Stewart Investors

The Nifty Fifty

History is full of bubbles, booms and busts, corporate collapses and crises, which illuminate the present financial world.

At Stewart Investors we believe that an appreciation of financial history can make us more effective investors today.

The Nifty Fifty was the name given to a group of US growth stocks which performed very strongly in the 1960s and early 1970s, becoming symbolic of the spirit of the times. The companies, which included household names like McDonald's and Polaroid, traded on very high valuations over many years.

The Go-Go Years

The 1960s were buoyant years for the US economy and stock market. From the mid-60s the term 'go-go' was used to describe an aggressive way of operating in the stock market, which involved trading for quick profits. It was applied in particular to certain mutual funds,[1] such as Gerald Tsai's Fidelity Capital Fund. The term 'go-go' gradually came to be applied to the whole period – the 'go-go' years.

New Investors

A key feature of the 1960s was the increasing number of investors in the US stock market. Seven times as many Americans held shares by the end of the 1960s than during the height of the 1929 bubble.[2] In the summer of 1970, the US Stock Exchange unveiled a survey showing the country had over 30 million shareholders.[3]

The decade saw the rise of a new breed of investor - the professional fund manager. It was a period of significant mutual fund creation and large fund inflows.[4] By the mid-1960s the mutual fund industry had $35 billion of assets under management, with new money flowing in at a net annual rate of $2.4bn. Mutual fund trading already accounted for a quarter of all transactions in the stock market.[5]

The rise of star fund managers was another feature of the 'go-go' years. Gerry Tsai was perhaps the best known of the new portfolio managers. His Manhattan Fund raised $247m in 1966 – the largest amount ever raised by an investment fund at that point.[6]

Wall Street was transformed over the decade by an influx of new personnel. By 1969, half of salesmen and investment analysts had come into the business since 1962.[7] They only had experience of a prolonged bull market, another factor sustaining the bubble in the Nifty Fifty.

The Nifty Fifty

The Nifty Fifty was a group of 50 stocks identified by market commentators, although it was never an official benchmark index. The companies shared similar characteristics: high quality franchises benefitting from surging economic growth and strong balance sheets. Delivering healthy profits and good returns for investors year after year, they came to trade on very high valuations. The group included Revlon, Procter & Gamble, Philip Morris, Pepsi, Pfizer, Merck & Co, Eli Lilly, Coca-Cola, IBM, Gillette, Wal-Mart, Disney, Eastman-Kodak and Polaroid. Certain sectors were particularly well represented, including consumer, healthcare and technology. Many are still household-names today, although some, like Eastman-Kodak, have disappeared.

It was said by many investors at the time that Nifty Fifty stocks should be bought and never sold. By the early 1970s they had become the darlings of many institutional investors and staples of their portfolios.

The Price/Earnings ratio
The price/earnings (PE) ratio is a valuation measure which compares the market capitalisation of a company (its value on the stock market) with its earnings per share. By the 1960s it was a key valuation metric used by professional investors and is still the most commonly used one today.

The PEs of some of the Nifty Fifty moved into stratospheric territory as the 1960s progressed. By the early 1970s, the highest rated companies, darlings of the market, were trading on stunning valuations: Johnson & Johnson (57.1x), McDonald's Corp (71.0x), Disney (71.2x), Baxter Labs (71.4x), International Flavours & Fragrances (69.1x), Avon Products (61.2x), Polaroid Corp (94.8x) and MGIC Investment Corp (68.5x).[8]

We might compare these valuations with those of the FANGs (Facebook, Amazon, Netflix and Google (now Alphabet)), the high valuation stocks driving today's US market. FANG PEs are as follows: Facebook (23.0x forward earnings), Amazon (179.2x), Netflix (111.5x) and Alphabet (24.8x).[9] The valuations of Amazon and Netflix appear extreme even by Nifty Fifty standards.

On 29 May 1969, Warren Buffet called time on the 'go-go years' by winding up his investment partnership. He saw little further upside because of the extended valuations.

Bear market
It had been a long party for investors which had to come to an end. Against a backdrop of rising interest rates, high oil prices, political instability over Watergate and the end of the Bretton Woods monetary system[10], US stocks entered a bear market in 1973. The years 1973 and 1974 were tough ones for equity investors. The Nifty Fifty stocks initially held up relatively well against the market but then came under severe selling pressure. As one columnist at Forbes Magazine put it: 'the Nifty Fifty were taken out and shot one by one.' From their highs, some of the share price declines to 1974 lows were precipitous: Xerox (-71%), Avon (-86%) and Polaroid (-91%). The vulnerability of highly-rated companies to rising risk aversion was starkly revealed.

Valuing growth
Common sense suggests the Nifty Fifty was a classic investment bubble, driven by the usual mix of strong economic growth and plentiful liquidity which pushed valuations to unsustainable levels over the short-term. Research suggests that holding the highest valued stocks in the Nifty Fifty resulted in particularly poor performance over multiple decades following the bear market of the early 1970s.[11]

Looking at the valuations of Nifty Fifty stocks at their peak led many to believe that they had reached vastly overextended levels by the early 1970s and were ripe for correction. However, a debate has raged among financial commentators about whether the companies were in fact at such extreme levels of overvaluation. For example, if you had continued to hold stocks such as Walmart, Coca-Cola or McDonald's, from the 1970s peak until the present day, you would have made very substantial returns.

Lessons for Investors
The Nifty Fifty highlights the dangers of a long, late-cycle bubble for equity investors.

It reminds us that de-ratings of highly-valued companies can be savage, significant and swift. Even high quality businesses can be poor investments if they are bought at extended valuations or not sold as valuations become extended. We believe that over a longer time period, 'a great company at a fair price' is preferable to 'a fair company at a great price.' For us, there are many companies where there is no price at which we would be happy to invest for clients.

It also reveals a problem at the heart of professional fund management - the danger of measuring returns against a benchmark index or peer group which can encourage a self-perpetuating bubble expanded by a wave of money. At such times, it becomes difficult for some in the fund management industry to take a contrarian view as, sadly, many are focused on short-term returns.

At Stewart Investors we are bottom-up, fundamental stock-pickers. We invest with an absolute return mind-set. That is, we define risk as losing money for our clients, rather than in terms of deviation from any benchmark index. We invest in companies we consider to be high quality in terms of management, franchise and financial strength, and which are acceptably valued.

We believe history plays a major part in assessing the quality of a company, especially its management. There is a quote attributed to Winston Churchill: "the farther back you can look, the farther forward you are likely to see." Investors are often prisoners of recent history which can have dangerous consequences, both for companies and investment managers. As stewards of capital, we try to extend our historical perspective as far back as we can to prevent us being too enthusiastic or depressed about a company.

We are focused on capital preservation and always consider the potential downside, as well as the upside, of any investment. We have historically tended to lag sharply rising markets, preserving capital better in falling ones.

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1 John Brooks, The Go-Go Years, 128.

2 David L. Western, Booms, Bubbles and Busts in US Stock Markets, 108.

3 The Go-Go Years, 12.

4 A mutual fund is a collective investment vehicle in the US.

5 The Go-Go Years, 101.

6 The New York Times, Gerald Tsai, Innovative Investor Dies at 79, 11 July 2008.

7 The Go-Go Years, 113.

8 Jeremy Siegel, Valuing Growth Stocks: Revisiting the Nifty Fifty, AAII Journal October 1998.

9 As at 24/04/2018. Source: FactSet.

10 Bretton Woods was the international monetary system agreed at Bretton Woods in New Hampshire in the US in 1944 which created the IMF and World Bank and established a system of fixed exchange rates with the US dollar as the international reserve currency.

11 J. Fesenmaier & G. Smith, The Nifty-Fifty Re-Revisited, http://economics-files.pomona.edu/GarySmith/Nifty50/Nifty50.html

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