SMEAD capital management

Missive

FEBRUARY 27, 2024

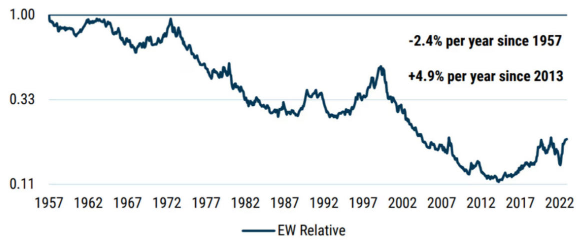
A Ticket to Purgatory

Dear fellow investors,

The Sherman Antitrust Act was created to stop our democratic republic from being ruined by "the concentration of capital in vast combinations." The fear was that if too much of the success of industry went to too few people, our system would get disrupted.

The bad news is that the federal government has ignored the original purpose of the act. In our opinion, our society was first disrupted by the success of the FANG stocks and is now being disrupted by the Magnificent Seven. The good news is that the stock market has a history of solving problems on its own. What has happened over time to the largest and most popular stocks as measured by market capitalization?

EXHIBIT 2: S&P500 – TOP 10 VS. 490 EQUAL WEIGHTED



Data from 1957-2023 | Source: Compustat, Standard & Poors

GMO QUARTERLY LETTER 1Q 2024

The chart above shows the relative performance if you bought the ten largest cap stocks in the S&P 500 Index at the start of each year and separately purchased the next 490 stocks in the index. You would have had occasional victories in the top ten, like in the recent 10 years, but massive long-term heartache over the last 65 years (thank you to GMO, Compustat and Standard & Poor's).

What are the arguments in favor of sticking with the Magnificent Seven and the S&P 500 Index masquerading as a diversified portfolio? First, it is different this time! However, it is always different this time and it is the rhyme with prior manias and top ten lists that sends you to purgatory. How did the Go-Go 1960s and Nifty 50 stocks work over ten years? How have Cisco and Intel done since 2000?

Largest Companies Globally by Market Cap

	1980		1990		2000		2010		2020	
Rank	Company	10-Yr Fwd Return	Company	10-Yr Fwd Return	Company	10-Yr Fwd Return	Company	10-Yr Fwd Return	Company	10-Yr Fwd Return
1	IBM	10%	Nippon Telegraph &	-1%	Microsoft	5%	PetroChina	-10%	Apple	?
2	AT&T	16%	Bank of Tokyo-Mitsubishi	-5%	General Electric	-6%	Exxon Mobil	-2%	Saudi Aramco	?
3	Exxon	18%	Industrial Bank of Japan (1)	-12%	NTT DoCoMo	-8%	Microsoft	26%	Microsoft	?
4	Standard Oil	10%	Sumitomo Mitsui Banking	-5%	Cisco	-6%	ICBC	4%	Amazon	?
5	Schlumberger	0%	Toyota Motors	10%	Walmart	2%	Walmart	13%	Alphabet	?
6	Shell	16%	Fuji Bank (1)	-10%	Intel	-2%	China Construction	4%	Facebook	?
7	Mobil	11%	Dai-ichi Kangyo Bank (1)	-8%	Nippon Telegraph &	-6%	BHP Billiton	3%	Tencent	?
8	Atlantic Richfield	13%	IBM	14%	Exxon Mobile	8%	HSBC	-1%	Tesla	?
9	General Electric	18%	UFJ Bank	-8%	Lucent	-28%	Petrobras	1%	Alibaba	?
10	Eastman Kodak	8%	Exxon	17%	Deutsche Telekom	-7%	Apple	30%	Berkshire Hathaway	?
	Top 10	12%	Top 10 Average	-1%	Top 10 Average	-5%	Top 10 Average	7%		
	S&P 500	14%	S&P 500	17%	S&P 500	1%	S&P 500	14%		

Source: @CharlieBiello, Bloomberg

(1) Return for Industrial Bank of Japan, Fuji Bank and Dai-ichi Kangyo Bank is 12/31/1990 to 9/21/2000 (on 9/21/2000, these three banks merged to create Mizuho Financial Group).

Second, the ticket into purgatory doesn't always have to come in the U.S. Look how bad the top ten list from 1990 did with eight of ten coming out of Japan or the 2010 list dominated by the China-led BRIC trade. Mania is an equal opportunity destroyer of wealth!

Lastly, many people look at this mania and compare it to the dot-com bubble of 2000. This comparison is like a fraternity brother feeling comfortable drinking 14 beers because his best friend knocked out a whole case. Nobody wrote either of them a letter and said, "You are too well to attend." As Cole shared with us last week, the difference from the Dotcom Bubble included 1% interest rates for a very extended time period. Therefore, many more of the 500 companies in the index have been inflated by nearly free money. Buffett says, "The kinds of companies we would like to own have been endlessly picked over!" This means the bear market that follows will include company shares outside of tech. The capital that doesn't get destroyed will flow into a smaller pool of depressed stocks.

A Ticket to Purgatory

In summary, we have no urge to go through purgatory with popular stocks that lead to long-term heartache. This mania appears to be headed to a bad ending. As always, fear stock market failure.

Warm Regards,

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Chief Investment Officer

This missive and others are available at www.smeadcap.com.

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