TRIVARIATE RESEARCH

THE NIFTY NINETY: A FRAMEWORK FOR PICKING STOCKS THAT ARE $100 BILLION CAP. OR LARGER

11/18/2021

ADAM S. PARKER, Ph.D., FOUNDER

adam@trivariateresearch.com
646-734-7070

COLIN COONEY, HEAD OF SALES

colin@trivariateresearch.com
617-910-7934

ALBERT MISHAAN, ANALYST

albert@trivariateresearch.com
732-710-8996

BRAD ROCHE, SR. SALES CONSULTANT

brad@trivariateresearch.com
516-434-9623

RESEARCH SUMMARY

Ten years ago, there were roughly 30 companies in the US equity market that had a market capitalization greater than $100 billion. At that time, most generalist portfolio managers had formed investment views of these companies, had seen the management teams present or met them over the years, and had a pretty good command of the investment debates for nearly all of these companies. However, today there are 93 companies that have greater than 100b market capitalization – double the number of companies that reached this exclusive barrier three years ago. These names account for roughly 60% of the total market cap. of the SP500. For equity investors whose performance is directly (or even indirectly) benchmarked to the SP500, it has never been more important to be able to generate performance from this exclusive club.

While conventional wisdom might say it is very difficult to generate alpha from mega cap stocks because they are well understood and covered, we wanted to dimension the potential alpha for this group before providing a framework for investing in this cohort.

In this report, we show the annual performance potential of the 60th vs. 40th percentile and 70th vs. 30th percentile performers among the $100 billion club. By overweighting (or buying) stocks that perform in the 60th percentile of the group, and underweighting (shorting) stocks in the 40th percentile, the average monthly performance spread is 2.6%. For a more skilled investors, getting 70th percentile overweight performance and 30th percentile underweight performance generates 5.4% monthly performance in this group of large cap stocks. For hedge funds, who on average run with close to a 200% gross exposure and a 60% net exposure today, performance is 2.9% and 5.7% for 60-40 and 70-30 exposure per month. Investors need a framework for analyzing this group, and that is our goal from today's research.
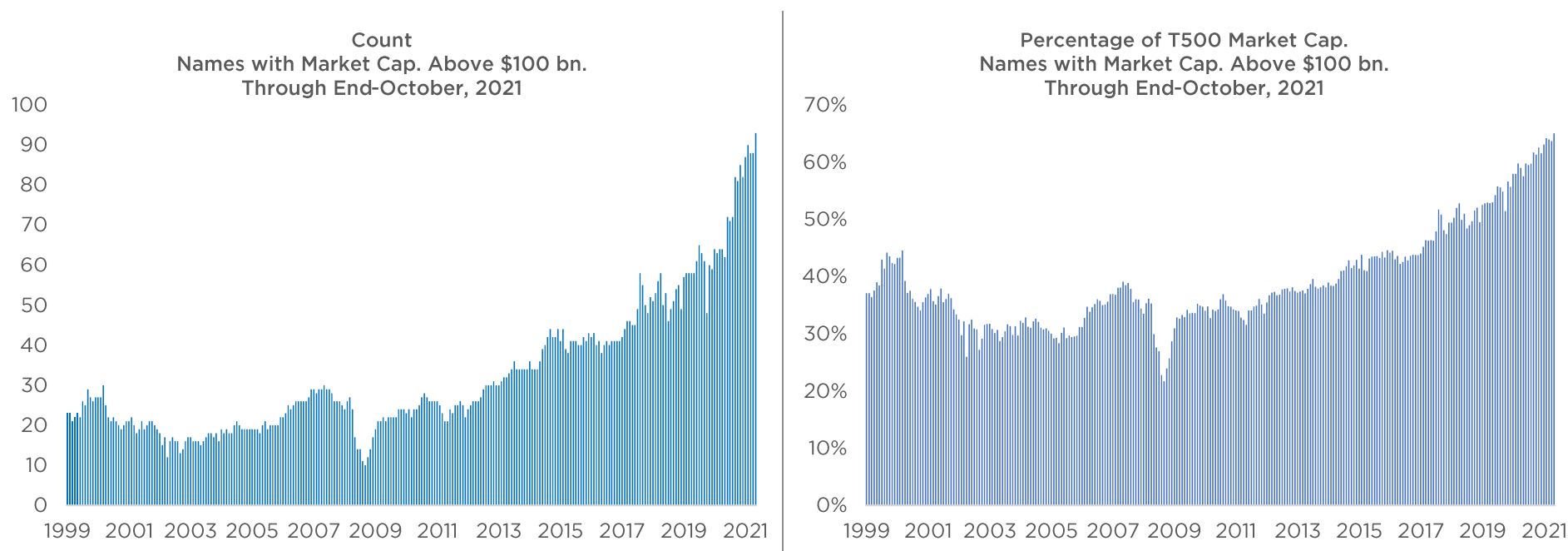
CONCLUSIONS

Given the $100 billion club has so much potential alpha, we want to provide ways for investors pick winners from losers. Our first approach is to evaluate the efficacy of our quantitative models, which we used to run live money at our prior venture, Trivariate Capital. Our approach is to forecast 18-month forward returns by first breaking the top 3000 US equities into 21 separate cohorts.   Using balance sheet, cash flow statement, income statement, valuation, sentiment, and accounting metrics, we build traditional statistical models designed to identify subsequent winners and losers through a ranking system. Our model has historically worked well on these stocks, with the top quintile (Q1) consistently and substantially beating the SP500, and the bottom quintile (Q5) consistently lagging the market. The $100 billion club overall modestly lags the market. As such, we think it make sense to use your quantitative model for idea generation in this Nifty Ninety group of stocks.

Following the assessment of our quant model, we looked for additional approaches to parse winners from losers. In total, we evaluated four additional methodologies to identify winners and losers in the $100 billion club including consensus sell-side recommendations, non-consensus buyside high conviction, share gain, and share loss.

We show the ranking of each stock on each of the five metrics and the aggregate score on pages 10-12. The stocks that screen particularly well now are the stocks that have high forecasted growth and are liked by the sell-side, including the big cap technology stocks (except Apple), and payments. The approach disfavors the semiconductor stocks. There is no doubt that the primary bias to this list is that it rewards what has worked recently for these stocks over the last five years, and that if there is a no paradigm it will fail. Hence, we thought it useful to show the ranking on each metric should investors want to weight the underlying components differently.
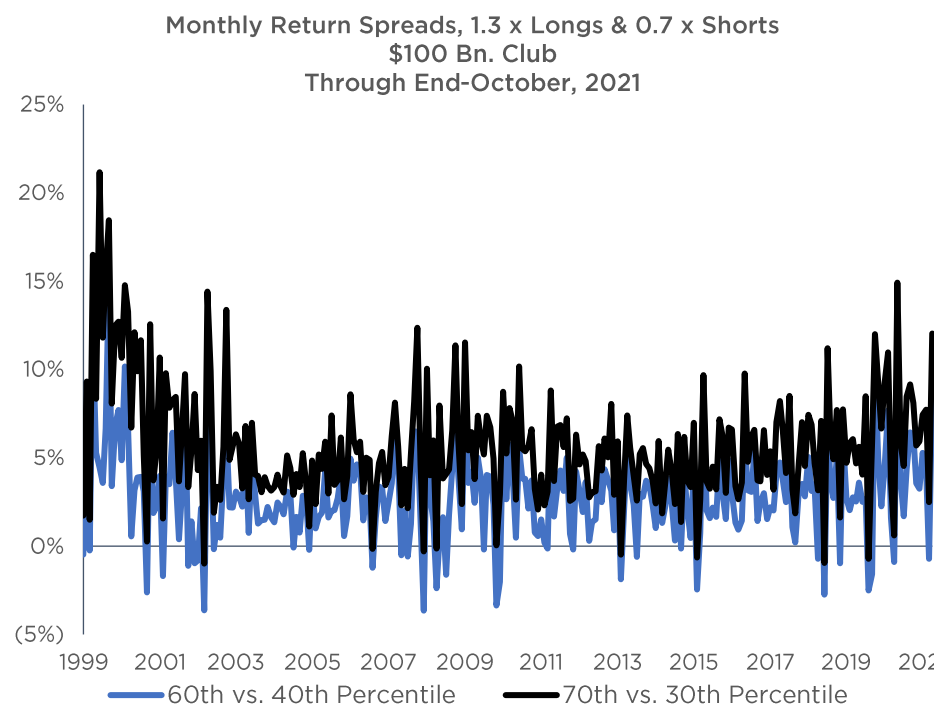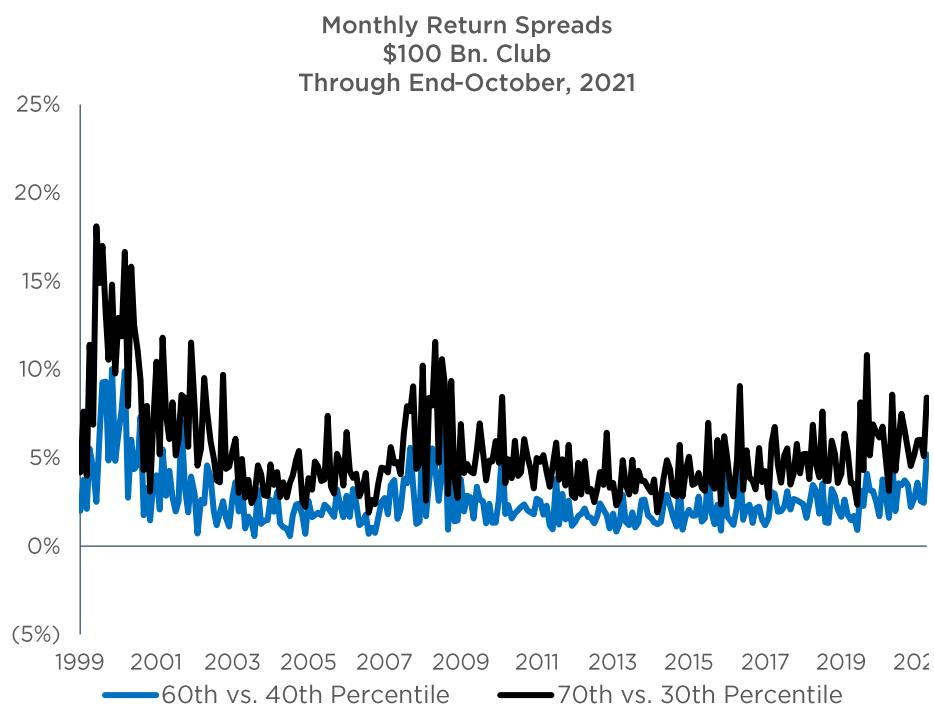
THE NUMBER OF STOCKS THAT ARE $100 BILLION CAP. HAS GROWN

Ten year ago, there were roughly 30 companies in the US equity market that were greater than $100 bn. market capitalization. At that time, most generalist portfolio managers had formed investment views on these companies, had seen the management teams present or met them over the years, and had a pretty good command of the investment debates for nearly all of these companies.. Today, however, there are over 90 companies (left) that have greater than 100b market capitalization, double the number of companies that had reached this exclusive barrier three years ago. These names account for roughly 60% of the total market cap. of the SP500 (right). For any equity investor whose performance is directly benchmarked to the SP500, it has never been more important – and more challenging – to be able to generate performance from these names.

Count
Names with Market Cap. Above $100 bn.
Through End-October, 2021

Percentage of T500 Market Cap.
Names with Market Cap. Above $100 bn.
Through End-October, 2021

ALPHA POTENTIAL IN THIS GROUP IS REASONABLE

While conventional wisdom might say it is very difficult to generate alpha for mega cap stocks because they are well understood and covered, we wanted to dimension the potential alpha for this group before providing a time-saving, and alpha-generative framework for them. Below we show the annual performance potential of the 60th vs. 40th percentile and 70th vs. 30th percentile performers among the 100 billion club. By overweighting (or buying) stocks that perform in the 60th percentile of the group, and underweighting (shorting) stocks in the 40th percentile, the average performance is 2.6%. For a more skilled investors, getting 70th percentile overweight performance and 30th percentile underweight performance generates 5.4% performance in this group of large cap stocks (left). For hedge funds, who on average run with close to a 200% gross exposure and a 60% net exposure today, performance is 2.9% and 5.7% for 60-40 and 70-30 exposure (right) per month. Investors can do well in this group of stocks.

Monthly Return Spreads
$100 Bn. Club
Through End-October, 2021

60th vs. 40th Percentile   70th vs. 30th Percentile

Monthly Return Spreads, 1.3 x Longs & 0.7 x Shorts
$100 Bn. Club
Through End-October, 2021

60th vs. 40th Percentile   70th vs. 30th Percentile

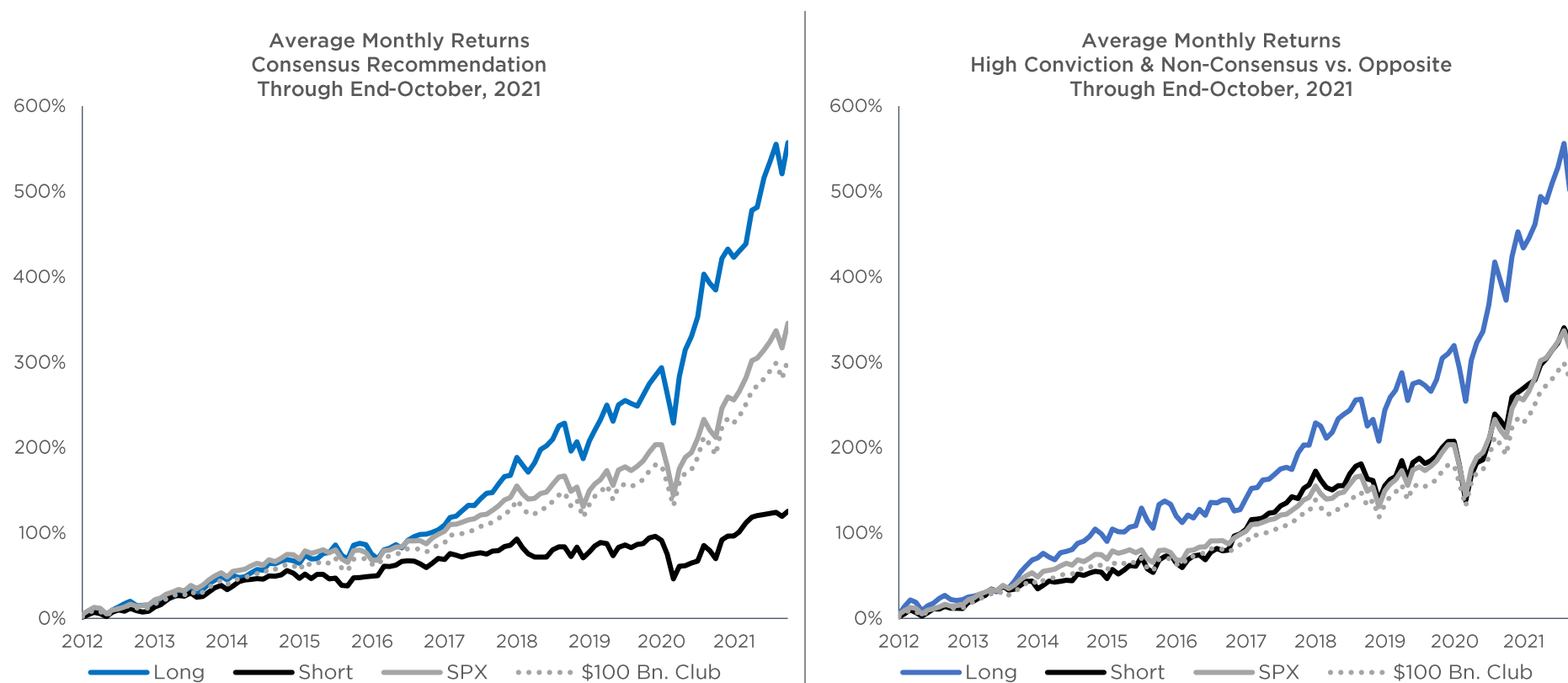# TRIVARIATE'S QUANTITATIVE MODEL DOES WELL ON $100B+ STOCKS

Given there is a huge group of stocks with some potential alpha, we wanted to provide ways for investors pick winners from losers. Our first approach is to evaluate the efficacy of our quantitative models, which we used to run live money at our prior venture, Trivariate Capital. Our approach is to forecast 18-month forward returns by first breaking the top 3000 US equities into 21 separate cohorts.   Using balance sheet, cash flow statement, income statement, valuation, sentiment, and accounting metrics, we build traditional statistical models designed to identify subsequent winners and losers through a ranking system. Our model has historically worked well on these stocks, with the top quintile (Q1) consistently and substantially beating the SP500, and the bottom quintile (Q5) lagging the market. The $100 billion club overall modestly lags the market. As such, we think it make sense to use your quantitative model for idea generation in this Nifty Ninety group of stocks.

Average Monthly Returns
Trivariate Quantitative Model
Through End-October, 2021
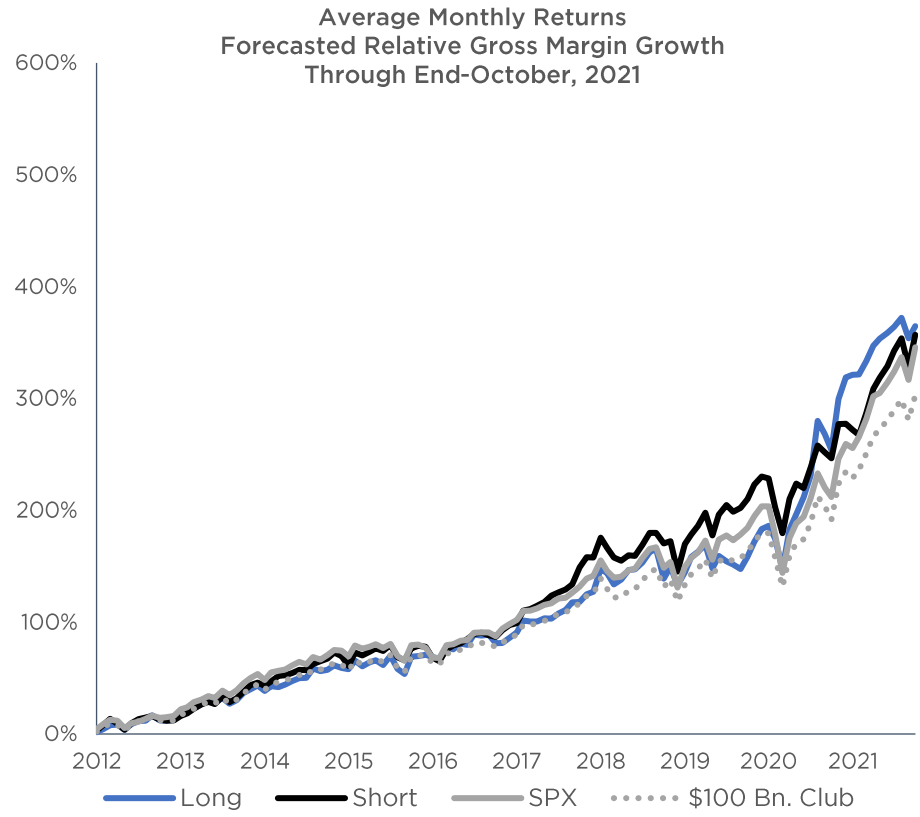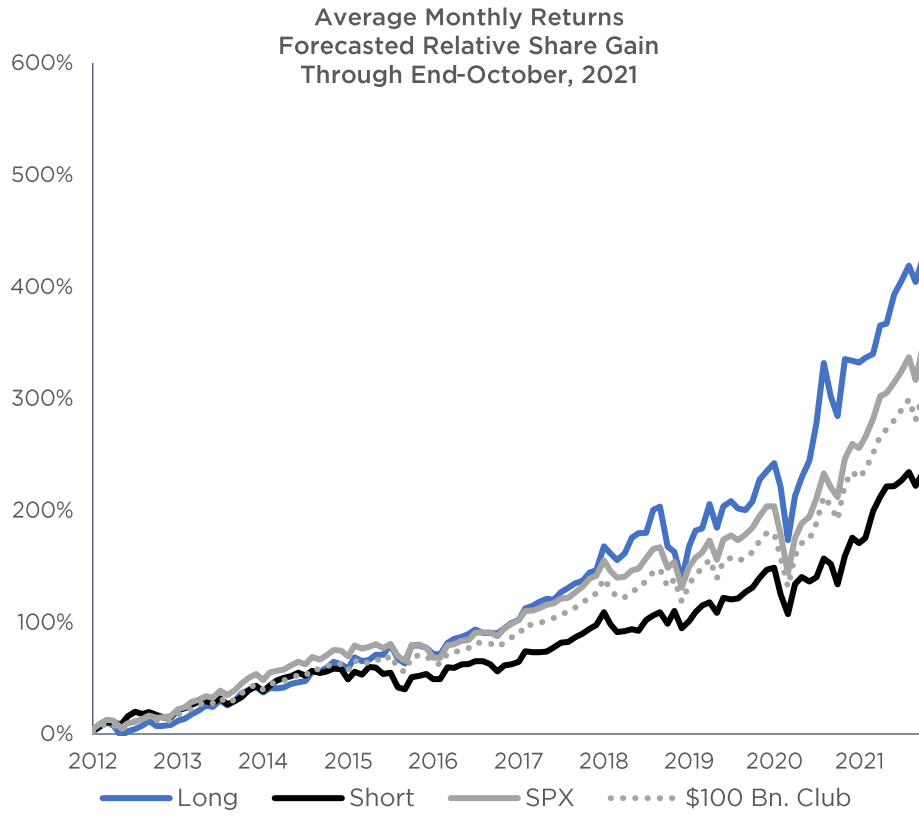

Long — Short — SPX ····· $100 Bn. Club
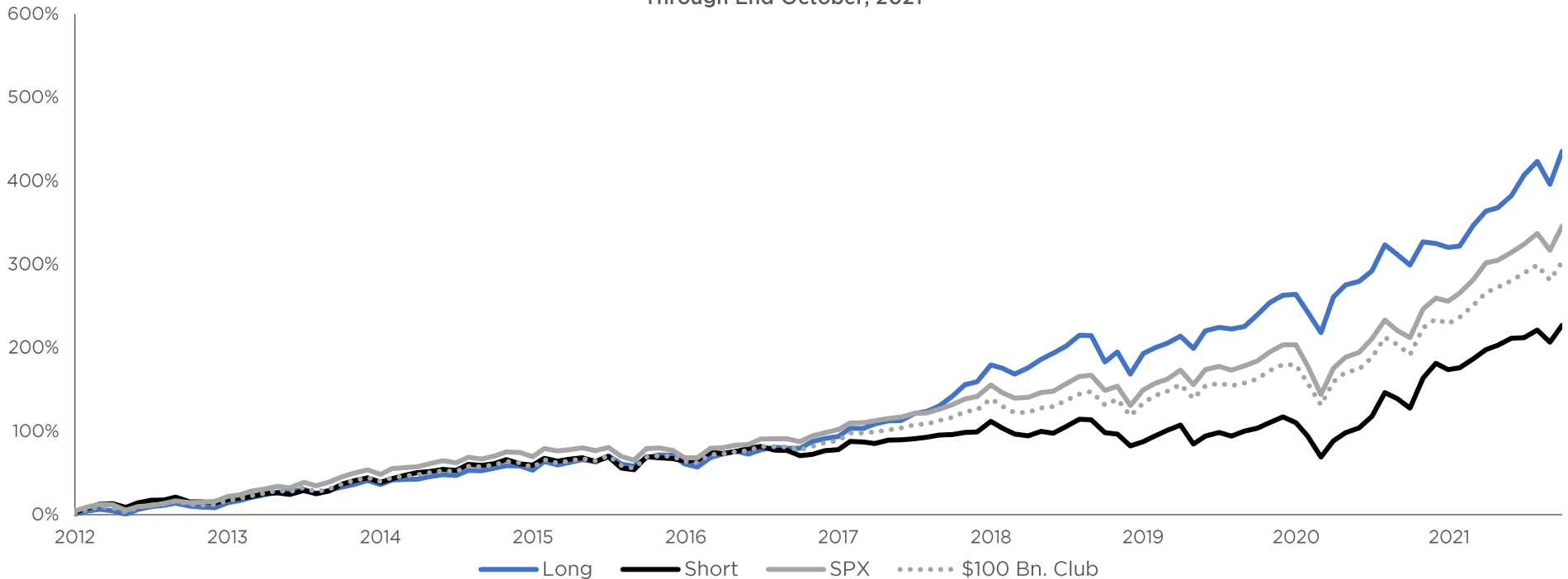
SELL-SIDE AND BUY-SIDE CONSENSUS CAN BE INFORMATIVE

Following the assessment of our quant model, we looked for additional approaches to parse winners from losers. In total, we evaluated four additional methodologies to identify winners and losers in the $100 billion club. Firstly, we thought it makes sense to see if there is any value in the widely available sell-side analyst ratings. To our surprise, there was strong efficacy. Buying the stocks in the top quintile of the sell-side's aggregate recommendation and shorting those in the bottom quintile generated strong spread. It maybe be that there are underlying factors, like these grow faster, having expanding margins, have positive momentum, but for whatever the reason, it is clear this aggregate sell-side rating score is helpful (left chart). We also looked at the performance high conviction (3% or more of long AuM) of a select group of approximately 60 hedge fund managers that are not widely owned by 500 other funds. These tended to strongly outperform (right chart), whereas the stocks with little high conviction ownership from our select group of funds by lots of high conviction ownership from others performed more in-line.

Average Monthly Returns
Consensus Recommendation
Through End-October, 2021

Average Monthly Returns
### High Conviction & Non-Consensus vs. Opposite
Through End-October, 2021

SHARE GAIN AND MARGIN EXPANSION ARE OTHER CONSIDERATIONS

Forecasted revenue growth also helped parse winners from losers, with the top quintile of forecasted growers (relative to the industry average) beating the average and market, and the bottom lagging (left chart). Forecasted gross margin was not an incrementally helpful discriminator, as the top and bottom quintile of gross margin expansion both beat the average (right chart).

**Average Monthly Returns
Forecasted Relative Share Gain
Through End-October, 2021**

**Average Monthly Returns
Forecasted Relative Gross Margin Growth
Through End-October, 2021**

Legend: Long — Short — SPX ····· $100 Bn. Club

OVERALL FRAMEWORK – AVERAGE ALL FIVE APPROACHES

When we take all five of the approaches (model rankings, consensus sell-side ratings, high conviction non-consensus views, forecasted revenue growth, forecasted gross margin expansion) and equal-weight the rank of each of the stocks that are $100 billion or larger and evaluate the subsequent return, we can see that those that are in the top quintile strongly beat the average and those in the bottom quintile strongly lag. We think this is a valuable approach to picking winners from losers among this group and that this has been particularly effective as the number of $100 billion cap. stocks has grown since 2016.

Average Monthly Returns
$100 Bn. Club Overall Framework
Through End-October, 2021
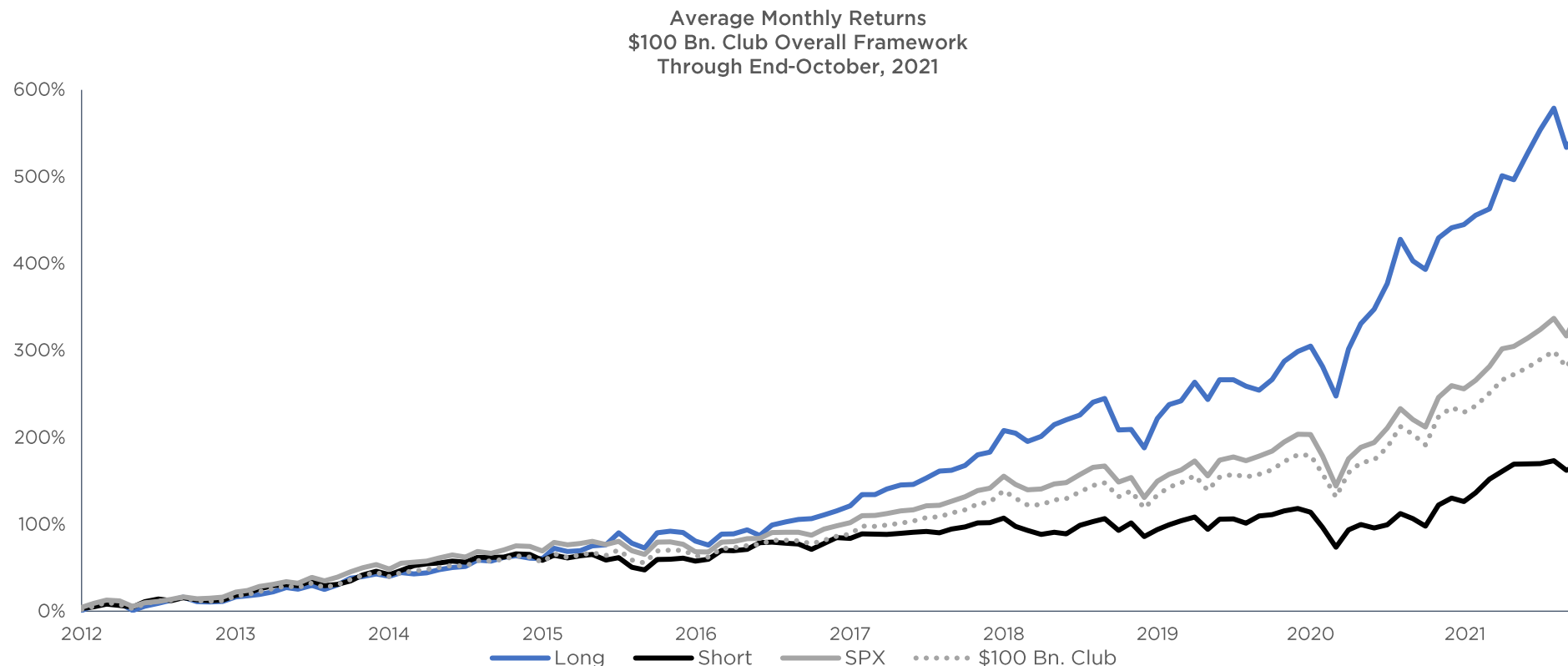
Stocks in the top third are shown below. There is clear bias toward software and payments today.

Ideas in Top Third of $100 Bn. Club Framework

Ticker	Company	Industry Group	Model Rank	Consensus Recommendation	Relative Forecast Share Gain	Relative Forecast Gross Margin Growth	High Conviction & Non-Consensus	Overall Framework Ranking
NOW	ServiceNow, Inc.	Software & Services	14	4	9	9	22	1
PYPL	PayPal Holdings, Inc.	Software & Services	21	12	11	11		2
DIS	The Walt Disney Company	Media & Entertainment	58	14	14	14	10	3
UNH	UnitedHealth Group Incorporated	Health Care Equip. & Serv.	1	8	51	51	2	4
CRM	salesforce.com, inc.	Software & Services	45	6	15	15	17	5
AMZN	Amazon.com, Inc.	Retailing	82	1	12	12	4	6
FB	Meta Platforms, Inc.	Media & Entertainment	3	11	35	35	3	7
GOOGL	Alphabet Inc.	Media & Entertainment	13	2	39	39	6	8
MA	Mastercard Incorporated	Software & Services	30	13	8	8	18	9
SNOW	Snowflake Inc.	Software & Services	63		2	2	13	10
ADBE	Adobe Inc.	Software & Services	24	16	36	36	9	11
SQ	Square, Inc.	Software & Services	25	54	10	10	23	12
EL	The Estée Lauder Companies Inc.	House. & Personal Prod.	37	44	13	13		13
RTX	Raytheon Technologies Corp.	Capital Goods	72	17	37	37		14
BLK	BlackRock, Inc.	Diversified Financials	19	37	23	23		15
ABNB	Airbnb, Inc.	Consumer Services			3	3	26	16
BA	The Boeing Company	Capital Goods		70	5	5		17
NEE	NextEra Energy, Inc.	Utilities		48	6	6		18
AMD	Advanced Micro Devices, Inc.	Semis & Semi Equipment		63	18	18	11	19
SHOP	Shopify Inc.	Software & Services	15	49	7	7	16	20
PM	Philip Morris International Inc.	Food, Bev. & Tobacco	20	47	40	40		21
DHR	Danaher Corporation	Health Care Equip. & Serv.	36	10	61	61	7	22
MSFT	Microsoft Corporation	Software & Services	47	3	68	68	5	23
ABBV	AbbVie Inc.	Pharma Biotech	67	39	44	44		24
CVX	Chevron Corporation	Energy	29	58	20	20		25
V	Visa Inc.	Software & Services	49	7	47	47	24	26
NVDA	NVIDIA Corporation	Semis & Semi Equipment	87	9	17	17		27
MDT	Medtronic plc	Health Care Equip. & Serv.	26	19	76	76		28
KO	The Coca-Cola Company	Food, Bev. & Tobacco	40	52	27	27		29
UNP	Union Pacific Corporation	Transportation		33	75	75	1	30
ANTM	Anthem, Inc.	Health Care Equip. & Serv.	12	15	43	43		31

THE MIDDLE THIRD IDEAS IN THE $100 BILLION CLUB

Stocks in the middle third are shown below.

Ideas in Middle Third of $100 Bn. Club Framework

Ticker	Company	Industry Group	Model Rank	Consensus Recommendation	Relative Forecast Share Gain	Relative Forecast Gross Margin Growth	High Conviction & Non-Consensus	Overall Framework Ranking
HON	Honeywell International Inc.	Capital Goods	9	75	52	52		32
TEAM	Atlassian Corporation Plc	Software & Services	8	32	24	24	42	33
AXP	American Express Company	Diversified Financials	52	79	16	16		34
CAT	Caterpillar Inc.	Capital Goods	65	78	25	25		35
ISRG	Intuitive Surgical, Inc.	Health Care Equip. & Serv.	33	76	33	33		36
MRK	Merck & Co., Inc.	Pharma Biotech	76	41	19	19		37
AMT	American Tower Corporation	Real Estate	10	45	22	22	31	38
SBUX	Starbucks Corporation	Consumer Services	27	60	85	85		39
MRNA	Moderna, Inc.	Pharma Biotech	60	89	1	1	34	40
TMUS	T-Mobile US, Inc.	Telecom Services	81	21	35	35	8	41
TGT	Target Corporation	Retailing	7	36	55	55		42
LOW	Lowe's Companies, Inc.	Retailing	2	30	78	78	31	43
AMAT	Applied Materials, Inc.	Semis & Semi Equipment	83	28	32	32	19	44
CSCO	Cisco Systems, Inc.	Tech Hardware & Equip.	17	69	48	48		45
PEP	PepsiCo, Inc.	Food, Bev. & Tobacco	34	74	41	41		46
TSLA	Tesla, Inc.	Autos & Components	53	82	4	4	38	47
JNJ	Johnson & Johnson	Pharma Biotech	50	56	62	62		48
WMT	Walmart Inc.	Food & Staples Retailing	46	34	58	58		49
CHTR	Charter Communications, Inc.	Media & Entertainment	59	64	84	84	14	50
NKE	NIKE, Inc.	Consumer Durables & App	70	21	77	77		51
GE	General Electric Company	Capital Goods	69	56	54	54		52
ZTS	Zoetis Inc.	Pharma Biotech	55	27	38	38		53
ABT	Abbott Laboratories	Health Care Equip. & Serv.	28	31	90	90		54
INTU	Intuit Inc.	Software & Services	78	39	49	49	13	55
HD	The Home Depot, Inc.	Retailing	4	53	70	70	29	56
BRK.B	Berkshire Hathaway Inc.	Diversified Financials	23	77				57
XOM	Exxon Mobil Corporation	Energy	39	85	26	26		58
VZ	Verizon Communications Inc.	Telecom Services	16	86	56	56		59
LLY	Eli Lilly and Company	Pharma Biotech	41	42	81	81		60
SPGI	S&P Global Inc.	Diversified Financials	71	22	30	30	39	61
PFE	Pfizer Inc.	Pharma Biotech	11	84	21	21		62
AMGN	Amgen Inc.	Pharma Biotech	48	83	64	64		63

THE BOTTOM THIRD IDEAS IN THE $100 BILLION CLUB

Stocks in the bottom third are shown below. There is clear bias against semiconductors and banks.

Ideas in Bottom Third of $100 Bn. Club Framework

Ticker	Company	Industry Group	Model Rank	Consensus Recommendation	Relative Forecast Share Gain	Relative Forecast Gross Margin Growth	High Conviction & Non-Consensus	Overall Framework Ranking
C	Citigroup Inc.	Banks	5	46	45	45	42	64
NFLX	Netflix, Inc.	Media & Entertainment	66	50	53	53	15	65
LIN	Linde plc	Materials	74	23	42	42		66
ACN	Accenture plc	Software & Services	31	51	63	63		67
PG	The Procter & Gamble Company	House & Personal Prod.	54	74	46	46		68
CVS	CVS Health Corporation	Health Care Equip. & Serv.	79	26	71	71		69
GS	The Goldman Sachs Group, Inc.	Diversified Financials	22	62	91	91		70
IBM	International Business Machines	Software & Services	18	80	87	87		71
DE	Deere & Company	Capital Goods	35	65	50	50		72
AAPL	Apple Inc.	Tech Hardware & Equip.	84	24	59	59		73
SYK	Stryker Corporation	Health Care Equip. & Serv.	73	68	60	60		74
T	AT&T Inc.	Telecom Services	51	87	80	80		75
SCHW	The Charles Schwab Corporation	Diversified Financials	61	61	28	28	21	76
PLD	Prologis, Inc.	Real Estate	42	43	89	89		77
TMO	Thermo Fisher Scientific Inc.	Pharma Biotech	44	6	72	72	36	78
BMY	Bristol-Myers Squibb Company	Pharma Biotech	75	40	57	57		79
UPS	United Parcel Service, Inc.	Transportation		66	83	83		80
COST	Costco Wholesale Corporation	Food & Staples Retailing	57	56	29	29	31	81
MCD	McDonald's Corporation	Consumer Services	38	25	88	88	26	82
BAC	Bank of America Corporation	Banks	64	67	31	31	38	83
CMCSA	Comcast Corporation	Media & Entertainment	43	18	79	79	36	84
MMM	3M Company	Capital Goods	32	91	67	67		85
WFC	Wells Fargo & Company	Banks	77	72	73	73	21	86
MS	Morgan Stanley	Diversified Financials	80	59	65	65	34	87
QCOM	QUALCOMM Incorporated	Semis & Semi Equipment	85	36	69	69		88
AVGO	Broadcom Inc.	Semis & Semi Equipment	86	30	74	74	29	89
TXN	Texas Instruments Incorporated	Semis & Semi Equipment	56	81	82	82		90
INTC	Intel Corporation	Semis & Semi Equipment	6	90	92	92	26	91
JPM	JPMorgan Chase & Co.	Banks	68	72	66	66	40	92
ORCL	Oracle Corporation	Software & Services	62	88	86	86		93

DISCLOSURES