



A Nobel Prize for Market Power

Janna L. Sampson, Co-CIO & Managing Member
December 2014

For many years, too many to call out, I have been part of a team that manages an investment strategy that invests in a universe of "Market Power" stocks. So you can imagine that I was excited when the 2014 Nobel Prize in Economic Sciences was awarded to Economist Jean Tirole for his analysis of Market Power and regulation. My field of study in graduate school—government regulation of large companies—was very similar to Jean Tirole's. Having the Nobel Prize in Economic Sciences awarded for my field of study, to an economist who studied at about the same time as me and for a concept that I use every day to manage money, was thrilling.

In case you are unfamiliar with the concept of Market Power, it is simply a company with a dominant market share and a barrier that protects that share from erosion due to competition. Companies with Market Power are often those that are scrutinized for anti-trust activity. In fact, the original universe for OakBrook's Select Equity strategy came from a U.S. Department of Justice list of companies that were being monitored for anti-trust activity. What is significant about Market Power from an investment perspective is that companies that have Market Power generally have higher returns on invested capital, have more stable earnings and, most importantly, tend to recover from setbacks and earnings disappointments more quickly than firms without it. Unfortunately, from an investment perspective, these firms also tend to be priced higher than their competitors without Market Power since investors understand that more stable earnings and higher returns on invested capital are attractive qualities.

At OakBrook Investments, we monitor a universe of about 150 US Market Power stocks. Over a full market cycle, this universe of Market Power stocks has outperformed the broad market as measured by the S&P 500 Index. OakBrook's Market Power Universe gross annual performance (10/1/2004 - 09/30/2014) was approximately 9.14% versus 8.11% for S&P 500 Index. It makes sense that these stocks would have higher returns than the broad market since they possess attractive qualities. However, there are periods when Market Power stocks significantly lag the general market performance. Additionally, since investment analysts are not experts in Market Power and often do not recognize that a company has it or enjoys the level of protection it provides for its earnings, the more stable earnings of these companies can, at times, look stodgy or uninteresting to investment analysts who are focused on finding the best short-run growth opportunities. Certainly during the times when the market is fearful of taking risk, the safety and stability of Market Power firms causes them to be very attractive investments. However, when the market turns to favor the riskiest, high flying growth companies, these more stable Market Power companies look boring.



A Nobel Prize for Market Power

Janna L. Sampson, Co-CIO & Managing Member

December 2014

Most investors' time horizon is very long. They are investing for retirement, their child's college education or other long-run goals. I do not believe that Wall Street analysts' focus on short-run earnings serves the best interest of most long-run investors. Focusing on a portfolio of Market Power stocks would serve those with longer investment horizons well. It is possible to outperform the return of the broad stock market with less volatility by investing in a diversified portfolio of Market Power stocks. That is what we do with OakBrook's Select Equity strategy. We have found that the return of a diversified Market Power portfolio can beat the large capitalization market indices over the long-run. Further, the favorable return characteristics of Market Power stocks can be augmented by looking for opportunities to buy them when they are undervalued as we do in the Select Equity strategy. Overlaying a value discipline helps to avoid the stocks most likely nearing a momentum top, those that have become over valued and therefore are most likely to suffer a correction in the near term. Based on my experience, many investors could clearly benefit from following the lead of the Nobel Committee in recognizing the importance of Market Power.

About OakBrook Investments, LLC

OakBrook Investments, LLC is a domestic equity management firm headquartered in Lisle, IL. Founded in 1998, it is 100% employee owned and majority female owned. The firm strives to meet the financial needs of institutions, public sector entities, corporations and high net worth individuals. For more information on our capabilities please contact David Vandergriff, Director of Marketing at d_vandergriff@oakbrookinvest.com.