

PM/Asset Allocator Series

S&P 500 Mega Cap surge leads to higher concentration risk, Converts offer natural risk-reducing diversification & growth exposure

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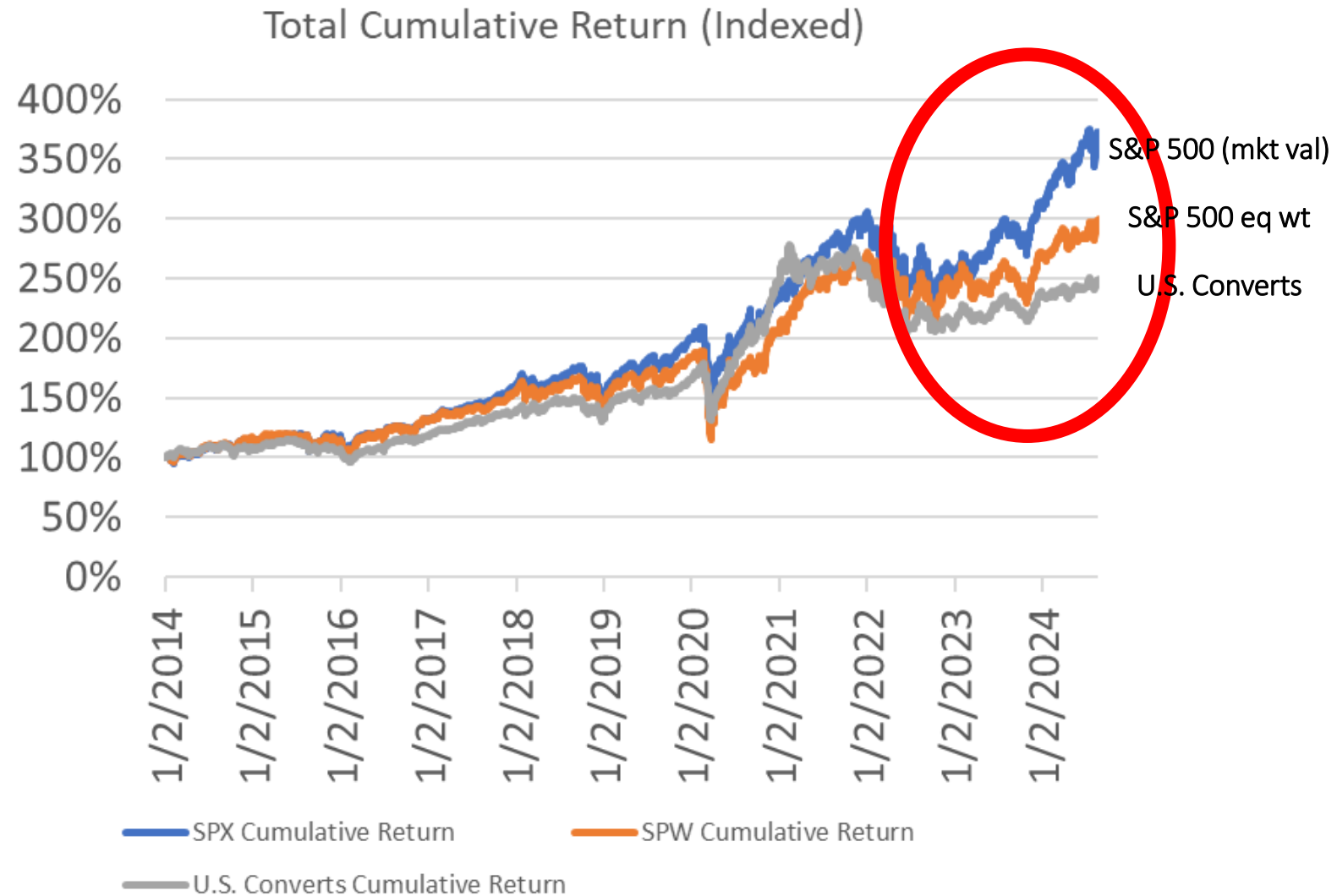
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August 22, 2024

Over the years converts have often been positioned as an S&P 500 alternative with lower risk and competitive returns. While long term returns have been attractive relative to the S&P 500, of late the asset class has underperformed the SPX and you're probably being asked by your investors about this.

Questions such as...Why has this happened, isn't the convert index as well diversified as the SPX and what are the implications for the asset class and investors?

Let's take a look to answer these questions...

Larger stocks rallied in the S&P 500 driving outperformance of SPX vs eq wt SPW; A break from the longer term trend



In 2023 and 2024 YTD the S&P 500 Top 50 returned 38.3% and 24.7% respectively driving the SPX outperformance of the equal wt. Index

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024 YTD
US Converts	7.8	(2.0)	10.7	16.8	(2.0)	23.0	50.3	4.3	(18.9)	13.5	4.4
S&P 500	13.7	1.4	11.9	21.8	(4.4)	31.5	18.4	28.7	(18.1)	26.3	18.9
S&P 500 Eq Wt	14.5	(2.2)	14.8	18.9	(7.6)	29.2	12.8	29.6	(11.5)	13.8	10.5
S&P 500 Top 50	9.7	1.8	8.7	22.3	(3.4)	32.5	24.5	30.8	(24.1)	38.3	24.7

* 2024 YTD as of 08/21/24 close

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This has lead to a divergence in recent convert returns versus the SPX. Longer term convert returns have been competitive

Annualized Returns	Trail.	Trail.	Trail.	Trail.
	1Y	2Y	5Y	10Y
US Converts	9.8	5.9	10.2	8.5
S&P 500	28.6	18.5	16.4	12.9
S&P 500 Eq Wt	18.9	10.8	13.2	10.4
S&P 500 Top 50	34.5	23.8	19.7	14.2

** Trailing as of 08/21/24 close*

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Mega caps currently dominate S&P 500 weighting and returns

2014	Mkt Cap (\$bn)	% of S&P 500
Apple Inc	505	3.0%
Exxon Mobil Corp	442	2.6%
Alphabet Inc	374	2.2%
Microsoft Corp	312	1.8%
Berkshire Hathaway Inc	292	1.7%
General Electric Co	284	1.7%
Johnson & Johnson	258	1.5%
Walmart Inc	255	1.5%
Chevron Corp	240	1.4%
Wells Fargo & Co	239	1.4%
Top 10	3,202	18.8%
Top 25	5,816	34.1%
Top 50	8,376	49.1%
S&P 500	17,052	100.0%

2020	Mkt Cap (\$bn)	% of S&P 500
Apple Inc	1,305	4.7%
Microsoft Corp	1,203	4.3%
Alphabet Inc	923	3.3%
Amazon.com Inc	916	3.3%
Meta Platforms Inc	585	2.1%
Berkshire Hathaway Inc	554	2.0%
JPMorgan Chase & Co	437	1.6%
Visa Inc	419	1.5%
Johnson & Johnson	384	1.4%
Walmart Inc	337	1.2%
Top 10	7,064	25.3%
Top 25	11,007	39.5%
Top 50	14,791	53.1%
S&P 500	27,880	100.0%

Current	Mkt Cap (\$bn)	% of S&P 500	Last 2Y Total Return
Apple Inc	3,442	7.0%	33%
NVIDIA Corp	3,161	6.4%	621%
Microsoft Corp	3,153	6.4%	51%
Alphabet Inc	2,052	4.2%	42%
Amazon.com Inc	1,890	3.8%	30%
Meta Platforms Inc	1,354	2.8%	219%
Berkshire Hathaway Inc	962	2.0%	50%
Eli Lilly & Co	905	1.8%	200%
Broadcom Inc	772	1.6%	217%
Tesla Inc	713	1.5%	-25%
Top 10	18,405	37.4%	
Top 25	24,850	50.5%	
Top 50	30,114	61.3%	
S&P 500	49,161	100.0%	37%

* Current as of 08/21/24 close

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Only ~10% of S&P 500 issuers with a total market cap of ~5% of the S&P 500 index are convert issuers (no mega caps)

S&P 500 Mkt Cap Rank	Issuer	Ticker	Mkt Cap (\$bn)	S&P 500 Mkt Cap Rank	Issuer	Ticker	Mkt Cap (\$bn)
24	Bank of America Corp	BAC	301	326	Ventas Inc	VTR	24
43	Wells Fargo & Co	WFC	189	333	PPL Corp	PPL	23
58	NextEra Energy Inc	NEE	164	339	Live Nation Entertainment Inc	LYV	22
63	Comcast Corp	CMCSA	155	340	Western Digital Corp	WDC	22
64	Uber Technologies Inc	UBER	154	345	Seagate Technology Holdings PL	STX	22
79	Booking Holdings Inc	BKNG	125	363	CMS Energy Corp	CMS	20
83	Palo Alto Networks Inc	PANW	116	369	Carnival Corp	CCL	19
104	Southern Co/The	SO	96	399	Expedia Group Inc	EXPE	17
112	Duke Energy Corp	DUK	87	404	NRG Energy Inc	NRG	17
124	Airbnb Inc	ABNB	76	405	CenterPoint Energy Inc	CNP	17
140	Welltower Inc	WELL	71	410	Enphase Energy Inc	ENPH	16
200	Kinder Morgan Inc	KMI	47	413	Southwest Airlines Co	LUV	16
208	Microchip Technology Inc	MCHP	44	417	Akamai Technologies Inc	AKAM	15
214	Ford Motor Co	F	43	419	Kimco Realty Corp	KIM	15
226	Royal Caribbean Cruises Ltd	RCL	41	428	Alliant Energy Corp	LNT	15
230	PG&E Corp	PCG	40	442	Evergy Inc	EVERG	13
251	Super Micro Computer Inc	SMCI	37	444	Insulet Corp	PODD	13
271	ON Semiconductor Corp	ON	33	473	Albemarle Corp	ALB	10
286	Dexcom Inc	DXCM	29	477	Pinnacle West Capital Corp	PNW	10
288	WEC Energy Group Inc	WEC	29	479	Match Group Inc	MTCH	10
293	Axon Enterprise Inc	AXON	28	480	Federal Realty Investment Trus	FRT	10
298	Global Payments Inc	GPN	28	493	Dayforce Inc	DAY	9
305	American Water Works Co Inc	AWK	27	502	American Airlines Group Inc	AAL	7
320	FirstEnergy Corp	FE	25	503	Etsy Inc	ETSY	6
321	Tyler Technologies Inc	TYL	25				

* The top 10 SPX stocks have a current cumulative weight of ~37% vs. just 19% in 2014. The index has become fairly concentrated on the back of the mega cap surge. The more diversified U.S. convert index on the other hand is weighted by the size of individual converts, so given the nature of the index the SPW equal weighted index is better suited as a broad equity benchmark for converts in our opinion.

* 9 of the top 10 SPX stocks have had exceptional cumulative gains in the last 2 years (NVDA 621%, META 219%, AVGO 217%, LLY 200%). None of these companies have converts. In fact only 7 companies within the S&P 500 top 100 are issuers of converts making U.S. Converts issuer diverse vs. the S&P 500.

* The AI narrative (drug pipeline in LLY's case) and earnings growth story may well drive the mega caps/Mag 7 a bit higher but nowhere close to the magnitude seen recently, in our opinion. We believe it is a good time to be cautious with mega cap/ Mag 7 weightings. No one could have predicted these large moves to the upside and we don't profess to have a crystal ball. But we believe it is best to be prudent with risk and that's where converts offer balanced exposure, downside protection and income with upside stock driven potential and no exposure to mega caps. The asset class offers a natural risk reducing opportunity for investors looking to peel out of some mega cap stock exposure, take some stock gains off the table and reduce risk ahead of the elections. The asset class also offers significant non-mega cap growth tech & healthcare exposure that should continue to benefit from AI/innovation tailwinds.

* Separately though, it would be a plus for the market if the convert eco system draws in bigger large/mega cap issuers into the asset class against the backdrop of their strong stock rally. The demand for such converts would be tremendous leading to very favorable terms for issuers in our opinion.

* I hope you are enjoying the tail end of summer. Best wishes for the fall investing season...

It is OK to forward this piece to institutional convert securities participants if you wish. To join our distribution please email manoj@gsrresearch.com

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