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Research Note
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The Magnificent Seven

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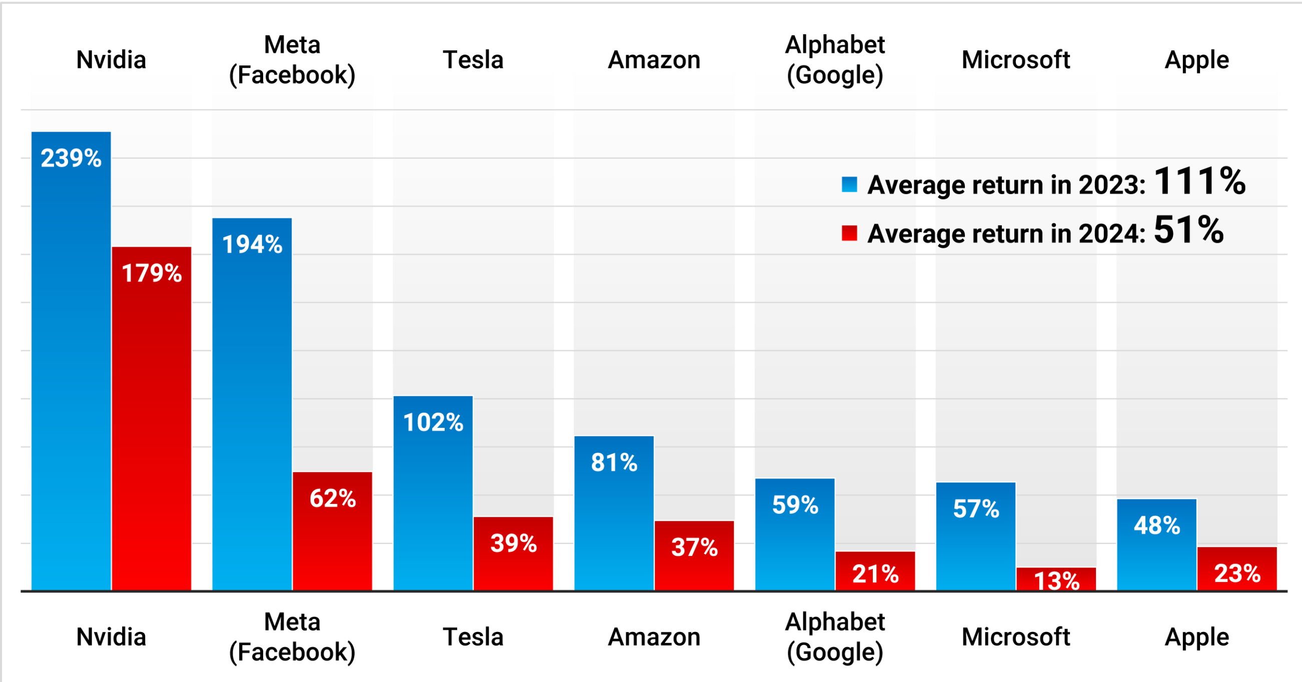
Over the last two years at our Annual Client Seminars, James (Timpson), Courtiers Head of Asset Management, mentioned "The Magnificent Seven" i.e. Apple, Amazon, Microsoft, Alphabet (Google), Meta (Facebook), Tesla and Nvidia.

Since Large Language Models (LLMs) hit the AI scene in 2023, this Magnificent 7 (Mag-7), now the seven biggest companies in the US by market capitalisation, have dominated global equity markets and form over 30% of the US S&P 500, the most tracked index in the world.

Last December, James shared a chart showing the Mag-7's average returns of 111% in 2023 and 51% in 2024. These figures are based on a year-end of 30th November to coincide with our Client Seminars, which are held early in December.

Mag-7 – Average Annual Returns (2023 vs 2024)



Source: Bloomberg & Courtiers. Chart shows price returns from 30/11/2022 to 30/11/2024.

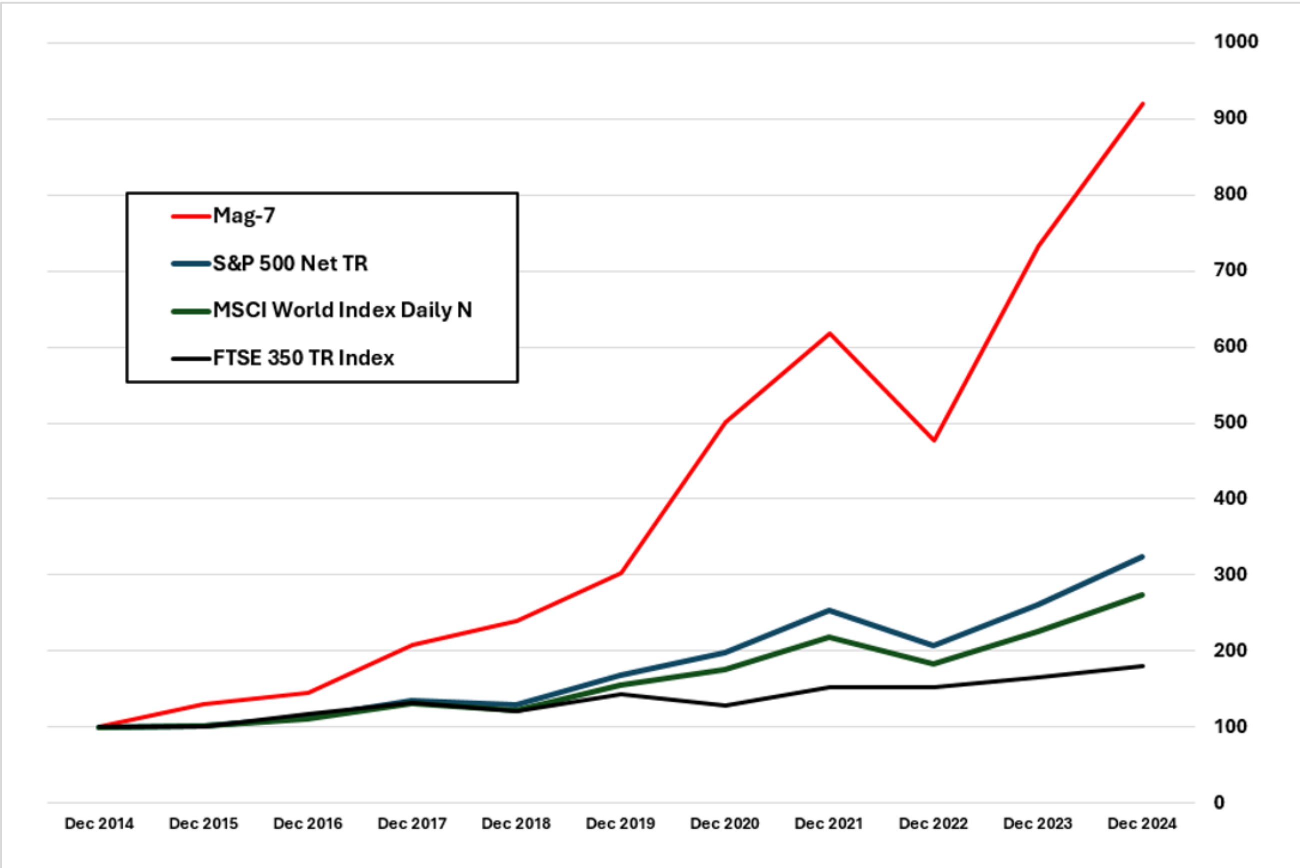
During a post seminar Q&A session, I was asked on stage for predictions for this year. I forecast that the Mag-7 would underperform in 2025. Now the golden rule among professional forecasters is "*if you give a date don't give a figure, and if you give a figure don't give a date*", and that is because forecasting is a mug's game. Having publicly broken the golden rule, I thought this mug had better explain why he had been so candid with his views on this group of seven companies with shares all selling at eye-watering valuations.

The Last Ten Years

Bloomberg now publishes the UBS Mag-7 Index, but this only started tracking the returns of Mag-7 shares from the end of 2018 and I wanted ten years of data, so I built a new index from scratch.

If you invested in the Mag-7 on 31st December 2014 and spread your money among each company by market capitalisation, by 31st December 2024 you will have enjoyed capital appreciation of 24.84% per annum[1]. Paltry dividends would have started at around 1.24% of capital and ended 2024 at 0.32%, taking your total return to over 25% per annum. To put this in context, £100,000 earning 25% per annum would be worth £931,000 ten years later.

Mag-7 Returns on £100,000 over Ten Years – vs Major Indices

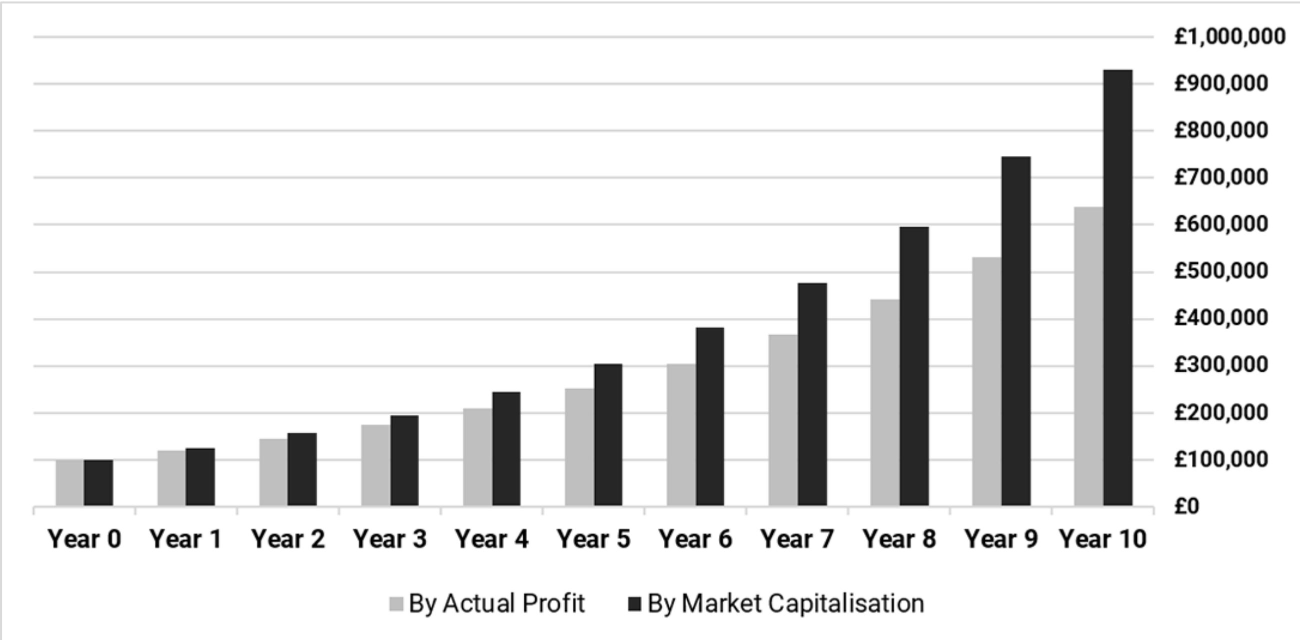


Source: Bloomberg & Courtiers

Actual profits from Mag-7 companies rose at 20.39% annually, a much slower pace than the appreciation in their market capitalisations. If the appreciation of share prices had matched the growth in net profits, then the final ten-year value of the initial £100k would have been £640,000, much lower than the £931,000 mentioned earlier.

[1] There are a wide range of ways in which returns from the Mag-7 can be calculated. In this case I simply took the change in market capitalisation, which I accept fails to account for buy-backs and rights issues. To test that I wasn't way out, I checked Bloomberg's total return figure for each stock over the period (this would allow for buy-backs, new issues and reinvested dividends) and then weighted those returns by Mag-7 market cap at December 2014. The result was an average return of 25.10% p.a., which is within a smidgeon of the 25% p.a. I assumed for the average annual return including dividends.

Mag-7 Returns on £100,000 over Ten Years – Actual Profit vs Market Capitalisation



Why did the market capitalisation of shares increase at a much faster rate than the rise in Mag-7 profits? Because investors piled into these companies and drove up the prices of their shares at a faster rate. As a result, the ratio of price to earnings (PER) of Mag-7 companies shot up. The weighted average PER for Mag-7 companies at the start of 2015 was 24.78. By the beginning of 2025 it rose to 35.62, 44% higher than ten years earlier. Over the last ten years, Mag-7 investors received a total return of 540% from increases in profits and dividends and a further 291% from other investors who were prepared to buy shares at much higher earnings multiples just to join the party.

Any investor who bought Mag-7 companies in January 2015 (and even back then their average 24.78 PER was elevated) can pat themselves on the back and enjoy their gains. But can these popular companies repeat their accomplishments of the last decade? History and maths are not on their side. The long-term average PER for the S&P 500 is around 20, and there is a tendency for PERs to mean revert (i.e. return to their historical average). If that happened with the Mag-7 then, absent any improvement in earnings, investors would lose over 43% of their value.

Example 1

Let's assume that Mag-7 investors expect a positive return over the next ten years of just 10% p.a. (which is reasonable but a lot less than the circa 25% p.a. they received in the last ten) and that PERs of these seven companies mean revert to 20. In this case, net profits from the Mag-7 would need to grow by 16.54% p.a., which is a little less than the 20% p.a. they gained since 2015. However, it's still a big figure and significantly larger than estimated GDP growth. You can also see what happens when PERs decline; in this example profits grow by 16.54% p.a., but the return to the investor is just 10% p.a..

The above example doesn't allow for market beta, which simply put says that the return expected by investors is directly related to the risk they are prepared to take with their money. In other words, if you buy an asset that is riskier and more volatile than the market, you expect a higher return than the market. Since its introduction in 2018, the annualised average volatility of the UBS Mag-7 Index is around 28.87%, whilst the average volatility of the S&P 500 Index is 19.55%.

Example 2

To keep the maths simple, let's round the Mag-7 average vol down to 28 and the S&P 500 average vol up to 20. This would indicate a quick and dirty beta for the Mag-7 of 1.4 (28÷20). In other words, in return for taking a higher risk, Mag-7 investors expect a return that is 140% of the market (S&P 500) return.

Using actual market data each month we derive expected returns for a wide range of market assets, including the S&P 500, under different scenarios. The rounded-down market expected return for the S&P 500 over the next ten years, under a positive scenario (earnings increasing and no crash) is 14% p.a.[2]. With a beta of 1.4, Mag-7 investors are expecting a return of 17.8% p.a.[3].

If we repeat the exercise from earlier where we expect PERs to mean revert over ten years, then to achieve the returns expected by their shareholders, Mag-7 companies will need to grow profits by a staggering 24.8% p.a.. Let's put it another way, to invest in the Mag-7 you must believe either that 1. these rapidly growing companies will not only maintain their current rate of velocity but will increase it in the next decade, or 2. that future investors will buy your shares at bigger earnings multiples than you paid for them (which is colloquially known as "*the bigger fool theory*", the principle that have inflated all bubbles throughout history).

The past is littered with booms and busts and savvy investors should be aware of these as they help keep one's feet on the ground. If you are looking for examples, have a read of Charles Mackay's 1841 classic "*Extraordinary Popular Delusions and the Madness of Crowds*". The first three chapters cover the French Mississippi Scheme (1719/1720), the British South-Sea Bubble (also 1720) and Dutch Tulipomania (1634-1637). They are fascinating, and I especially recommend cryptophiles read this last one, as the only difference between Bitcoin and Tulip bulbs is that the latter are intrinsically worth something! The "Nifty Fifty", the Japanese everything bubble of the late-eighties, the Tech Bubble of the late-nineties, and the Credit Bubble (Global Financial Crisis) of the mid-noughties are more recent examples of overpriced assets leading to big losses. And I shouldn't forget the 2010s Bond Bubble that dramatically ended in 2022 when UK Gilts dropped -41.57% in the year (and they are meant to be safe!).

I have set out my reasons, mathematical and historical, for eschewing Mag-7 stocks. It's not that I think they are bad companies; quite the reverse. They have all been pioneers in their own fields and risen to dominate in their respective sectors. But remember, in 1997 Apple was going bust and was only rescued by the return of Steve Jobs, its brilliant founder, and in 1998 Google was just a concept in an academic paper. What other concept company or business in the doldrums will rise to challenge the Mag-7 market leaders over the next ten years? When DeepSeek hit the news last month, Nvidia shares fell nearly 20%. Perhaps that is the early warning tremor of a more serious disruption to come.

To meet the requirements of our Multi-Asset Funds' mandates, we have to stick within a predetermined level of market risk ("beta"). This precludes us from going heavily into high volatility assets. Even if I wanted to – and I don't – we could not buy the Mag-7 in our portfolios at the same % weight as they form of the S&P 500. It would tip our risk levels beyond their ceilings, and the long-term success of Courtiers' Multi-Asset Funds is based on broad diversification within strict, mandatory, risk controls. It's not that we have no exposure to the big US tech giants – we do, but it's indirect through positions that we hold in US indices. Those investors that still believe the Mag-7 will deliver superior returns over the next ten years can easily buy the shares directly through any decent stocks & shares platform, especially as they are among the largest and most liquid companies in the world. But please don't bet the farm…history shows that when things go wrong, overpriced stocks get hit the hardest.

Caveat emptor!

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[2] The actual figure was 14.92%p.a. using the classic Gordon's Growth Dividend Discount Model (DDM). This is arguably overstating expected returns due to the persistently high price-to-book ratio, which likely fails to account for the intangible assets accruing to the benefit of the company. In other words, its highly likely that the return from reinvested/retained profits is overstated, thus inflating projected returns.

[3] If you are wondering why this is lower than simply multiplying the expected market return by 140%, it's because the beta only applies to the return over the risk-free rate, which I've used as 4.5%; roughly the yield on ten-year US treasuries at the end of January.

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