50 Years Later: Lessons from the Nifty Fifty

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Rising inflation and interest rates. A tumultuous political environment. Significant shifts in monetary policy. The stock market hits bear market territory, dragged down by many of the growth companies that led the market higher for the previous decade.

A summary of the first half of 2022? Yes. But it is also an apt description of what occurred in 1973 and 1974. History may not repeat itself, but once again it is rhyming.

Fifty years ago, the "Nifty Fifty" growth companies captured the imagination of institutional and individual investors alike. Many, such as Pfizer, Gillette, Coca-Cola, McDonald's, Walt Disney, and American Express, are still ubiquitous global brands. Others, such as Sears Roebuck, Xerox, Polaroid, and Eastman Kodak, live in infamy for their eventual failures. In December of 1972, however, what they all had in common was an air of invincibility–popularly dubbed "one-decision stocks"–and eye-popping valuations–an average price-to-earnings (P/E) ratio of 42x compared to 19x for the S&P 500®.[1]

Today's highest profile companies have been known by a variety of acronyms, but by any name the years-long market leadership of Apple, Microsoft, Amazon, Alphabet, Meta, and Tesla has rhymed with the leadership of the Nifty Fifty in the '60s and early '70s. More broadly, by the end of 2021, the extended dominance of growth stocks over their value counterparts had pushed the Russell 1000® Growth's P/E ratio to 34x compared to 23.3x for the S&P 500®.[2]

How the rest of the story plays out in 2022 and beyond remains to be seen. Yet what played out after the Nifty Fifty declined precipitously in 1973-74 provides some valuable lessons for long-term investors.

At first, the story of the Nifty Fifty seemed obvious: these companies were overpriced, bound to crash, and should never have commanded such high valuations–a classic bubble. Zooming out, however, the story changes. An investor who purchased an equal-weighted portfolio of the entire Nifty Fifty (as defined by Morgan Guaranty Trust) at its peak in December 1972, and did nothing but rebalance it monthly for the next 25 years (until August 1998), would have returned 12.5 percent annually, roughly in line with the S&P 500®'s 12.7 percent annualized return over the same period. Collectively, the Nifty Fifty delivered earnings per share (EPS) growth of 11 percent annually for those 25 years; the S&P 500®'s annualized EPS growth over the same period was 8 percent.[3] Ultimately, the premium valuation commanded by this collection of companies in 1972 came close to properly reflecting the premium fundamental results they would produce in the coming decades.

Of course, the high-level results of the Nifty Fifty also fail to tell the whole story. As with any portfolio, the fortunes of the underlying companies diverged dramatically. One might fairly assume that a portfolio which performs roughly in line with an index held 50 percent outperformers and 50 percent underperformers. In the case of the Nifty Fifty, however, only 30 percent of companies outperformed the S&P 500® from 1972 to 1998. And this is hardly an anomalous distribution. In their seminal study, "The Capitalism Distribution," Longboard Asset Management observed that only 36 percent of stocks in the Russell 3000® Index actually outperformed that index from 1983 to 2006. Over the same period, the data showed that the average annualized return of an individual stock was negative, and it was the top 25 percent of all stocks which were responsible for all the market's gains–one in five companies returned more than 300 percent, while one in five lost more than 75 percent of its value in its lifetime.[4]

Riverbridge was founded 35 years ago on the belief that a timeless investment philosophy and a teachable, repeatable investment process could tilt the odds toward identifying companies capable of compounding their earnings power for decades and hold them for long enough for market returns to reflect the intrinsic value they've built. There are fewer companies capable of doing this than many appreciate, but they share common characteristics: purpose-driven management teams who have built flexible and adaptable cultures, strategic customer relationships, enduringly differentiated products and services, and the ability to internally fund their growth.

Our investment team remains singularly committed to identifying these fundamentals, monitoring their persistence, and allocating capital to businesses that demonstrate the ability to execute and change in the face of a future none of us can precisely predict. Our long-term track record of compelling risk-adjusted returns is a testament to this commitment, and never is it more important than during periods of market and economic turbulence to focus on companies with the building blocks for enduring value creation.

References:

[1] http://csinvesting.org/wp-content/uploads/2015/11/valuing-growth-stocks-revisiting-the-nifty-fifty.pdf

[2] Factset, data pulled 6/30/2022

[3] http://csinvesting.org/wp-content/uploads/2015/11/valuing-growth-stocks-revisiting-the-nifty-fifty.pdf

[4] http://docplayer.net/58926779-The-capitalism-distribution-total-lifetime-returns-for-individual-u-s-stocks-1983-to-2006.html