Investing in 'The Latest Thing' Companies Could Make You Rich - But it Probably Won't

A few weeks ago, a long-standing client said to me "If only I had invested $1,000 in Microsoft, Apple or Google when they first listed!"

That got me thinking about the *'Do Stocks Outperform Treasury Bills?'* research by Hendrik Bessembinder of Arizona State University.

The main finding is that advocates of buy-and-hold investing have a fresh batch of powerful evidence supporting the wisdom of their ways.

It also shows that if you fancy yourself as a stock-picker, you had better be truly exceptional, because if you are not, the chances are that the future is not going to be pleasant! That is the sobering news from this new academic research.

Having said that, buying one stock offers better odds than buying a lottery ticket.

However, the bad news is that those 'better' odds are still much too dire to stake one's future on.

Not only do most stocks deliver long-term underperformance when compared to some of the low-risk assetsavailable, but the great bulk of equity-market wealth is created by just a tiny percentage of the very best stocks.

The research studied the performance of more than 64,000 global stocks from January 1990 to December 2020, it revealed that the compound returns of 55.2% of U.S. stocks, as well as 57.4% of non-U.S. stocks, underperformed an essentially risk-free one-month U.S. Treasury bill.

Moreover, the whole of the $75.7 trillion in net global stock market wealth created over the past 30 years was generated solely by the top-performing 2.4% of stocks.

As previously mentioned, these findings are courtesy of Hendrik Bessembinder, a finance professor at the W.P. Carey School of Business at Arizona State University, and they also underscore the importance of diversification.

“Accurately identifying the precious few "home run" stocks amid the many thousands of underachieving names is extremely difficult.

Your portfolio is more likely to suffer because you chose wrong and failed to invest in the market's best stocks over the long term.

The results help to explain why active strategies, which tend to be poorly diversified, most often underperform,” according to Bessembinder.

A better alternative to trying to find these rare needles in haystacks might be a paraphrase used by Jack Bogle, the Vanguard founder and pioneer of index investing; “Just buy the haystack”.

The reality is that if most stocks are underperforming, yet the market as a whole does well, the only way these two things can occur together is that there are a few very big stocks doing really well that pull the whole market up.

Below are the 30 best stocks of the past 30 years, measured by wealth created between January 1990 and December 2020.

A quick mention about wealth creation: The stocks below didn't necessarily deliver the highest percent changes in share price. Rather, they created the most shareholder wealth, which is essentially the increase in market value adjusted for cash flows in and out of the business, such as dividends and share repurchases.

Think of it this way: A micro-cap stock that grows into a small-cap stock after delivering a 10,000% price increase rewards anyone lucky enough to have bet on that name, but it adds very little to equity investors' overall collective wealth. It doesn't drive the major indexes higher, fill the coffers of pension funds or enrich anyone beyond the comparatively small number of traders and investors initially involved in the stock. (You can see that this is completely different from selecting Apple, Google and Microsoft a day or so after IPO, when they were tiny setups, vying for money, market share and name awareness alongside thousands of other companies).

However, these 30 top global stocks from the past 30 years, mainly very well-known names to most of us, with one not so well-known Chinese based company, have generated massive wealth for a great many investors over the decades.

30. Nvidia
29. Walt Disney
28. Oracle
27. LVMH Moet Hennessey Louis Vuitton
26. Coca Cola
25. Intel
24. Altria (Marlboro Cigarettes)
23. UnitedHealth Group (Insurance)
22. Alibaba
21. Mastercard
20. Roche
19. Visa
18. Kweichow Moutai (World’s largest beverage company)
17. Home Depot
16. JP Morgan Chase
15. Exxon Mobil

14. Proctor & Gamble
13. Nestlé
12. Berkshire Hathaway
11. Taiwan Semiconductor
10. Johnson & Johnson
9. Samsung Electronics
8. Meta Platforms
7. Wal-Mart
6. Tesla
5. Tencent
4. Alphabet
3. Amazon
2. Microsoft
1. Apple

Of these top 30 stocks in wealth creation, Exxon Mobil created the most, at $939 billion, and Amazon had the best monthly return, generating 2.6 percentage points of return above T-bills per month.

So when you start picking these new, dynamic, potential millionaire-makers (trying to find the needle in the haystack), you are taking on a hugely unbalanced risk, with a tiny chance of a great return but a very large chance that you'll lose ground to inflation.

That's true, as far as it goes, but the main message of the study is the huge value of diversification and 'buying the haystack', which can be very easily done these days through index funds and ETFs.

Investors selecting individual stocks are statistically better positioned by selecting those market-leading, profitable large companies with good cash-flow, capital reserves, and intrinsic value.

Apple, Google and Microsoft were definitely not in this category when they listed at $22, $85 and $21 respectively!

For most people choosing individual small stocks, you're very likely to miss the very few that turn out to be winners.

If you are planning for your retirement or some other significant life event, this extensive research seems to make it clear that buy and hold index investing gives you a much better and less risky chance of achieving your own financial objectives.