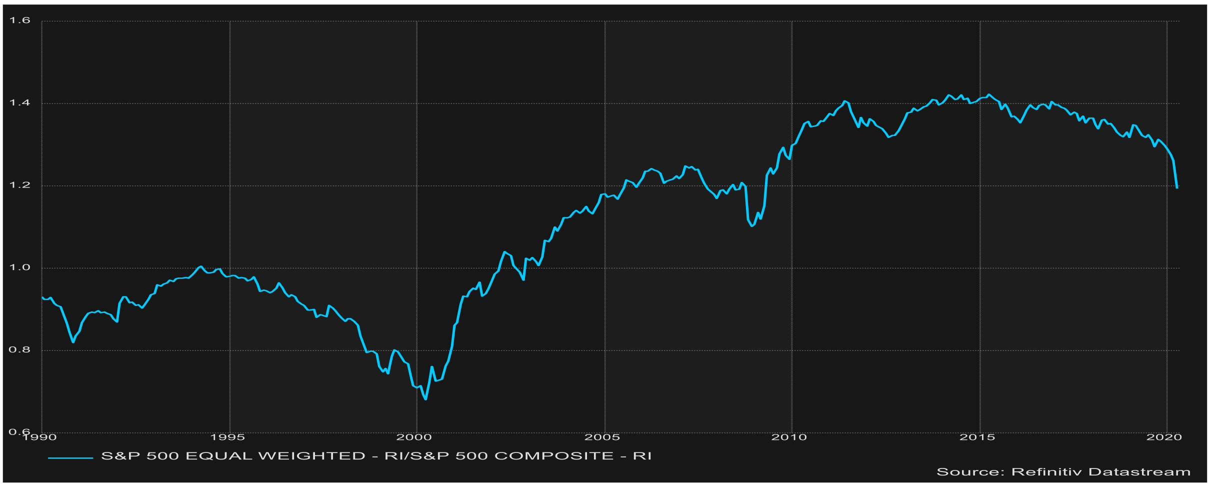
S&P 500: A Narrow Rally Rather than a Real Rally

With the S&P 500 having recovered close to half of the ground it lost during the Covid-19 crisis, onlookers could be forgiven for concluding this implies a widespread rally in stocks which could reflect investor anticipation of an economic rebound based on easing lockdowns, central bank actions and fiscal stimulus. Numbers, however, can be deceiving – rather than signalling a broad-based rally in share prices, the S&P rally to date is actually reflective of a recovery concentrated in a narrow number of large cap relatively defensive names.

While the S&P 500 is down by 16% from its peak the median stock is down by 28%. This can be seen by comparing the performance of the S&P 500 (which is a market capitalisation weighted index) to the equal weight S&P which gives every company an identical weight despite their size. The chart below shows the extent of the underperformance of the equal weight S&P.



The underperforming equal weight index contains a higher weight of non-mega cap stocks which are more representative of the average company and of the general economy. Whereas the S&P 500 index itself is becoming more of a market of some stocks rather than a stock market. The top five stocks now account for circa 21% of the index, which is higher than at the peak of the TMT bubble 20 years ago when the top five accounted for c.19% of the index. The big five have a weighting equal to the lowest 350 stocks. Microsoft alone has a market value approaching that of the entire FTSE 100 in the UK!

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The largest 25 companies make up close to 40% of the S&P 500. These are large mega-cap companies which are in relatively strong positions, with defensive characteristics, scale, and strong balance sheets. As they are far more likely to survive this crisis than the average company their stock prices have performed better than average during this crisis, but this has a disproportionate impact on the S&P 500 and flatters it compared to the equal weight index. So the S&P 500 is not accurately reflective of the economy, nor the broader stock market.

During this equity sell-off, government bonds, the traditional safe haven, are offering extremely low or negative yields. Our belief is that many cautious investors have turned to defensive stocks rather than expensive bonds, accentuating the outperformance of the mega-cap defensive names.

Therefore, the case is strong for arguing that the market move off the lows is not a broad market rally – it appears to be more of a defensive rally as to date it has been the defensive names which have outperformed. The evidence suggests that it definitely cannot be called a recovery rally as the parts of the S&P that are more representative of the broader economy have underperformed.

That is where we believe the opportunity is for investors. Rather than anticipating economic recovery, market participants continue to be more defensively positioned and the level of caution remains elevated. There hasn't been any meaningful recovery rally yet – and when we see that, it will benefit the economically sensitive stocks most, particularly as these were already valued at a large discount to defensive and technology stocks, and this gap has widened in the defensive rally.

We mightn't be there yet, but when we get a rally driven by the real expectation of an economic recovery it could be significant, particularly for those stocks that haven't fully participated in the rally to date.

Note: stats referenced in the article sourced from: Refinitiv Datastream, and Eikon on 15th May 2020

Appian AM NAV's Fund Prices 30-04-2020

NAV		YTD	SI	QTD
		%	%	%
AMAF	141.2387	-11.26%	41.24%	4.45%
AGDGF	161.536	-24.65%	61.54%	7.18%
AGSCOF	137.1825	-26.74%	37.18%	12.78%
AIF	100.4763	-9.28%	0.48%	7.75%
AELF	103.2528	-0.45%	3.25%	-

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- **If you invest in any of the funds you may lose some or all of the money you invest.**
- **Past performance is not a reliable guide to future performance.**
- **Appian Funds may be affected by changes in currency exchange rates**
- **The value of your investment may go down as well as up.**