Ashdon Investment Management

Lessons from the *Nifty Fifty*

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>
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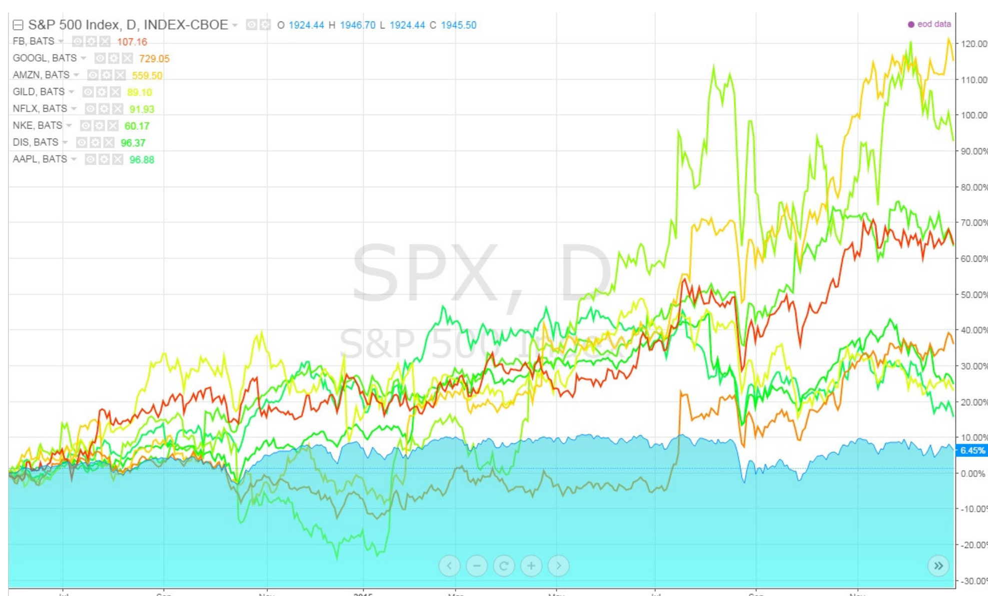
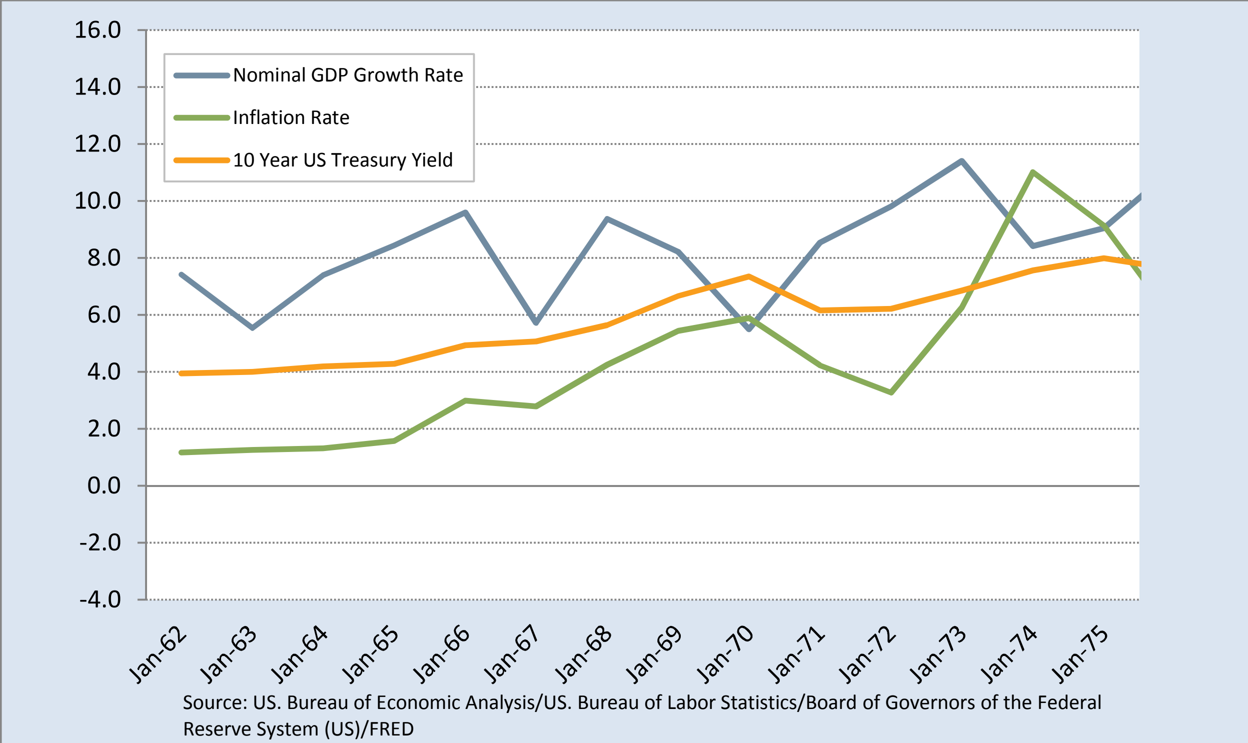
Lessons from the Nifty Fifty

Through the end of 2014 and the entirety of 2015, the US equity markets lost breadth, a term used in bull markets to describe the number of advancing companies relative to declining companies in the market. When breadth is full, companies across the board are going up in value (a healthy bull market), and when breadth is weak, market "leadership" gets narrower and narrower into a handful of companies. The chart below showing the S&P 500 (SPX) in blue along with other top performing names visualizes this well:

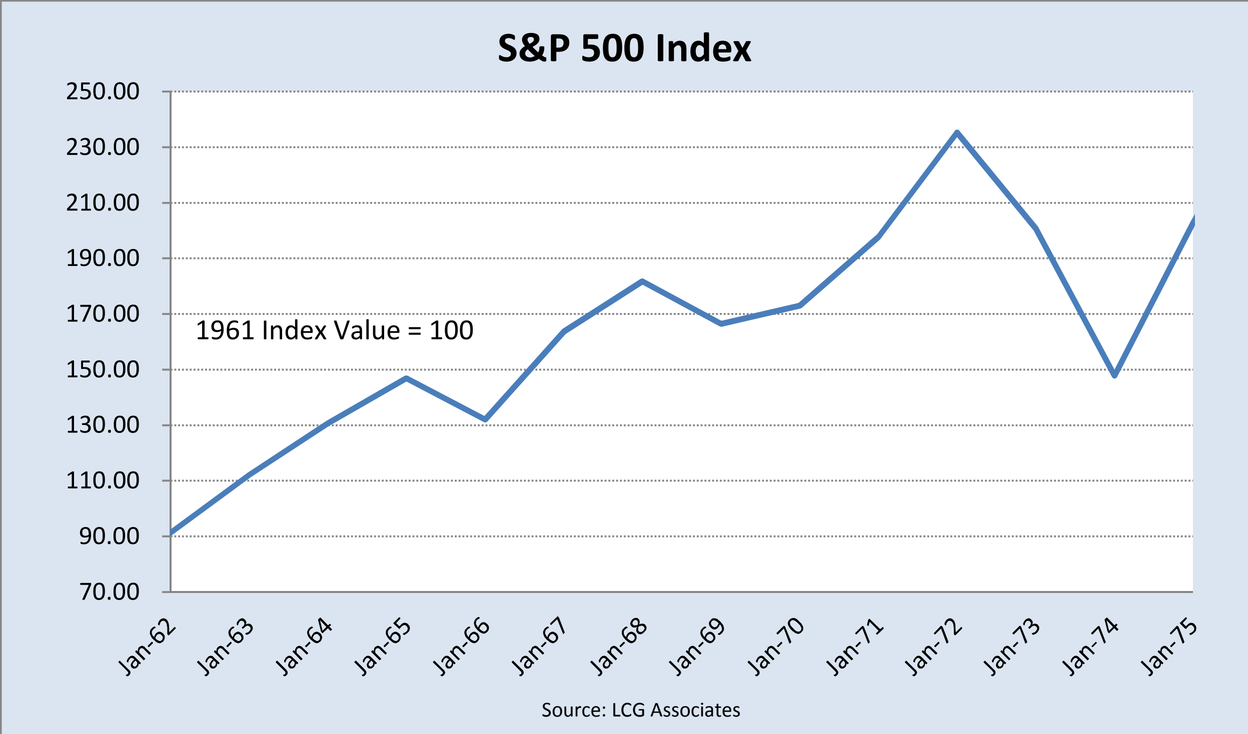


The S&P 500 Index managed to finish the year positive due to significant gains from a small number of companies essentially "propping it up". These companies, **F**acebook, **A**mazon, **N**etflix, **G**oogle (collectively termed *FANG*s), Gilead Sciences, Nike, Disney and Apple, were the prized trades for momentum-oriented, growth equity money managers during the year. Sadly, if you were a mutual fund manager and you didn't own these names, it showed up in lackluster performance. When markets lose breadth but the pressure to perform remains, the disconnect between those few top performers and the rest of the market can be driven worse due to FOMO… or the fear of missing out on large rallies in the market's "high flyers".

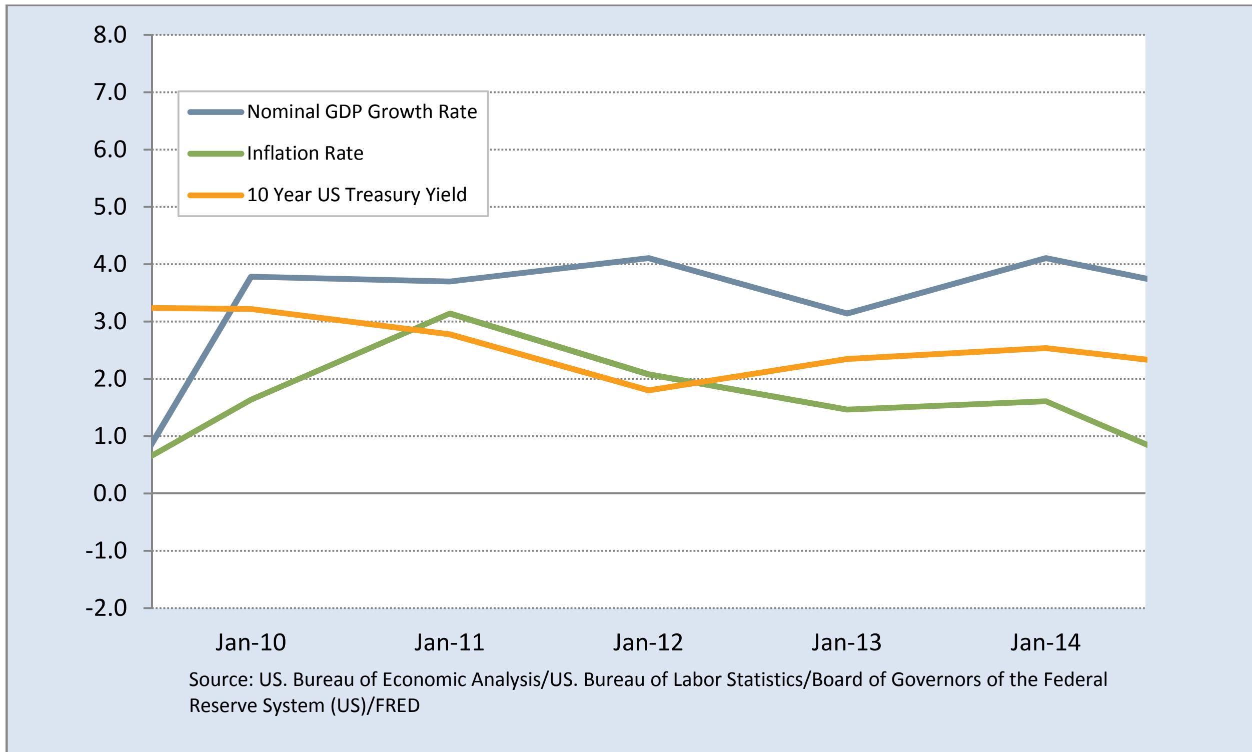
Market environments like this are not uncommon, and we believe that this particular environment is very similar to the bull market of the mid to late 1960's, leading up to the bear markets of '73 and '74. The economic back drop of that time was similar to today, with low inflation, relatively low interest rates and real GDP growth.



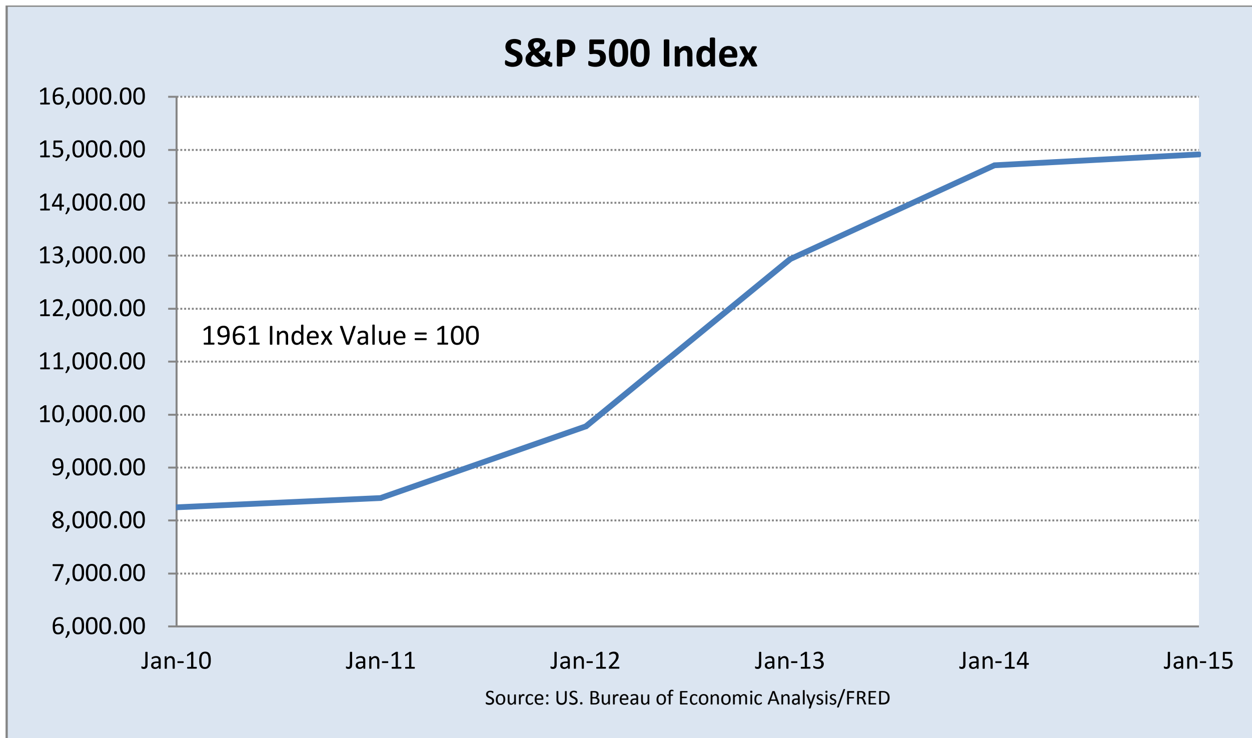
Economic environments like this are usually good for the profit outlook on large, growing corporations. Seeking returns, money will flow into equity markets and company valuations go higher as a result.



Our current economic environment has been similar to the highlighted 1960's period.



As expected, money has flowed into equity funds and company valuations have increased.



Similar to now, in the late 60's leading up to the bear markets of '73 and '74, the equity markets displayed weak breadth. This marked the end of the period known for the *Nifty Fifty*, a term that stock brokers coined for the 50 or so companies that promised the highest earnings growth. These companies were well-known brands to us then and especially now (Coco-Cola, IBM, General Electric, McDonalds and Polaroid were a few). Being supported by an extremely optimistic outlook towards the US economy, investors easily bought the exposure from these companies' enduring growth. As a result, valuations lifted substantially and money managers were questioned if they didn't own them – the mantras of the time were "buy and hold forever", "one decision stocks" and the "only stocks you ever need to own". By the market peak in 1972, these companies had reached nosebleed valuations, whilst lesser-known, slower growing companies were already trading at steep discounts. "The *Richly Nifty Fifty* and the *Depressed Rest*", was a common phrase describing this market period.

Sample Group P/E Ratios	**12/31/1972**
Johnson & Johnson	57.1
Walt Disney Corp	71.2
Coca-Cola Co	46.4
Proctor & Gamble	29.8
Xerox	45.8
Schlitz Joe Brewing Co	39.6
Sears Roebuck & Co	29.2
McDonalds Corp	71.0
General Electric	23.4
Gillette Co	24.3
Phillip Morris Cos.	24.0
Polaroid	94.8
S&P 500 Index	**18.9**

Source: Jeremy Siegel in AAII Journal

FANGs are the current market's *Nifty Fifty*. These companies along with the other four listed above have performed very strongly in this bull market. With every growth-oriented mutual fund and most retail investors owning large positions, they have become significant individual weights in their corresponding indices. These are companies we touch and feel every day and it is hard to see the future without them, much like the companies of the *Nifty Fifty*. And like the *Nifty Fifty*, they trade at atmospheric valuations.

FANG P/E Ratios	**12/31/2015**
Facebook Inc	105.6
Amazon Inc	975.2
Netflix Inc	305.6
Alphabet Inc (Google)	35.6
S&P 500 Index	**21.2**

Source: Morningstar, Inc.

The ending of the story of the *Nifty Fifty* is one of over-sold expectations. First, it is true that an investor who bought into these companies to "buy and hold forever" made money. However, buying into them at any point in the late 60's, especially the peak in 1972 when optimism was the highest, would have produced returns equal to the S&P 500 Index *only if held through the end of 1998*. Judging by the valuations demanded in the marketplace this was not the story brokers sold to investors. Secondly, if a money manager or individual investor purchased the *Nifty Fifty* during the late 60's or early 70's, they would have experienced huge drawdowns during the bear markets of '73 and '74, with names like Xerox, Avon Products and Polaroid falling over 71%, 86% and 91% from their highs in '72. "They were taken out and shot one by one", was a famous quote by a Forbes staff writer describing the widespread sell-off. Unless the execution of investment advice/fund manager skill/individual investor's financial plan was perfect, participants likely sold these names for a loss. Only those participants who bought before the bear market of '73-'74 and held the positions through 1998 would have realized returns equal to the S&P 500 index (12.7% for the period analyzed). In the end, there was so much hype for average market returns…

Although we believe that the fundamental growth stories of *FANG* are sound, the prices at which they are selling for are currently stretched. When combined with weak market breadth, we believe that the risk is high that buying into these names now will only disappoint.

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