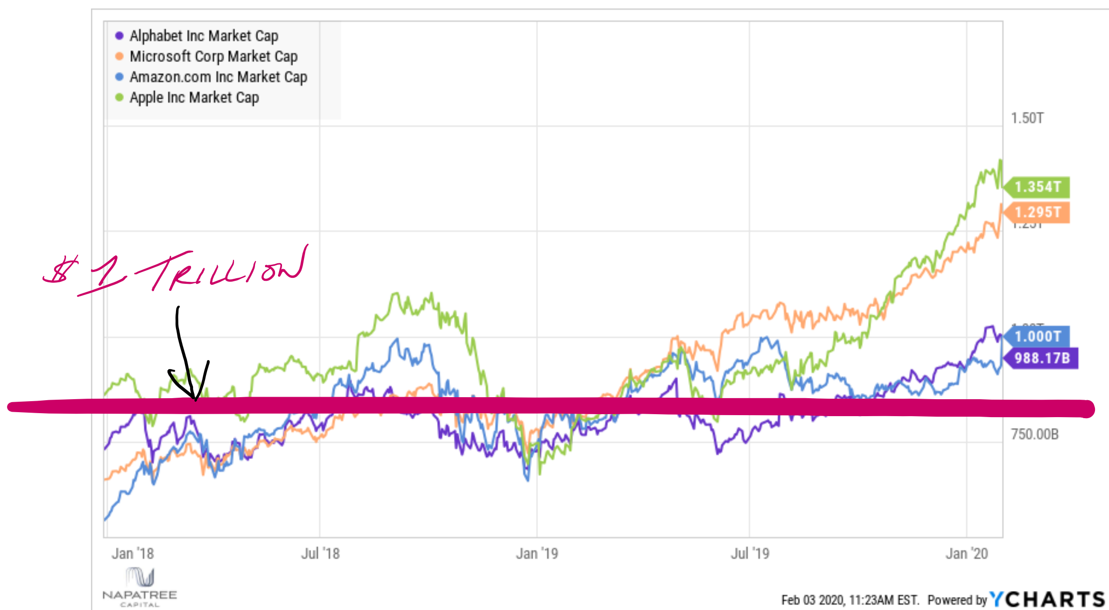
Market capitalization – or market cap, in investment parlance – is a measure of both the size and value of a company. It is calculated by multiplying the share price by the number of shares the company has outstanding. The higher the stock price, the higher the market cap, the more valuable the company.

In April of last year, MSFT briefly touched the trillion-dollar mark, before a pullback. Less than three months later, the stock broke through that level again and never looked back.

It took AAPL stock a bit longer to reach the trillion-dollar milestone. The market cap grew to $1.1 trillion in July 2018, before shares sold off more than 40% and didn't achieve $1 trillion until early September 2019. AAPL shares staged an impressive rally from that point, appreciating nearly 40% in the final quarter of 2019, closing the year at $1.3 trillion market cap. Incidentally AAPL stock appreciated a staggering 92% from January 3, 2019 to December 31, 2019.

Alphabet (GOOG) and Amazon (AMZN) flirted with the 13-digit milestone but ended the year at $922 billion and $916 billion respectively, before breaking through in January.

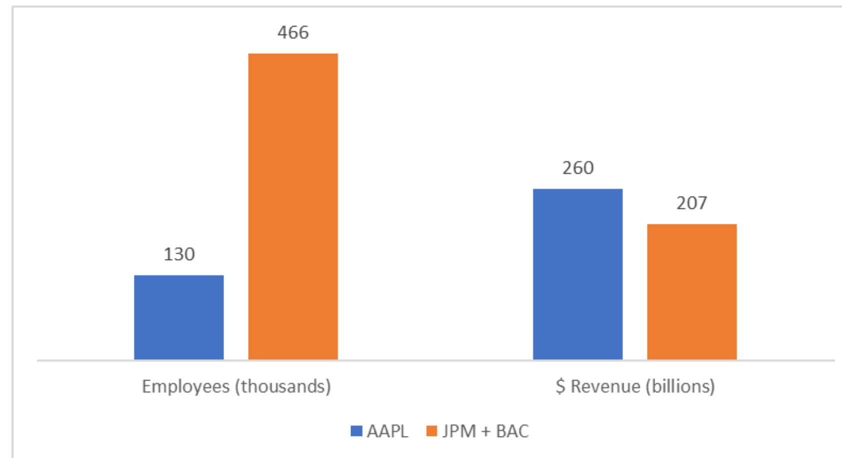
24 Month Snapshot of Market Cap



Facebook (FB) is the fifth largest company of the S&P 500 by market cap. Interestingly, at $580 billion, FB is *less than half* as large as either AAPL or MSFT, yet it is larger than 98% of the companies that

comprise the remainder of the index. Here's some other data to put the 13 digit phenomenon in perspective:

- The combined size of Apple and Microsoft are larger than the aggregate of AT&T, United Health, Disney, Intel, Home Depot, Coca-Cola, Merck, Chevron, Wells Fargo, and Pfizer.
- Apple is 1.8x larger than the market cap of JP Morgan (JPM) and Bank of America (BAC) *combined;* yet the two financial institutions have 3.5x the number of employees and control nearly $3 trillion of customer deposits.



- Apple's market cap is a little more than half the size of the total gross domestic product (GDP) of the United Kingdom; if it was a country, Apple would be slightly larger than Mexico and slightly smaller than Australia in terms of GDP.
- If Apple and Microsoft were to form their own country, it would be the 8th largest economy in the world behind France, which has 67 million people. By comparison, the population of "AppleSoft" (or is it "Micrapplis"?) would be less than ½ of 1% of the population of that country.
- One last comparison: Wal-Mart stock would have to double, and then double again, to be as valuable as Apple. Wal-Mart generates twice the revenue of Apple and has nearly 2 million employees to Apple's 130,000.

There is a multitude of analogies that could be made to put such astronomical numbers in perspective. At the risk of overkill, we'll stop here. It is critical for investors to understand how markets calculate value (or size). It is only one measure to compare companies, but an extremely important one.

We do believe size matters. Our research suggests that the mega cap trend of investing is getting long in the tooth. And remember: The S&P 500 is weighted based on market cap, so index returns are dominated by the performance of AAPL, MSFT, GOOGL, and AMZN. Our investment philosophy has a bias toward value-oriented mid cap companies (although we own AAPL in our actively managed value strategy). The approach has been out of favor for several years, but we believe the market rewards patience.

2020 MARKET OUTLOOK

We tend to be market observers rather than prognosticators, and we pay close attention when both valuation and sentiment are near an extreme. Lofty stock prices paired with extreme optimism often precede meaningful peaks in stock prices. At the very least, the combination of these factors leads to volatility. In a note on January 13, 2020 titled "Time to Play Defense" (which can be accessed on our website), we outlined why we see higher risk for equities than we've seen in the past three years. A brief summary of the influences for that decision are below:

> **VALUATION**: stock price performance is exceeding earnings estimates by a wide margin for some of the largest publicly traded companies. This dynamic has occurred in the past; however, we are wary of "expensive" stocks when broad economic growth is only slightly above 2%, especially with continued pressure on the Federal Reserve to accommodate asset prices. Highly unusual to have easy monetary conditions during what most consider a booming economy and a federal budget deficit of $1 trillion.
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> **SENTIMENT**: Panic-like conditions from the fourth quarter of 2018 paved the way for outsized gains in stocks in 2019 (it wasn't the only condition, but a major catalyst). Fear is powerful. As stocks climbed throughout last year, investors became increasingly confident. Studies suggest an "over" allotment to stocks and optimism at an extreme level coming into 2020.
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> **STOCKS vs. BONDS**: the annual income earned by owning the S&P 500 is roughly $1.75 for every $1,000 invested. The income earned on a federally insured 90-day bank certificate of deposit (CD) is $1.60 for every $1,000 invested and the investor gets her capital back after 90 days.

Prior to publishing this note the market sustained a significant pullback, blamed largely on the Coronavirus. No one could foresee this potential pandemic, but the market had been "over" bought, and the conditions allowed for greater volatility than typical. We've looked at past health scares and will hopefully get a piece out soon on the outlook. A gentle reminder: there is always something to worry about. In the past 17 years the market has endured a SARS epidemic (2003), the Avian Flu (2006), Swine Flu/H1N1 (2009), Cholera Outbreak (2010), MERS (2013), Ebola (2014), Zika (2016), and Ebola again (2018). Often any prolonged sell off was due more to macro-economic factors than individual shocks.

OUR CURRENT POSITIONING…

We rebalanced client portfolios in the second week of January, taking a more defensive posture and lowering overall equity exposure prior to the drawdown. Market volatility is likely on the rise and as we said in our last note, we want to ensure our clients our prepared.

Thanks for your continued trust in Napatree Capital.

Jeff Liguori, Chief Investment Officer