CAPSTAR FINANCIAL

On The Mark

Tech boom despite the economic gloom?

July 17, 2020

Key Takeaways

- The stock market rally in 2020 has been led by a handful of stocks in the technology sector.
- The concentrated returns in a select handful of stocks have also impacted the divergence in US and International stock performance.
- While it appears tech stocks may be disconnected from the economic reality, the answer to this mystery perhaps lies outside the U.S.

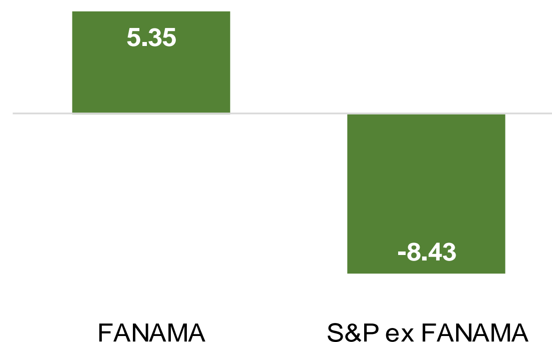
Implications of a concentrated rally

If you are left scratching your head once again on why the stock markets have continued their climb even in the face of record high U.S. daily infections, you are not alone. With the recent rise in COVID-19 outbreaks, some states have put their re-opening plans on hold, or dialed back their plans, thus likely slowing the momentum in economic recovery. Despite the recent challenges, the S&P 500 is nearly flat for the year, down -0.38%, through Friday, July 10th[1].

Looking under the hood reveals a similar theme where investors are once again flocking to the virus-resilient technology sector of the market and leaving the rest of the stock market behind. For a period during the months of May and June, we finally saw broader participation in the markets as the economy began to reopen, which made investors hopeful for a wider recovery. While it's too early to determine if that trend has reversed, in just ten days since the start of July 2020, the growth of combined market caps of the S&P 500's five biggest companies (Apple, Alphabet (Google's parent), Amazon, Facebook and Microsoft) has been more than the actual market cap of any other company in the index[2]. Market capitalization is the value you get when you multiply all the outstanding shares of a stock by the price of single share, in other words, the growth of these five stocks, combined, in a mere ten days is worth more than any other company in the S&P 500 index.

If you were to add Netflix to this famous five bunch, the performance gap relative to the broader market is eye opening. These six stocks make up 22.5% of the S&P 500 market cap and have contributed 5.4% to the S&P 500 return while the remaining 494 stocks remain hurt by the pandemic and have contributed -8.4% to the S&P 500 return year to date through June 30th, 2020.

YTD Contribution to S&P 500

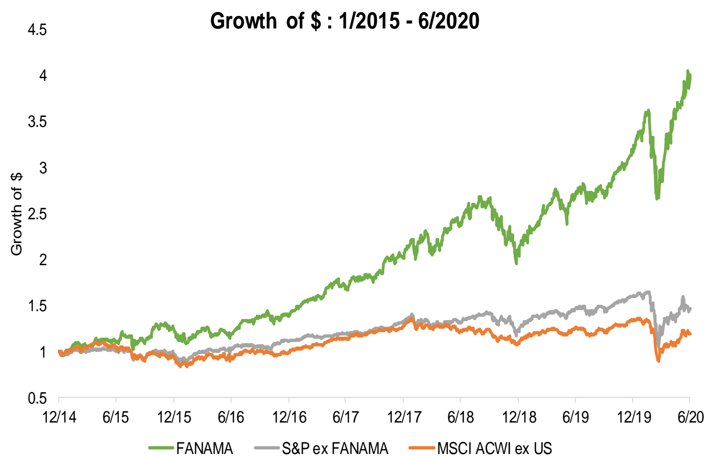


Source: FactSet. FANAMA = Facebook, Alphabet (Google), Netflix, Amazon, Microsoft, Apple. As of 6/30/2020

This trend is not just short-lived but can be seen over the last five years as well. With technology making up a bigger chunk of the S&P 500 market cap index over time, it has favored the market-cap weighted index over the equal-weight version, which uses the same stocks as the cap-weighted S&P 500 but is allocated a fixed weight instead. The S&P 500 has outperformed its equal-weighted

counterpart by nearly 26.3% since 2015 with the gap generally growing over time.

The concentration in returns from the six large mega-cap tech stocks has also impacted the divergence in U.S. and international equity performance. Since the lows of the great financial crisis to the highs in 2020, the US stock market has gained over 401%, while the international market is up less than half of that (+143%). However, when the performance of the largest six stocks were removed from the S&P 500 (S&P ex FANAMA), US equity markets performance was closer in line with international (MSCI ACWI ex US) equity markets as seen in the below graph.



Source: Bloomberg

Are tech stocks disconnected from the economy?

In the quest for an answer, perhaps the most logical explanation is one offered by Barry Ritzholz in his latest Bloomberg column. He cites, the answer perhaps lies outside the U.S. Many technology companies rely on global economies for a large share of their revenue source in addition to the US markets. In the recent crisis, developed nations like South Korea, Germany and Japan have managed to contain the pandemic and are ahead in the re-opening plans relative to the U.S. According to Standard & Poor's, companies in the S&P 500 derived 43% of their sales from overseas markets in 2018. However, the overseas revenue share is much higher for big technology companies. For example, Apple, Facebook and Alphabet generated approximately 55% of their revenue outside the U.S. while Netflix and Microsoft generate nearly 50% from abroad. Amazon is the exception among the six stocks, generating a sizeable majority of its revenue within the U.S.[3]

Despite what seems like a grim situation for the US economy given the latest developments in select states, some companies are well-positioned to not just survive the lockdown, but can also thrive, as consumers have shifted to remote work and finding ways to stay sane while social distancing. In addition, many of these companies will benefit from the rest of the world's economic recovery as well. This is not an endorsement nor a recommendation for these stocks but simply a way to help explain how so much of the market's gains has come from a concentrated group of technology stocks despite what appears to be a slew of bad headlines this year.

[1] Morningstar
[2] https://www.jpmorgan.com/content/dam/jpm/securities/documents/cwm-documents/5-Things-to-Know-This-Earnings-Season.pdf
[3] https://www.bloomberg.com/opinion/articles/2020-07-13/big-tech-drives-the-stock-market-without-much-u-s-help

AssetMark, Inc.

1655 Grant Street
10th Floor
Concord, CA 94520-2445
800-664-5345

IMPORTANT INFORMATION

This report is for informational purposes only, and is not a solicitation, and should not be considered as investment or tax advice. The information has been drawn from sources believed to be reliable, but its accuracy is not guaranteed, and is subject to change.

Investing involves risk, including the possible loss of principal. Past performance does not guarantee future results. Asset allocation alone cannot eliminate the risk of fluctuating prices and uncertain returns. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. No investment strategy, such as asset allocation, can guarantee a profit or protect against a loss. Actual client results will vary based on investment selection, timing, and market conditions. It is not possible to invest directly in an index.

AssetMark, Inc. is an investment adviser registered with the Securities and Exchange Commission.
©2020 AssetMark, Inc. All rights reserved.

100582 | C20-16292 | 07/2020 | EXP 07/31/2021