IFB282: In Defense of the Top 5 Companies in the S&P 500: Things Investors May Not Know

[This transcript was generated by artificial intelligence. Timestamps are not 100% accurate depending on the platform used for listening].

Dave

0:00

All right, folks, welcome to Investing for Beginners Podcast. Today we have episode 282. Today we're going to talk about, we're going to discuss in defense of the top five companies in the s&p 500. Things investors may not know about these companies. So without any further ado, let's just jump in.

And we'll work through the companies based on as of today, May 2 2023. And their market cap alone could be interesting in five years to see if these five companies are still in the top five in the s&p 500. So moving on, we'll start with Apple because Apple's the big dog in the s&p 500 As of right now. So what are some things that people may not know about Apple that could contribute to the company's continued to do well?

Andrew

0:45

Yeah, give me the hard one first, right, like huge, massive company. Yeah, I guess the biggest thing for me with Apple, which, when I saw it, it really opened my eyes is their ROIC is ridiculous. So ROI C stands for return on invested capital. And the easiest way you can think about it is if a company is investing for growth in new projects, how successful are those in actually growing the company? And so for a company like Apple using our ROIC Calculator Spreadsheet, I came up with something way above 100%. Now, does that mean the company is going to 20x? From here?

No, of course not. That's not necessarily going to happen. But the fact that they grow at such an efficient rate, or they can turn $1 into $3, almost. It's something that makes up business way different than so many others. And I think that's why Buffett likes it. And so when you have a business, that that's that big, and growing that efficiently, it just generates a lot of cash. And so a lot of that goes back to shareholders in the form of dividends and buybacks. And the way they've been able to reduce the number of shares outstanding, through buybacks, that does a lot for your stock price. So your slice of stock gets much more valuable, even if the company doesn't grow that much, when you are reducing the share count by that much.

Dave

2:19

Yeah, totally. If you kind of think about that, let's say that the shares, just to use easy numbers, let's say that the earnings are worth $100. And you start out with 10 shares, and every year, they buy back a share to the year five, but the earnings stay at $100. So your earnings per share goes from what is that 10 to five shares, it goes to $20 a share just by buying those shares back and not improving the earnings through that whole same period. And so if you have the other side, let's say the of the shares going down, and then you have the earnings going up, then that just multiplies on itself.

And it becomes even more valuable, because like you said, your slice of the share becomes that much bigger. And that makes it even more valuable. And that's what can be so impressive about companies that are doing what Apple is doing is using their efficiency to grow the earnings of the business, as well as reducing the sheer count available, which drives up the value of the earnings for each shareholder. And that kind of math is the kind of math we all see. And you don't see it a lot.

But when you do, it's startling when you kind of think about it, and just kind of look at it in relation to what the business is doing. So I guess what are some things that maybe Apple is doing? You know, everybody knows the iPhone, right? And maybe the iPad and the Mac? But what other little toys or what other stuff are they doing that are kind of helping grow the company going forward?

Andrew

3:51

It's interesting, because they're kind of putting their tentacles out into a lot of different things. And we'll see how that plays out for them. A company who's done that really well as a company called Google, right? They found a lot of good small bets. So apples in things like cars, they're coming out with Apple Car, they're in looking at developing virtual reality glasses, Apple glasses, and those actually might look decent and sell good, like, you're from a Terminator movie or something.

And they're also you know, we've seen them dabble in the media services and kind of not go directly head to head against maybe Amazon or Netflix, but kind of they're sticking to a little niche there and kind of strategically, you know, going after Friday Night Baseball and things like that. So, I mean, the ecosystems really compelling. I think obviously, a lot of people know who they are, and know that people still like the company. And so for me, it's like people have been counting the people have been saying this company is going away or it's the The end of Apple for so long, but then revenues continue growing.

So, I don't know, we all like to think of the end, right? Like, like, oh, okay, the days have been over. But kinda like I was sharing with my story on lamb research the other day, right? It's like, right? Well, just because you think the days are over doesn't mean that it could be even close, you just don't know what the future holds. So who knows like what their next growth driver will be. But when you're that efficient, and have a lot of bad, that's and still come out strongly.

Dave

5:30

You certainly can. And the, I like what you were saying about like the media, for example, they had chose the super popular like Tiglath cell, for example, fantastic show. And I think they even won an Academy Award for one of their movies recently. So they've, even though it may not be as big of a part of their business as as it is for Netflix, obviously, or even Disney in Amazon, they certainly are putting the feelers out there and also trying to do the best that they can kind of allow staying in their lane, so to speak, and just adding another revenue stream to the business.

And the one that I have been noticing a lot because it sits in my wheelhouse is the whole apple wallet, and really trying to grow that part of the business. And they recently added a savings account, I've had a credit card that is more recent, not super recent, but recent, or that's a word. And all those things are trying to kind of grow the adoption of the apple wallet hasn't really come to roost yet.

But at some point, maybe it will and you know, if we start using our phones to make payments, and other things like they're really trying hard to do, that could be a huge growth driver for them going forward. Because, you know, especially here in the United States, where Apple is really the predominant phone, that would be very beneficial for them in that respect as well.

Andrew

6:54

It's really like growing this ecosystem. And it's, it's like you have different platforms that are all important or useful to you as a customer. And I don't know if you'll allow me to skip to Google. And then we'll go back to Microsoft later. Because I feel like Google makes a very similar kind of strategy. You know, the numbers on Google Chrome are compelling. And how many people actually use that and a lot of people's whole lives are on Google Chrome. So you combine that with their ecosystem with Android.

And just the way these companies kind of integrate themselves and make, I guess the biggest thing I'm trying to say is like they're increasing the customer value, and giving you all of this value for free. That makes you kind of stick around, and then they figure out monetization later. But it's all part of this, like growing value given to the people who are using their stuff that makes them sticky. That makes their group their growth per the efficient. I mean, what kinds of things do you see with Google? And kind of all they're building ecosystems?

Dave

8:02

Yeah, the stickiness, one of the things that jumps out to you right away, you think about how much you can get into the ecosystem. And when you really start to dive into Chrome, and some of the Google, I guess, accessories, if you will, is there are so many things that you don't really know, at Google Photos, you know, a lot of us it's not life changing, but it's borderline life changing, being able to download all that off of your phone into Google Photos and having access to that through the app wherever you go whenever you want it. And those kinds of little things, even though they start to charge you when you get to a certain level, but below that they don't.

And it allows you to really get deep into the weeds of what it is that they can do with all these different little add ons that you don't realize, but it winds to the stickiness. And you think about going to YouTube and thinking how many hours have you wasted or spent on the YouTube platform just going down a rabbit hole and a rabbit hole and a rabbit hole. And that's not including the whole shorts ecosystem that they've recently created, which makes it even more compelling. I know my daughter spends way more time on YouTube and shorts than she does watching TV.

And it's kind of mind boggling. And I know a lot of her friends are kind of deep into that into the weeds of that as well. And considering my daughter's 10 and her friends are similar age, then that bodes really well long term for the business because that's what the kids are going to grow up knowing. And all those things can lead to continued revenue growth, ad revenue, and all those different things over a very, very long period of time. And we haven't really even touched on the whole AI thing. And really what's kind of going on in there, you know, and that probably is more of an Amazon or I'm sorry, an alphabet slash Microsoft conversation that we can switch to here in just a minute but that's a Another avenue of revenue growth that the company can entertain, that they really haven't embraced yet, not quite as much as Microsoft has or been a lot more blunt about it or open about it. And that's something that's going to drive alphabet or Google for a long time.

Andrew

10:15

It's a great point too, because if I think of like my friends, family who have little babies and kids, it's YouTube, right? It's live on my youtube or YouTube kids, and are watching all the shows, and they're all going down the same algorithms between the CoCo melons or whatever the next one is, I can't remember off the top of my head, right? It's a great point that there are building that stickiness. At literally the youngest age you can and it's not like, diapers that you'll grow out of.

We're all gonna be consuming media for the rest of our lives. And that is a very interesting idea. I think as investors, we think of like, you know, me myself, whether we and my friends spend money on for now, to your point, I mean, that's, that is building on the YouTube ecosystem, as well as in other places. A completely different place where people are consuming content. And that habit will be hard to break, if that ever gets broken. Right? And where's that going to aggregate? Where are people listening to this, right, Apple podcasts, their YouTube videos, it's

Dave

11:23

all those, all those all those places, you know, the other thing I didn't really touch on was the whole Other Bets segment of their business. The most publicized part that people may or may not be familiar with is the whole WeMo idea with the self driving part of the business. But that whole segment has a whole bunch of money, they're throwing against the wall, to see if anything sticks. And we don't really know what's really being built behind there. Beyond Waymo, and maybe deep thinking, I think is the other idea. And that's, that's really about it, there's not a lot of publicity about what whatever else, they're, you know, brewing up behind the walls, so to speak.

And I mean, the company gets a lot of criticism for the money that they basically lose in that segment. But the flip side of that is, we don't know what they're creating, that could lead to the next big thing for alphabet. And there's a good chance that there will be something behind the scenes there or behind the curtain that will contribute mightily to alphabet going forward at some point.

Andrew

12:24

100%. And I just wanted to throw something for investors in my think, Alright, sounds like a little bit of drinking the Kool Aid, something that you can pick out with pretty much all of these big tech companies right now, which is mind boggling. And this is something you uncovered in one of your blog posts a couple years ago, I'm sure you remember the amount of cash equivalents that these businesses have in the form of securities.

So like recently, you know, this is back in, as we're recording this in May, I'm sure this is old news, by the time this goes live, but everybody's talking about the bonds that while these banks owned right, these investments that they held that did not turn out well. Kids, you know that a company like alphabet has over $100 billion in their own investments that they can liquidate at any time to invest in more Other Bets to invest in whatever the next technology is their next growth Avenue.

It's all just sitting there on $12 billion of debt, right? This is huge war chest that they're just sitting on to, really, they could just blow it all, but they're not they're choosing to be very conservative. And I'm just curious, historically, if that's been something that the business world has seen at that kind of a scale, look at Apple, they have just pulled them up on quick fs 120 billion and long term investments, 24 billion in short term, 23 billion in cash, about 90 billion in debt, or close to 100 billion in debt. So plenty of a net cash position to deploy to swallow up the next big tech company or, you know, build a small team and diversify the revenue streams, the YouTube TV just going back to the whole alphabet thing. How big is that going to be? One day? I mean, I've been a subscriber to that.

And that's been really cool. But they take out all the cable companies. So it's just very interesting how much potential these companies have. And just because they've been the best companies over the 20, last 20 years doesn't mean that their time and the sun's next to saralee done. Right. Well, it remains to be seen. I don't want to say it's a guarantee thing, but you know, it does look good right now.

Dave

14:44

Yeah, it does. And it looks good. It looks good for more than the next few years. It looks good for five or possibly even 10 years, even just thinking about that war test that you were talking about, that they're sitting on. That kind of money can help those companies sustain themselves for a long period of time. And one of the things that's kind of amazing, we focus mostly on Apple and alphabet so far, but Microsoft, this company has seen a rejuvenation, if you will, over the last six, seven years, and the but the company has been around since the 70s.

And so it's not like it's some brand new company that just sprang out of nowhere, it's been around for a really long time. And one of the things that I guess is, it shows the power of capitalism, it also shows the power of a great leader, and that the company was able to basically reinvent itself and become the next thing, even though they had already been a previous next thing.

And so they rose to prominence during the.com era, and then went into kind of hibernation mode, if you will, for quite a while. And when Satya Nadella took over, and I think it was 2012, or 13, that seems to be kind of the time where they started to kind of come out of their cocoon. And it really kind of changed. The timing may be a little different on that than I'm stating, but it's somewhere in that time period. But anyway, Microsoft has their own, they have quite a few items that they can expand upon. To continue the company being a dominant player for a very long time,

Andrew

16:19

it's really too much to kind of even cover or wrap your head around, just outside of like what most people think of where you're talking about Excel word like the Office suite, and then the Xbox and then the cloud unit, which is the most exciting part. But even outside of that they have like these platforms for developers where basically it's they've become the meeting place for for people who write code and a place where they can share it, just the technology. And again, that kind of goes to the idea of creating value, the amount of value they've created for developers to make Microsoft a developer tool of choice, through their various services that, you know, people may or may not be familiar with is compelling. From a 5g kind of rollout standpoint, the overall cloud standpoint, they've really the way I described them, when I first recommended them a couple years ago, or maybe year and a half ago.

Like they really are the infrastructure, I almost look at them as like the railroads of the next generation of technology. And when you position yourself in that way, you can really leverage the innovation and manpower of, of humankind. And you don't have to be in there, like trading blows with another company, you're just more so providing the infrastructure to allow all the other companies play in your sandbox. And that's, that's very compelling for a very long term kind of idea. And one reason which I should have mentioned at the beginning, but I'm a shareholder in Apple, I'm also shareholder in Microsoft. And one of the reasons why is because they have this basic infrastructure throughout multiple stacks in the technology floor plan.

Dave

18:06

Yeah, exactly. And you think about, they're setting the foundation for everything else to be built upon that. And when you do that kind of thing, it's really hard to take the foundation out and have everything else continue to stand. And so it's really smart on their part to really approach it from that angle. Because like you were saying, they're allowing all these other people to use their platform to build on top of that, and it's going to be real hard for people to move that platform to another foundation, from where they're building it.

And that that alone will provide them with a lot of durability going into the future. And, you know, the the other thing that I have been excited about, and kind of we talked a little bit about this, too, is the whole AI thing, and how much that's going to benefit Microsoft, just based on, you know, everybody gets excited about the whole competition with search. And that's, you know, that's the buzzword is the Bing is coming for Google search. And that may or may not be true. But really, it's all the computing power that it's being used on AI that's really going to drive Microsoft forward. Because the way that that business makes money is by people using their computing power.

And the more people use something like Chet GBT, for example, that drives more usage on their servers, which drives more revenue, it also makes the product better as well. And so those are kind of reinforcing self enforcing aspects that I don't think a lot of people really realize or talk about is the sexy part of, you know, you know, being is coming for Google search, and it's, you know, instead of 2% it's now 3%. Well, okay, what do but I think the bigger conversation is really more around what AI is going to do for Microsoft and alphabet and Amazon and how that's going to benefit those businesses with their cloud computing. And in everything that's kind of wrapped all in that I think that's really the thing that maybe doesn't get as much attention. But I think will really drive all three of those companies forward into the future. And

Andrew

20:11

you're totally spot on. It truly is incredible. So if I look at a company's revenue, and usually this tends to happen on smaller companies, if I see revenue growth 14% 14% 1317 18%, a five year track record like that, I'm like, wow, this is a really fast growing company. If it's trading at a decent price, I'm going to be really excited about this. And then oh, by the way, that's Microsoft's growth rate. And yeah, obviously, that's not sustainable. But after 2019, it doesn't look like that can continue after 2020. It doesn't look like that can continue. On and on and on.

So yeah, again, it's, it's best years are behind its best years are behind it. Well, maybe. But people have been saying that for the past five, six years. And they continue to do well. So you know, again, do I think they're going to be the best business in the next 10 years? Probably not. But are they going to compound on a rate that makes other investors jealous? I would not be surprised. And it's amazing how well, their numbers have shown them to perform. And it's because of how integral their products and services have been. As infrastructure for technology.

Dave

21:27

Yeah, totally. Yep. I 100%. Agree. So let's, let's talk about number four. Yeah, talk about number four, Amazon.

Andrew

21:36

So this is a fun one, right? Yeah. If you're a beginner investor, you might not know that Amazon also has a cloud unit, similar to the Microsoft's cloud data. Microsoft's cloud is called the Azure. Amazon's is called AWS. And like you said, Dave, the buzz of the last three months has been all about AI. And not many people are talking about how that's driving the usage of servers. But then when you look at both Microsoft's Azure results, and a Amazon's AWS results are like a nice investors like those numbers.

So that story checks out, right? Oh, yeah, for Amazon, it's interesting, because they have that. And then they also have the retail segment that everybody's familiar with. And I guess it remains to be seen how both of those will kind of play out. But I've heard people talk about, like, how you could break up those two businesses and make them into their own separate businesses. And those could be too crazy investments as well. So, you know, how do you see Amazon, and how investors can maybe take another viewpoint to it?

Dave

22:54

I think Amazon is, you know, it seems like it's kind of become the third wheel, if you will, behind Microsoft, and alphabet, especially in the whole cloud business. But it would probably surprise most people to know that Amazon Web Services, AWS is actually the leader in cloud services as of right now. And so they're actually the big dog and everybody else is trying to catch up with them. Microsoft Azure has done really, really well and has closed the gap over the last few years.

But Google Cloud Services has lagged in both of those companies. But they get more press, in part Recently, because of the whole AI part of it. But Amazon has done a fantastic job of really creating this infrastructure that people really want to work on. As far as the the cloud goes. And they were really one of the I guess the premier leaders of that. There's a lot of negativity around the retail part of the business because they overspent during the pandemic. They took on a lot of costs, with warehousing with people. And, and you also can you kind of juxtapose that with Andy Jassy who's now the new CEO taking over for Jeff Bezos, when he stepped away, all those things kind of happening at the same time.

So there's been a lot of pushback on the retail side of the business. But really what Amazon was doing was really setting themselves up for the next wave of increases that could happen with the retail part of the business. And they haven't, they're not losing any strength. They're certainly not losing any sort of desire to be a disruptor in any sort of space that they choose to go into, whether it's pharmacy, whether it's grocery, whether it's retail, whether it's clothing, you know, egg production, I mean, you know, just about anything you can think of, they've done a really, really, really, really good job of creating this ecosystem in the retail system that allows them to be super productive and successful. and make their customers happy.

That was really one of Jeff Bezos really prime directives, if you will, was delighting customers, and they continue to do that with their execution on delivery with, you know, becoming once you become an Amazon Prime member, the benefits that you get for being that are just kind of staggering. You get the video service, you get the music, you get, you know, books, you get delivery, you get all these crazy things, kind of on top of all that. And so I think that part of the business is maybe underlooked, a little bit.

And I think as we get farther away from, from the pandemic, I think you're going to start to see that part of the business start to improve. And that's going to give Amazon kind of another leg up. And I think that continued, the business will continue to excel and succeed. It's, it's a powerhouse in retail. And that's not going away.

A

Andrew

25:53

When I think of what are some things I'll probably keep with me for the next few decades until something better comes along. It's my Amazon Prime account. And it's my audible subscription, which is owned by Amazon. So I don't know how much that's worth to a broad group of people. How big should a business like that be in the stock market? But those are valuable services that you did not have?

Even 510 years ago? No, no, you didn't. So I guess the last ones your most favorite topic, probably Berkshire Hathaway tell us what's the big thing that people don't understand about Berkshire?

Dave

26:37

The probably the biggest thing that people don't really understand about what's going on under the hood of Berkshire is their investments and their status and leadership in the whole renewable space. There's a lot of discussion across the country on renewables, renewable energy, how we're going to create it, where it's going to come from this that narrow thing, but with it, would it shock you to know that Berkshire is actually the largest renewable producer in the United States as a utility, they are the biggest, and they produce the most solar and the most wind.

And they also have a very large position in the natural gas space, they work with pipelines to help move the natural gas from point A to point B. And even though natural gas is not air, quote, as clean, it's still a, I guess, a transition drug, if you will, from the fossil fuels of coal, particularly and oil and then to natural gas. And Berkshire is positioned themselves to be one of the leaders going forward in in all those spaces for a very, very long time to come. And especially in the solar and the wind. They have the largest wind factory when producing farms in the country. And they are huge. I've done a lot of research on trying to find a great, I guess, investment in the solar or the wind. And it came down to Berkshire, they were the biggest they're the ones producing the most. And nobody knows about it.

Nobody talks about a Berkshire energy, Berkshire Hathaway Energy. That's the unit, who is actually run by Greg Abel, who is the gentleman who's going to actually take over Berkshire one day, that's his baby. And it's it's a massive unit, it's the largest utility producing these kinds of energy in the country. Next era, energy is probably next, and they get the most pub, most publicity, the most buzz. But Berkshire energy is actually bigger, and has been more efficient. And the best part of it is all under the Berkshire Hathaway umbrella. And so it gets the benefit of all the great capital allocation that Buffett has been able to do. And all the money that they make goes back to the mothership and and they can use it to either reinvest back in Berkshire energy, or they can use it for other entities within the company.

So it's a great position to have. And like I said, hardly anybody knows about this. And very, very few people talk about the positioning in the portfolio, and how important that's going to be going forward. Well, it's funny,

Andrew

29:01

because I've heard you talk about it for maybe two, three years now. And I guess Buffett must have been paying attention because he you know, he finally decided, oh, maybe I'll include this unit in my little leather, the shareholders. So right now, that's Warren B for finally listening to a couple of couple crazy dudes on the podcast.

Dave

29:25

But that's probably the biggest, that's probably the biggest driver that a lot of people don't know about with Berkshire. I mean, everybody knows Warren, everybody knows that the investment portfolio and in the insurance portfolio, and those are all great, and those are all performing really well and will continue to be great investments into the future. But the utility one is really going to be the one that's going to drive the bus, you know, in probably the next five to 10 years.

Andrew

29:50

For sure. I mean, anything else about Berkshire that's maybe different from its peers and makes it a great investment.

Dave

29:58

I think probably the other segment that that that a lot of people don't talk about is the railroad. I know there's been some a lot of negativity about railroads recently because of some of the horrific crashes that have happened. But BNSF, which is the rail railroad that Warren and Charlie bought all those years ago, is one of the top producers in the United States. And what a lot of people don't realize is that majority of the products that we move across the United States are done via rail.

And Berkshire owns the second largest railroad in the United States. And that's going to, that's not going away. I mean, it's been around since the 18. What 40s. And it's still, it's still an efficient way to move product from point A to point B. It's cheaper. It's cleaner. And it's an easier way to move stuff across the country. And so I don't see that going away anytime soon.

Andrew

30:51

Oh, and by the way, one of the biggest insurance, auto insurance companies, and the biggest shareholder of Apple stock, so yeah, you're getting a good collection there.

Dave

31:01

Yeah, yeah. Yeah, for sure. It's a, it's a strong collection of stuff.

Andrew

31:06

So what would you say to a beginner investor who feels maybe a little nervous about putting money into the s&p 500? Or into any of these stocks? In particular, what would you tell them?

Dave

31:17

Well, I guess the thing I would look at is, what are the businesses that are driving the returns for the s&p 500. And, you know, these are, are a large part of that growth. But then you also have to look at kind of stepping away from the stock market returns of these companies is looking at the businesses and the opportunities that they have now. And going forward. And do you think those are going to continue as a general rule, and if you feel like that is, then that should give you some comfort into deciding whether these merit a choice in your portfolio or not.

And if you choose to invest in them individually, they all have strengths and weaknesses, and those are things you have to decide and learn. But if you buy the s&p 500, then you don't have to pick and choose, then you can just you get all of them. And that's the that's the benefit of doing it that way is that you get all of them, warts and all and they will help you grow your wealth over a long period of time. It just depends on what kind of investor you want to be. And it comes down to that, but you're really not going to go wrong either way. Well said. All right. Well, with that everyone, we will go ahead and wrap up the show for this week.

Don't forget to subscribe to the show on your preferred podcast app if you've enjoyed our little podcast. If you would kindly consider giving us a review. It greatly helps the show. And don't forget to browse the incredible materials we've created for you at E investing for beginners.com. Lastly, continue growing your knowledge as in investing for beginners insider with insights and educational trips, delivered right to your inbox for free sign up today. And with that, we will go ahead and wrap up today's show. Thank you guys for listening, go out there and invest with a margin of safety. Emphasis on the safety. Have a great week and we'll talk to you next week.