



**BAILLIE GIFFORD**

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# Introduction

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What can a US academic's research teach Baillie Gifford about the handful of companies behind nearly all net gains on global stock markets?

**Tim Alcorn, Head of Investment Risk, looks at what we've learned**

Studies of 'asymmetry' by Professor Hendrik Bessembinder – which looked at global stock market returns between 1990 and 2018 – established that just 1.3 per cent of stocks contributed all of the net gain when compared to the performance of US Treasury bills.

Following this discovery, the next step for the Arizona State University scholar was to sift through vast volumes of company data over a much longer time frame to discover the common characteristics of those big winners. Bessembinder looked at the wealth creation of companies over 10 year periods. As the data covers many decades, some companies were measured multiple times.

**26,285**  
1950 ————— 2019  
number of firms analysed

This research, sponsored by Baillie Gifford, revealed surprising things about successful companies – insights that might make these companies easier to spot earlier and to hold over time. The papers are available (links at the end of this document), but what follows is a summary of three big lessons from Bessembinder on extreme stock market performers.

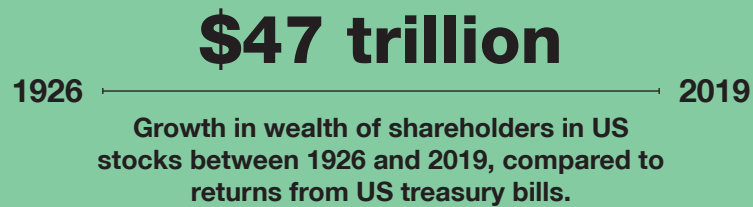
# Focus on growth

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Investing in research and development while still achieving superior growth in returns, scale and profitability is a key characteristic of winning companies. Firms succeed or fail for myriad reasons, but this appears to be a must-have.

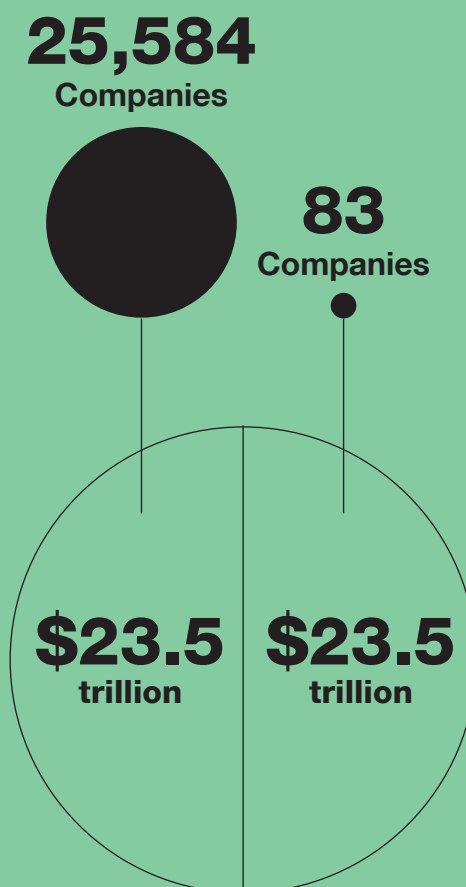


Bessembinder's new research into successful firms stemmed from his discovery of how, over a longer time frame, very few companies have made a big difference.



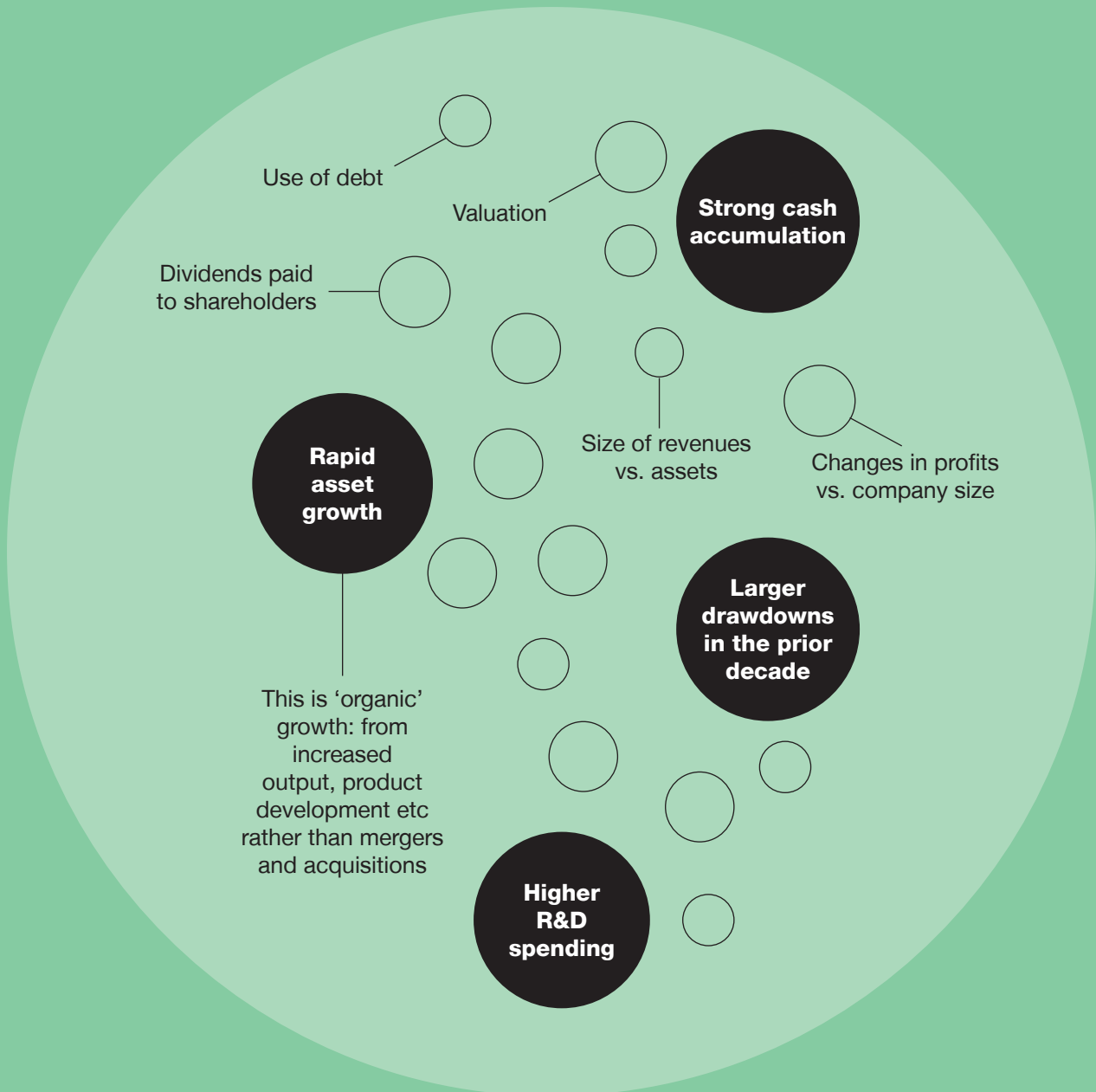
### An uneven split

This \$47 trillion has been disproportionately generated by a small number of companies – fewer than 100 of them have created half of this wealth.



## The data only tells us so much

Bessembinder looked at 22 key fundamental metrics in his analysis of 26,285 firm/decades – the wealth created by a company over 10 years – going back to 1950. He found only four stand-out factors to have statistical significance.



## Improve the odds

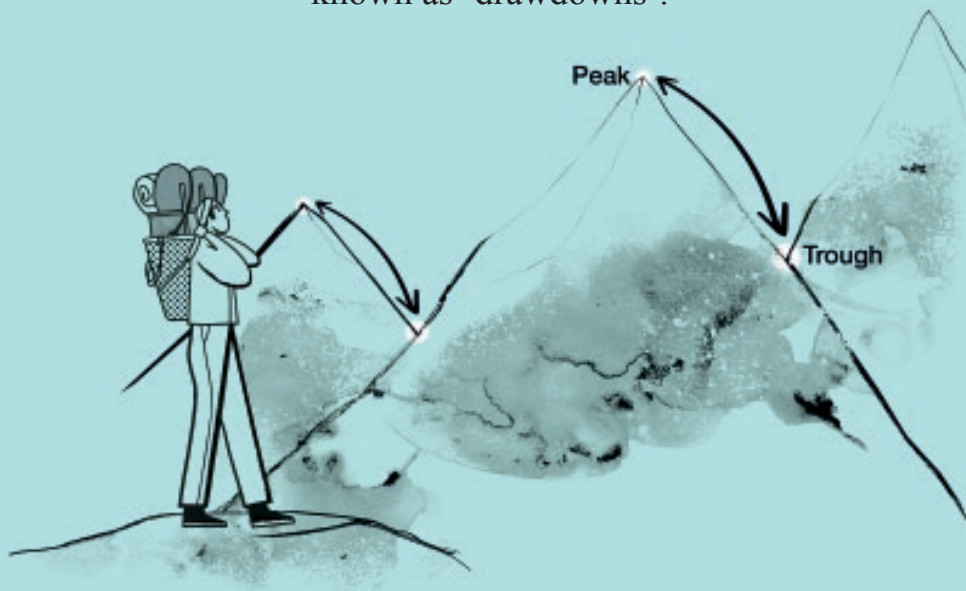
Such analysis of past performance can't help predict which firms will succeed in future. Nevertheless Bessembinder's work points out a clear correlation between possession of these measurable characteristics and long-term performance.

### What Bessembinder teaches

By looking at firms' outcomes decade by decade, Bessembinder provides patterns of evidence suggesting that, over long-term horizons, returns follow fundamentals. This means that the firms that perform best are those that quickly grow their assets and accumulate cash. Whether it's a high-returning young company or a wealth-creating mature company, spending more on research and development is key to profitability. Investors should deploy capital into the growth companies likeliest to generate capital returns. Bessembinder's analysis makes these companies easier to spot.

# Expect drawdowns

Long-term investors in top-performing companies must have the stomach for large peak-to-trough share price declines, known as ‘drawdowns’.



Bessembinder highlighted two examples, Apple and Amazon:

## Apple

**\$1.64 trillion**

1981  
January

shareholder wealth generated

2019  
December

**74%**  
drawdown

**May–Aug 1983**  
during infighting  
leading to ousting of  
Steve Jobs

**80%**  
drawdown

**Feb 1992–Dec 1997**  
being outcompeted by  
PCs and rise of  
Microsoft Windows

**79%**  
drawdown

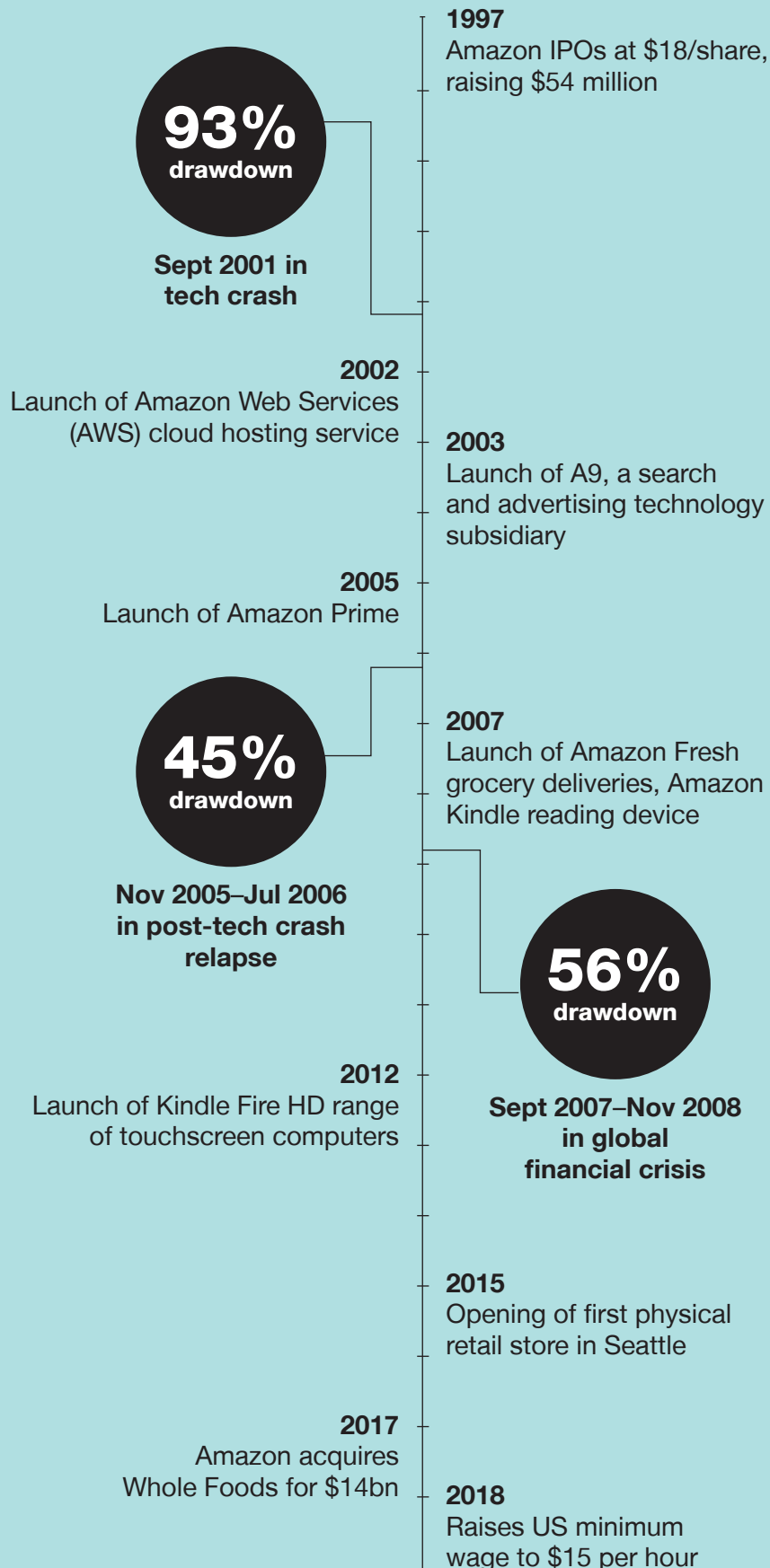
**Mar 2000–Mar 2003**  
(including 76%  
Aug–Sept 2000)  
in tech crash



## Amazon

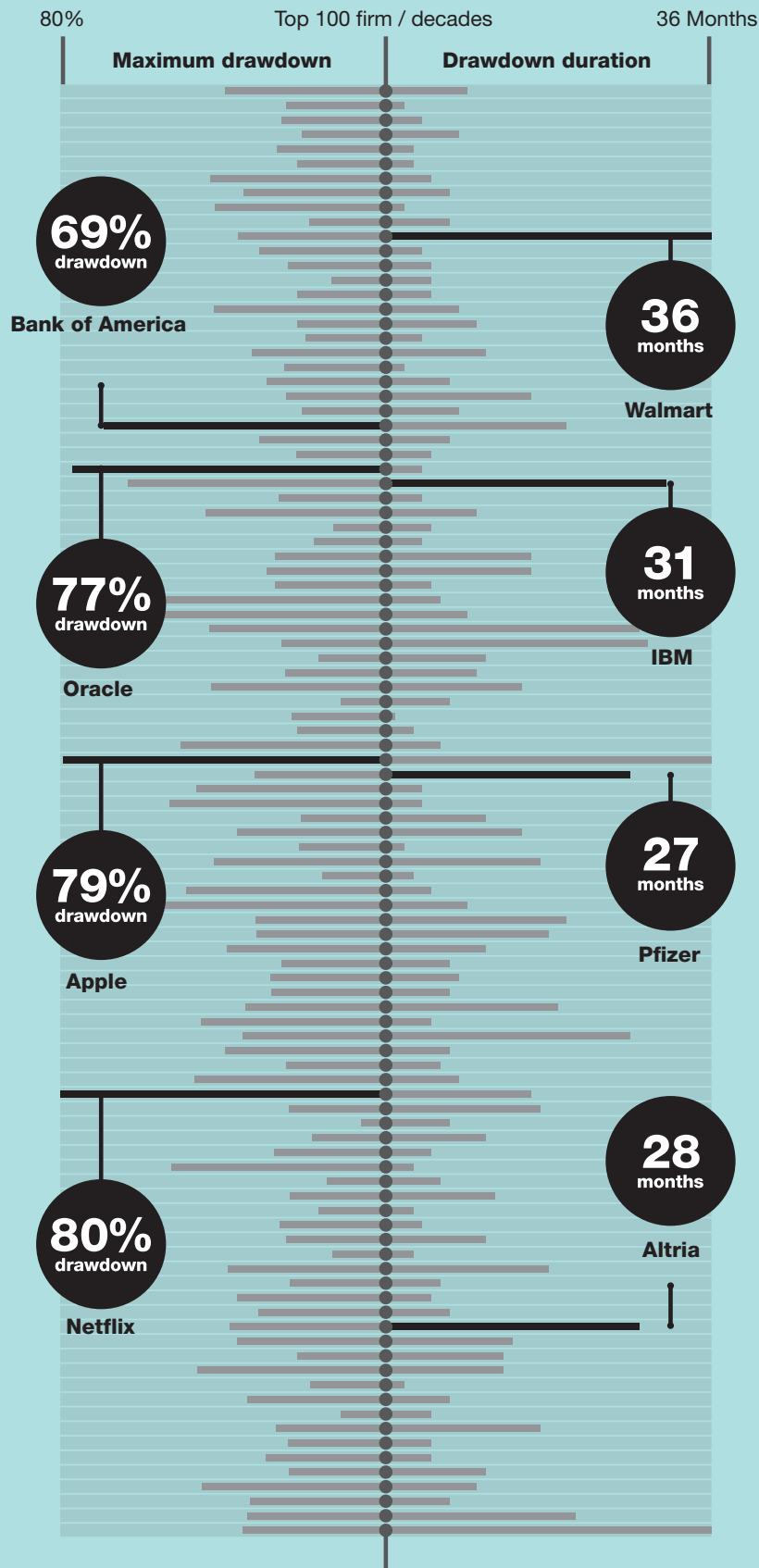
# \$865 billion

1997 June ————— 2019 December  
shareholder wealth generated



## The pattern is replicated across multiple companies and sectors

Painful drawdowns are widespread across the 100 firms that created the most shareholder wealth over the decades.



# 32.5%

Average loss of value in a drawdown in the same decade as spectacular success

# 10 months

Average duration of those drawdowns

## What Bessembinder teaches

It's not news that even top-returning companies are prone to severe drawdowns. However Bessembinder's research reveals the severity and length of some of these periods of falling value.

Investment managers must therefore tolerate occasional volatility in pursuit of big long-term gains. As share prices often reflect investors anticipating each others' next move, the share price of a listed company sometimes has a remote relationship with the business it represents. This suggests that investors shouldn't seek to be different from the index, but to ignore it. The focus should instead be on the fundamental progress of a business.

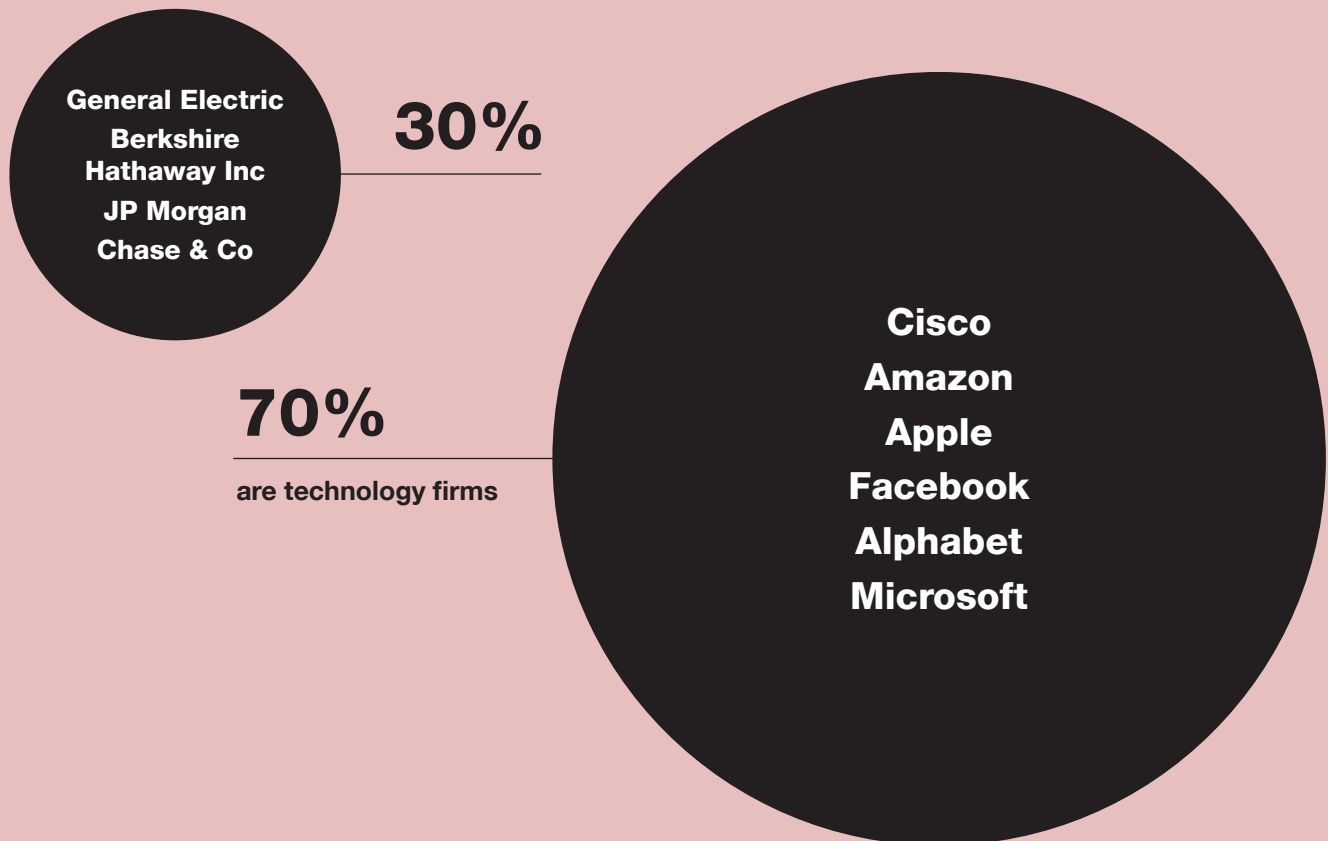
# Beware biases, don't assume

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Just because tech stocks have been some of the strongest performers, it doesn't follow that companies in that category have an outsized chance of extreme performance. Bessembinder's research reveals the opposite to be true.



## Top 10 examples of wealth creation in US companies over 10-year periods (between 1950–2019)



### So are technology firms more likely to succeed?

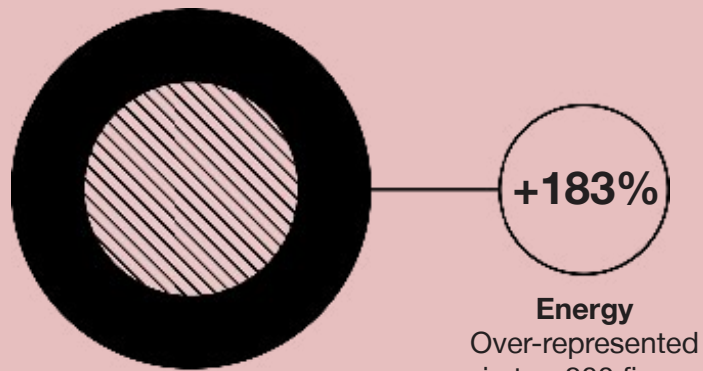
Just because Amazon, Apple and Microsoft are prominent among the wealth creators of recent decades, it doesn't follow that tech companies have a better chance of outperforming. In fact, among outperformers, there is a smaller proportion of tech stocks than those in less glamorous sectors.

### Unsung heroes

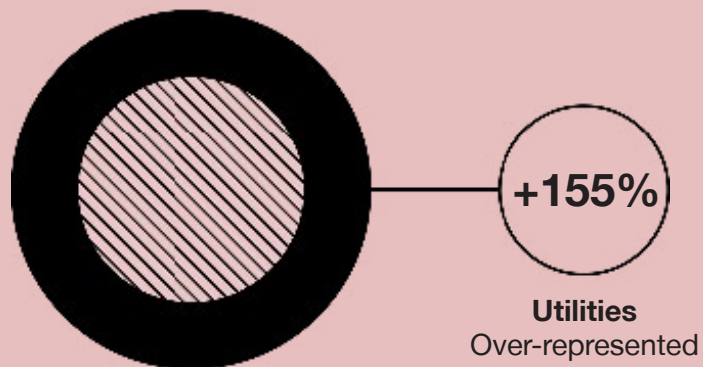
A number of technology firms feature prominently in the top wealth creators in Bessembinder's 26,000-company dataset.

But the proportion of outperformers versus more average performers is higher in other sectors such as energy, telecoms and utilities.

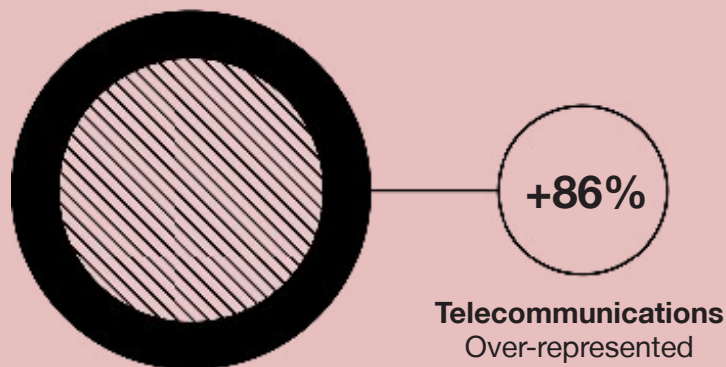
● Number of firms from each sector in the data set's top 200 wealth creators, as a percentage of ● the number of companies from those sectors in the entire dataset (minus the top 200 firms)



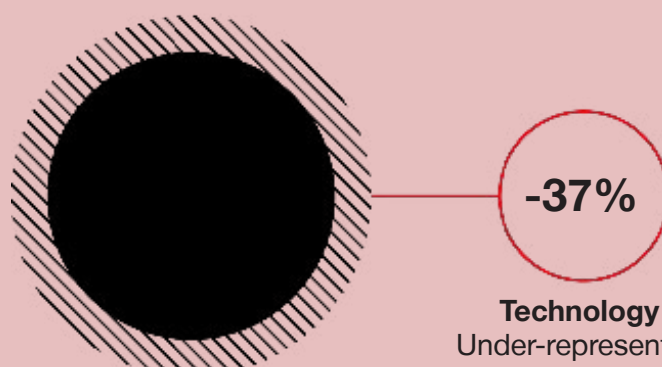
**Energy**  
Over-represented  
in top 200 firms



**Utilities**  
Over-represented  
in top 200 firms



**Telecommunications**  
Over-represented  
in top 200 firms



**Technology**  
Under-represented  
in top 200 firms

### **What Bessembinder teaches**

Perceptions of industries can be misleading. Investors should beware the assumptions and mental short-cuts they use in describing top winners and what drives them. Industry definitions don't help and sometimes over-simplify. Amazon for example is not a 'tech company' but a tech-enabled retail company. What's needed is a careful study of individual firms and their competitors. The best approach is to build relations with founders and managers to help assess their chances of success.

# Thanks to Hank

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Hendrik ‘Hank’ Bessembinder is a professor of competitive business at Arizona State University. His 2017 paper ‘Do Stocks Outperform Treasury Bills?’ revealed that the entire gain in the US stock market since 1926 was attributable to the best-performing 3 per cent of listed companies. The paper was the first to provide an academic basis for the long-established investor practice of ‘running your winners’. The practice is based on the power of ‘asymmetry’ in investing: the belief that gains from successful investments can, over time, far outweigh losses from failures. The paper has been downloaded more than 32,000 times and cited in 41 further studies.

In 2019, in research sponsored by Baillie Gifford entitled ‘Do Global Stocks Outperform US Treasury Bills?’, Bessembinder showed that the skewed nature of stock market returns was even more extreme internationally. About 61 per cent of non-US stocks underperformed Treasury bills in the 1990–2018 period, and 1.3 per cent of stocks contributed all of the net gain when compared to the performance of US Treasury bills.

The above research is taken from Prof Bessembinder’s papers, also supported by Baillie Gifford. Published in July 2020, the research examines the characteristics of ‘Extreme Stock Market Performers’.

## **Extreme Stock Market Performers, Part I**

Expect Some Drawdowns

[\*\*bailliegifford.com/drawdowns\*\*](https://bailliegifford.com/drawdowns)

## **Extreme Stock Market Performers, Part II**

Do Technology Stocks Dominate?

[\*\*bailliegifford.com/technologystocks\*\*](https://bailliegifford.com/technologystocks)

## **Extreme Stock Market Performers, Part III**

What are their Observable Characteristics?

[\*\*bailliegifford.com/characteristics\*\*](https://bailliegifford.com/characteristics)

## **Extreme Stock Market Performers, Part IV**

Can Observable Characteristics Forecast Outcomes?

[\*\*bailliegifford.com/outcomes\*\*](https://bailliegifford.com/outcomes)



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