

# Global Insight

## Weekly

## In the land of the giants

Kelly Bogdanova – San Francisco

The five largest stocks in the S&P 500 have accounted for a disproportionate share of stock market returns for some time now. We look at why this is concerning but also why it's not. Patience is required for holders of diversified equity portfolios.

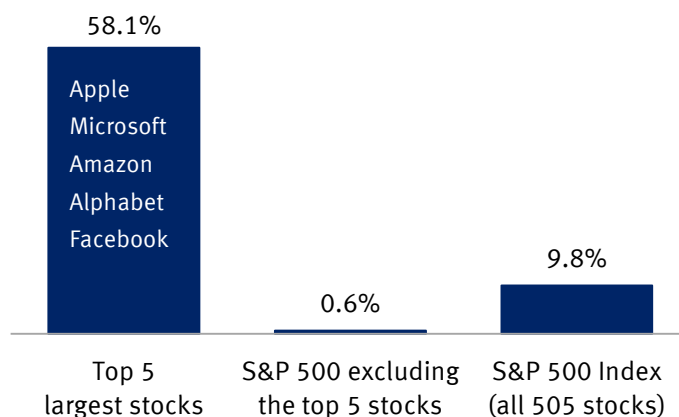
The major equity indexes can be quirky. They are intended to reflect the performance of “the market,” a broad and diverse group of stocks, and they often do. But lately some U.S. indexes haven't mirrored the performance of the overwhelming majority of their stocks.

Take the S&P 500, for example. It's widely considered the benchmark or representative U.S. market index due to its composition of large-capitalization stocks, diversified across 11 sectors and numerous sub-industries.

So far in 2020 and for the past year, a handful of the largest stocks within the S&P 500 have far outpaced the index as a whole. Take these giants out of the index, and it's easy to see there is a chasm between the “haves” and “have-nots”:

- The S&P 500 has risen 9.8 percent in the past 12 months (period ending July 31, 2020). This is a healthy return, about two percentage points above the long-term annual average stretching back almost 100 years, excluding dividends.
- But the five largest stocks by market value (capitalization) represent almost all of the index's gains. These tech-oriented stocks have surged 58.1 percent during the same 12-month period: Apple, Microsoft, Amazon, Alphabet (Google), and Facebook.
- When these tech giants are stripped out of the index, the remaining stocks in the S&P 500 have risen only 0.6 percent collectively, according to a study by our national research correspondent.

The five largest stocks have dominated S&P 500 returns  
Price return in the past 12 months



Source - National research correspondent, RBC Wealth Management, Thomson Financial, FactSet, Bloomberg; data through 7/31/20

### Market pulse

- 3 What to expect from the U.S. economic rebound
- 3 How Canada's recovery is taking shape
- 4 Earnings in Europe better than expected
- 4 Growing divide between China and the U.S.

Click [here](#) for authors' contact information. Priced (in USD) as of 8/6/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see [page 6](#).**  
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Management

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### Not a tech bubble redux

This mismatch is concerning to us because the outsized influence of the five largest stocks on the S&P 500, and that of the next largest 20 stocks, is similar to what occurred during the tech bubble roughly 20 years ago.

The five largest stocks make up 22.6 percent of the S&P 500's market capitalization. That's notably above the 18.0 percent level at the peak of the tech bubble, as the top chart shows. The top 25 stocks represent almost as much of the S&P 500 as they did back then.

But we don't think this is the tech bubble 2.0. There are some key differences between then and now.

First, the five largest stocks are less expensive. Today they trade at an elevated price-to-earnings (P/E) ratio of 34.3x based on the forward 12-months consensus earnings forecast. At the height of the tech bubble, the five largest stocks traded at an unseemly P/E ratio of 46.9x. Today's tech giants are also less expensive on other valuation metrics, including net debt-to-EBITDA.

Second, the large mismatch in stock performance seems justified to us based on earnings trends. In the last 12 months, which includes the difficult COVID-19 collapse in earnings, the tech giants have grown earnings by 6.0 percent, while the rest of the S&P 500 has experienced a 13.1 percent decline in earnings, according to our national research correspondent.

Third, there is also a big disparity in profit margins. Net margins have risen 17.5 percent for the five tech giants compared to 10.2 percent for the rest of the S&P 500, on a trailing 12-month basis.

### Be disciplined

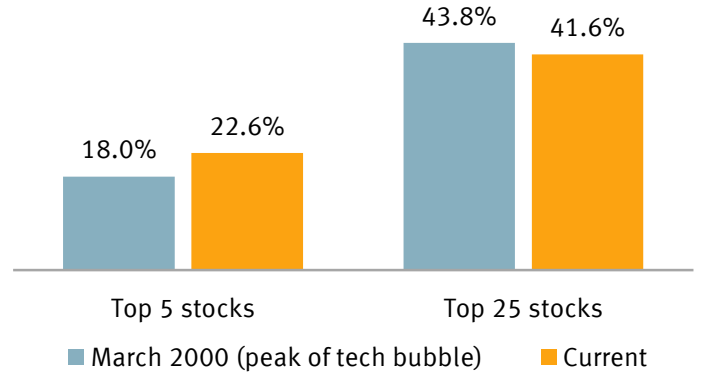
As we've [written previously](#), it's not unusual for a handful of stocks to get hot for periods of time. We think mismatches in performance between the largest contributors to S&P 500 gains and diversified portfolios will largely sort themselves out over the medium and long term.

It's notable that among the five largest stocks during the height of the tech bubble—Microsoft, Cisco Systems, General Electric, Intel, and Exxon Mobil—only one is among the five largest stocks today: Microsoft. And even that stock went through a difficult stretch for more than 10 years after the tech bubble burst.

S&P 500 leadership changes over time, which reinforces our longstanding view that it's prudent to hold diversified portfolios. Until shifts in leadership occur, patience is required.

### Market concentration today is comparable to the tech bubble era

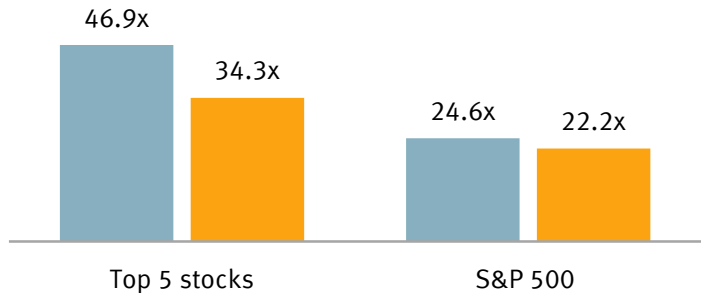
Percentage of market capitalization (weight) in the S&P 500



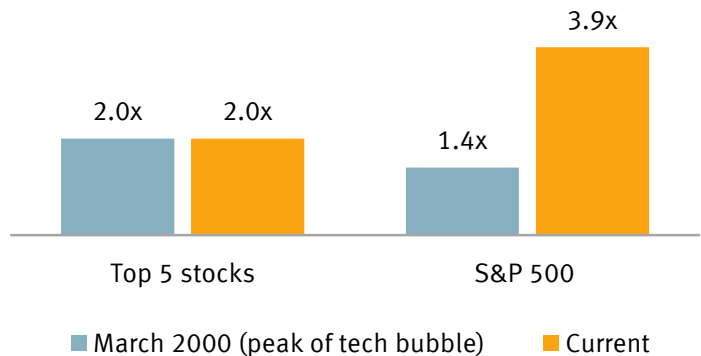
Source - National research correspondent, Thomson Financial, FactSet, RBC Wealth Management; data represents 3-month moving average for both periods, current data as of 7/31/20

### The largest 5 stocks are less expensive than during the tech bubble era

Price-to-earnings ratio based on next 12 months consensus earnings forecast



Price-to-earnings divided by growth rate (PEG ratio) based on next 12 months consensus earnings forecast



Source - National research correspondent, Thomson Financial, FactSet; current data as of 7/31/20



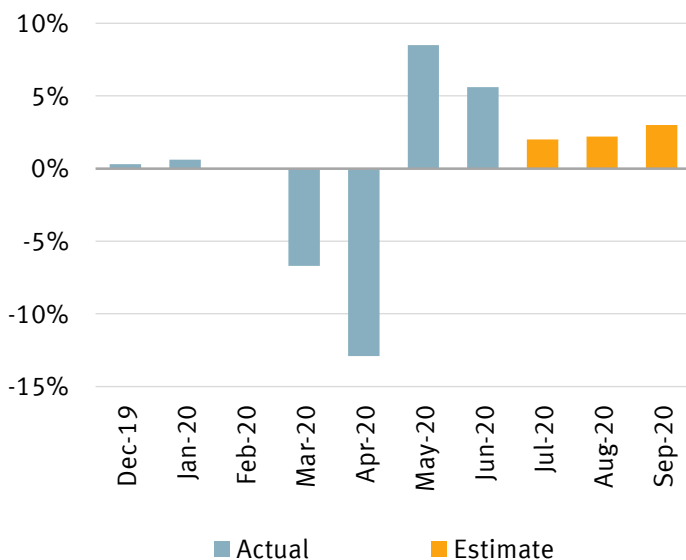
## United States

Alan Robinson – Seattle

- **Stocks eked out moderate daily gains for most of the week** with the S&P 500 pushing within 2% of its all-time high posted on Feb. 19. In the tug of war between fiscal stimulus and COVID-19 fears, the former won out as the Senate moved toward a deal before its August recess, with election-year pressures making an eventual deal likely. Virus caseloads in the hardest-hit states appeared to plateau, and positive news flow regarding potential vaccines continued.
- While fiscal stimulus is important in the near term, its longer-term consequences came into focus as ratings agency **Fitch dropped the outlook for its AAA rating on the U.S. from stable to negative**, citing a deteriorating public finance picture. But bond yields continued to fall despite this downgrade and the Mortgage Bankers Association 30-year mortgage rate setting a new record low at 3.1%.
- On the economic front, U.S. data were mixed during the week, with **positive Institute for Supply Management surveys offset by weaker-than-expected construction spending**. All eyes are waiting for the July unemployment report due on Aug. 7. Consensus forecasts are for the unemployment rate to drop to 10.5% from the 14.7% peak seen in April.
- **This will be the first major data point to shed light on the likely third-quarter rebound in the economy.** While

Third-quarter data should improve q/q, but heavy lifting was done at end of Q2

U.S. personal consumption expenditures (m/m change, not annualized)



Source - RBC Wealth Management, FactSet, Atlanta Fed estimates

consensus forecasts are for GDP to grow by 18.8% this quarter from the 32.9% contraction in Q2 2020, if we drill into the monthly details, we see a more muted trend. This was due to an activity surge in May and June, which implies the bulk of the economic rebound may be behind us.

- **Microsoft (MSFT) stock rose during the week as it announced its intention to strike a deal to buy social media upstart TikTok's assets in the U.S., Canada, Australia, and New Zealand.** We think this would assuage White House concerns over China's control over U.S. data, and also potentially provide Microsoft a competitive advantage in the growing field of artificial intelligence.



## Canada

Carolyn Schroeder & Sayada Nabi – Toronto

- **Canada's imports and exports jumped sharply in June on the automobile sector's recovery**, though a slower gain in exports led the goods trade deficit to widen to CA\$3.19 billion. According to RBC Economics, the bouncebacks in exports (+17.1% m/m) and imports (+21.8% m/m) were stronger than expected, but both measures were still down relative to pre-pandemic levels. The June increase in trade flows was led by 200%+ increases in both exports and imports of motor vehicles and parts, but increases were also posted in most sub-categories on both sides. **The big risk going forward remains that re-escalation of COVID-19 in the U.S. could prompt renewed shutdowns and weigh on Canadian trade flows again.** At this point, it still looks more likely that the resurgence will stunt the pace of near-term growth south of the border than to re-test the exceptionally low levels of activity in Q2.
- **Canadian GDP data showed a modest economic recovery across the country.** Following an 18% drop across March and April, Canadian GDP rebounded 4.5% in May, and Statistics Canada projects another increase of 5% in June. **The gain in May was widespread but primarily led by the goods and public sector industries along with retail trade.** Construction output grew 17.6% m/m, manufacturing rose 7.4% m/m, and retail was up 16.6% m/m. Moving over to the hospitality sector, accommodations and food services, which experienced a 70% decline over March and April, bounced back 24.2% m/m. While there were many signs of economic recovery throughout the nation, the arts and entertainment segments of the economy declined an additional 3% m/m. As the population continues to alter its day-to-day activities, RBC Economics expects a continued growth lag in the services industry as demand will be under pressure due to the remaining safety protocols amid the pandemic.



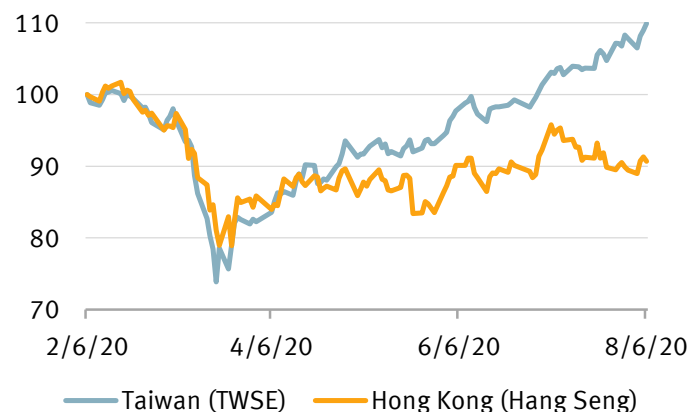
## Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- We are more than halfway through the Q2 earnings season in Europe. So far, in aggregate, Q2 results have been better than expected, though, admittedly, consensus expectations were very subdued. **Some 60% of the companies in the STOXX Europe 600, an index of UK and Continental European entities, have beaten consensus earnings per share (EPS) estimates**, a higher rate than the average over the past decade, which stands at 50%.
- Aggregate EPS has declined 23% y/y overall. This was severely impacted by the poor performance of the Energy sector, where earnings collapsed by close to 70% y/y as the freefall in oil prices prompted large asset write-downs. **Excluding Energy, STOXX Europe 600 companies' EPS declined on average by "only" 10% y/y.**
- This seems like an unusually small decline in earnings, given the sharp economic contraction experienced globally in the period. It can be explained by a few larger companies, which did relatively well, cutting expenses ferociously to support earnings, thus skewing the average. **A more telling measure of what companies had to confront is suggested by the EPS contraction for the median stock.** This measure excludes outliers and is more reflective of the highly unfavourable economic conditions faced by European and UK companies in Q2, and points to a more severe earnings contraction of 35% y/y (vs. a 17% y/y decline in Q1).
- Unsurprisingly, cyclicals, especially Financials, but also Industrials and Materials, delivered weak earnings in the quarter. Conversely, the **Consumer Staples and Information Technology sectors have posted the highest levels of beats** versus consensus expectations so far.

### Taiwan Index outperforms Hong Kong

Relative stock index performance (last six months)



Source - RBC Wealth Management, Refinitiv; normalized daily stock index levels, with 2/6/20 = 100

- Given expectations were exceeded in Q2, **2020 earnings estimates have troughed**, with the consensus now projecting full-year earnings to fall by some 30%. Continued improvement in economic activity and a recovery in oil prices would underpin earnings revisions further, in our view. Consensus expectations currently have earnings rebounding by some 35% in 2021.
- The Bank of England (BoE) kept both the bank rate and its asset purchase target unchanged at 0.1% and £745 billion, respectively. **The BoE thus retains the ability to provide further stimulus in the autumn**, when both the nature of the trading relationship with the EU and shape of the economic recovery will likely be clearer.



## Asia Pacific

Jasmine Duan – Hong Kong & Nicholas Gwee, CFA – Singapore

- Asian equities have traded mostly higher this week, but volatility arose in the Chinese and Hong Kong markets after the **U.S. said it will expand its "clean network" campaign against "untrusted" Chinese apps.** This effort could affect some popular apps, such as internet giant Tencent's (700 HK) WeChat. After weeks of threatening to ban TikTok, a video-sharing app, President Donald Trump offered a 45-day reprieve to allow Microsoft (MSFT) to explore buying TikTok's U.S. operations.
- **The U.S. and China will hold talks on Aug. 15 to discuss the progress and challenges in implementing the Phase 1 trade deal**, according to Bloomberg. China has been lagging behind the purchase target set in January due to the COVID-19 outbreak. By the end of the first half of the year, China had bought about 23% of the total purchase target, an acceleration from May's 19% but still far from the target.
- The market viewed the signing of the Phase 1 deal as a milestone between the two countries. However, with **tensions escalating on the trade, technology, financial, and even diplomatic fronts, talks on Phase 2 appear increasingly remote**, in our view. Even Trump has said that the first deal means less to him now. If the Trump administration views the U.S.-China conflict as between two fundamentally opposed systems, it may be harder to strike any agreement going forward.
- China's latest Purchasing Managers' Index (PMI) data suggest **the country extended its economic rebound in July** on recovering foreign demand and strong fiscal support. The official Manufacturing PMI rose from 50.9 in June to 51.1 in July with the main driver a rise in new orders. The export orders component jumped, suggesting that headwinds to foreign demand are easing.



## MARKET SCORECARD

## Data as of August 6, 2020

| Equities (local currency) | Level      | MTD   | YTD    | 1 yr   | 2 yr   |
|---------------------------|------------|-------|--------|--------|--------|
| S&P 500                   | 3,349.16   | 2.4%  | 3.7%   | 16.2%  | 17.5%  |
| Dow Industrials (DJIA)    | 27,386.98  | 3.6%  | -4.0%  | 5.2%   | 7.4%   |
| NASDAQ                    | 11,108.07  | 3.4%  | 23.8%  | 41.8%  | 41.3%  |
| Russell 2000              | 1,544.62   | 4.3%  | -7.4%  | 2.8%   | -8.3%  |
| S&P/TSX Comp              | 16,579.10  | 2.5%  | -2.8%  | 2.7%   | 1.0%   |
| FTSE All-Share            | 3,358.54   | 2.3%  | -20.0% | -14.3% | -20.2% |
| STOXX Europe 600          | 362.49     | 1.7%  | -12.8% | -1.4%  | -6.7%  |
| EURO STOXX 50             | 3,240.39   | 2.1%  | -13.5% | -1.6%  | -7.0%  |
| Hang Seng                 | 24,930.58  | 1.4%  | -11.6% | -4.0%  | -10.4% |
| Shanghai Comp             | 3,386.46   | 2.3%  | 11.0%  | 21.9%  | 25.2%  |
| Nikkei 225                | 22,418.15  | 3.3%  | -5.2%  | 8.9%   | -0.4%  |
| India Sensex              | 38,025.45  | 1.1%  | -7.8%  | 2.8%   | 0.9%   |
| Singapore Straits Times   | 2,559.10   | 1.2%  | -20.6% | -19.3% | -22.1% |
| Brazil Ibovespa           | 104,125.60 | 1.2%  | -10.0% | 1.9%   | 28.5%  |
| Mexican Bolsa IPC         | 37,998.34  | 2.6%  | -12.7% | -4.5%  | -23.0% |
| Commodities (USD)         | Price      | MTD   | YTD    | 1 yr   | 2 yr   |
| Gold (spot \$/oz)         | 2,065.82   | 4.6%  | 36.2%  | 40.1%  | 71.1%  |
| Silver (spot \$/oz)       | 28.95      | 18.7% | 62.2%  | 76.0%  | 89.3%  |
| Copper (\$/metric ton)    | 6,498.75   | 1.2%  | 5.7%   | 14.9%  | 6.5%   |
| Oil (WTI spot/bbl)        | 41.95      | 4.2%  | -31.3% | -21.8% | -39.2% |
| Oil (Brent spot/bbl)      | 45.16      | 4.3%  | -31.6% | -23.4% | -38.8% |
| Natural Gas (\$/mmBtu)    | 2.16       | 20.0% | -1.4%  | 2.3%   | -24.5% |

| Govt bonds (bps chg) | Yield   | MTD  | YTD    | 1 yr   | 2 yr   |
|----------------------|---------|------|--------|--------|--------|
| U.S. 10-Yr Tsy       | 0.535%  | 0.6  | -138.3 | -116.8 | -240.5 |
| Canada 10-Yr         | 0.463%  | -0.4 | -123.9 | -77.6  | -189.0 |
| U.K. 10-Yr           | 0.108%  | 0.4  | -71.4  | -40.7  | -119.6 |
| Germany 10-Yr        | -0.531% | -0.7 | -34.6  | 0.5    | -92.0  |

| Fixed Income (returns) | Yield | MTD  | YTD  | 1 yr  | 2 yr  |
|------------------------|-------|------|------|-------|-------|
| U.S. Aggregate         | 1.05% | 0.1% | 7.8% | 8.8%  | 18.9% |
| U.S. Invest Grade Corp | 1.83% | 0.3% | 8.7% | 11.3% | 24.1% |
| U.S. High Yield Corp   | 5.22% | 0.5% | 1.2% | 5.6%  | 11.6% |

| Currencies        | Rate     | MTD   | YTD   | 1 yr  | 2 yr  |
|-------------------|----------|-------|-------|-------|-------|
| U.S. Dollar Index | 92.7740  | -0.6% | -3.8% | -5.0% | -2.7% |
| CAD/USD           | 0.7514   | 0.8%  | -2.4% | -0.2% | -2.3% |
| USD/CAD           | 1.3307   | -0.8% | 2.4%  | 0.2%  | 2.3%  |
| EUR/USD           | 1.1877   | 0.8%  | 5.9%  | 6.1%  | 2.8%  |
| GBP/USD           | 1.3142   | 0.4%  | -0.9% | 8.0%  | 1.5%  |
| AUD/USD           | 0.7237   | 1.3%  | 3.1%  | 7.0%  | -2.0% |
| USD/JPY           | 105.5400 | -0.3% | -2.8% | -0.9% | -5.3% |
| EUR/JPY           | 125.3500 | 0.5%  | 2.9%  | 5.1%  | -2.6% |
| EUR/GBP           | 0.9037   | 0.4%  | 6.8%  | -1.8% | 1.3%  |
| EUR/CHF           | 1.0808   | 0.5%  | -0.4% | -1.2% | -6.2% |
| USD/SGD           | 1.3687   | -0.4% | 1.7%  | -0.9% | 0.0%  |
| USD/CNY           | 6.9535   | -0.3% | -0.1% | -1.0% | 1.5%  |
| USD/MXN           | 22.4147  | 0.6%  | 18.4% | 14.5% | 21.0% |
| USD/BRL           | 5.3279   | 2.0%  | 32.2% | 41.0% | 42.6% |

Source - Bloomberg. Note: Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing. Data as of 9:35 pm GMT 8/6/20.

Examples of how to interpret currency data: CAD/USD 0.75 means 1 Canadian dollar will buy 0.75 U.S. dollar. CAD/USD -2.4% return means the Canadian dollar fell 2.4% vs. the U.S. dollar year to date. USD/JPY 105.54 means 1 U.S. dollar will buy 105.54 yen. USD/JPY -2.8% return means the U.S. dollar fell 2.8% vs. the yen year to date.

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|-----------------------|-------|---------|---|---------|
|                       |       |         | Count   | Percent |
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| Hold [Sector Perform] | 635   | 42.25   | 130   | 20.47   |
| Sell [Underperform]   | 92    | 6.12    | 12  | 13.04   |

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