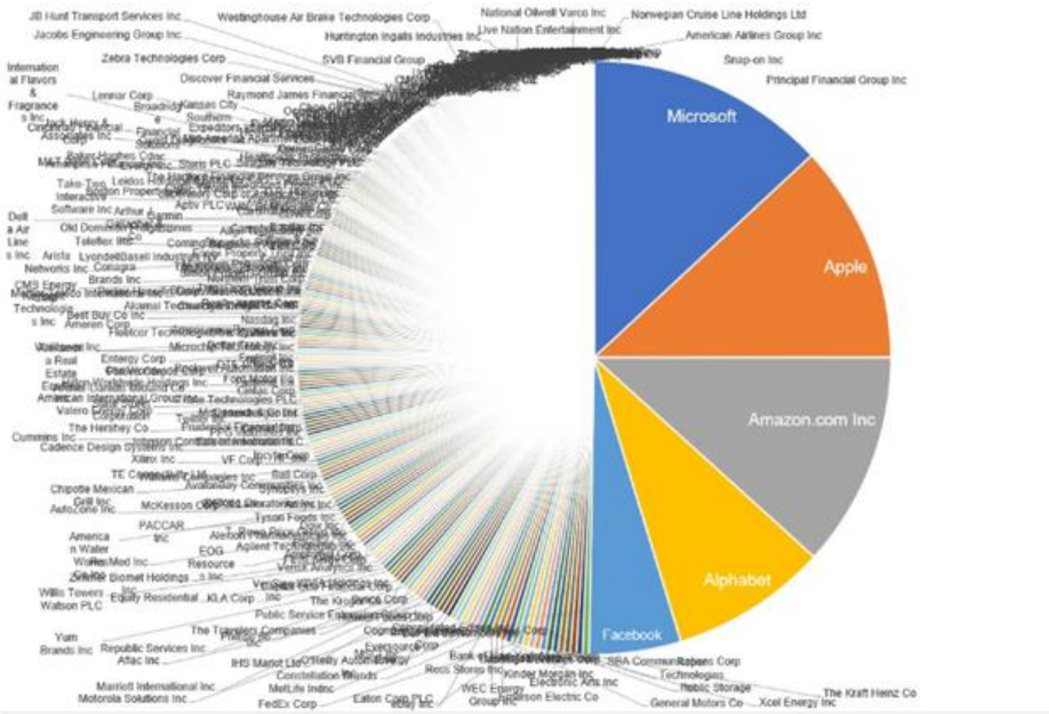
VT Tyndall North American Fund

COVID-19 Commentary 6th May 2020

Will the Mega Caps Continue to Dominate?

In a market that continues to surprise many investors, the one thing seems to remain constant is the dominance of the mega caps. The acronyms started many years ago with FANG and have morphed over time to incorporate other behemoths like Microsoft and Apple. These mega caps, with market caps of over $500bn, have been the mainstays of the market in terms of both performance and flows. It is interesting to note that the market cap weighted S&P 500 index is -11.83% year to date versus -19.85% for the equal weighted S&P 500 index, showing the outsized contribution to performance these stocks have made.

In terms of market cap the chart below shows how warped things are in the S&P 500, with the largest five stocks contributing the same market cap share as the bottom 350 companies.



But could this be an amber light of caution? History tells us that stocks and sectors tend not to dominate for extended periods and tend not to remain elevated in terms of their weighting in the index. These stocks have been in the ascendency for about a decade, is it time to call time?

One of the unfortunate things about the use of acronyms to club certain stocks together is that, in reality, they tend not to be very similar. Whilst they may all be mega caps that dominate their industries, these businesses are very different and have idiosyncratic drivers. When ascertaining which companies can continue to thrive and which ones may struggle, we look to the fundamentals of the business and also its stock price performance. It is interesting that despite its complete dominance in its core markets, Alphabet has been broadly in line with the market since January 2016. Facebook has given investors a similar result. Even Amazon and Netflix, clearly boosted by the lockdown, had their time consolidating and tracking sideways. The real standouts have been Apple and (particularly) Microsoft, the latter of which has showed a prolonged period of outperformance against the S&P 500 and is at a new all-time relative high. We view this as bullish, and when we look at the business we can see that Microsoft is very well positioned in the Cloud, in the Enterprise, with the Office suite of products that so many of us use, and also with the Consumer with its Xbox gaming franchise. This dominance across diverse sectors makes it a core holding for the fund.

One of the reasons that investing in the US is so exciting and rewarding is that we are on a constant mission to find the next mega caps. Whilst it still makes sense to own some of these very large companies, the law of large numbers does come into play, as does the fact that these are very well discovered stocks; there aren't many funds that don't own any of the stocks mentioned above, and most own several. So where can we find those companies that are mid-caps today but may become large caps tomorrow?

Technology is clearly the sector to focus on, alongside healthcare in second place, because these two sectors are the hotbed of innovation. As we can see the world constantly changing around us, we look for those companies that have the solutions to the problems we face, particularly now in this new virus-affected world. A theme which stands out to us is the continued and accelerated move from offline to online; not just in shopping of course, but in many aspects of our daily lives. One such stock is Chegg, a name we have owned for years now, which offers students on-line revision and study aids. In its most recent blow-out quarter – reported on Tuesday, with a **32%** gain on the day – it has become clear that this learning platform is fast becoming a hub that students are flocking to whilst campuses are closed. It' is this supercharging of the business, via zero cost customer acquisition, that makes this company such a winner today and gives us great confidence that it will be a much larger company in the next few years.

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Source unless otherwise stated: Bloomberg

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