On The Mark

ASSETMARK

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Shrinking Equity Market?

Key Takeaways

- Despite the 2021 IPO boom in the U.S. market, there has been a 40% drop in the number of public companies since 1996.
- Private equity, companies not listed on a stock exchange, has filled the gap and now represents more than 85% of companies with revenue above $100 million.
- The equity market remains a healthy place to earn a risk premium, with opportunities available across both public and private markets allowing investors choice on which is right for their goals and needs.

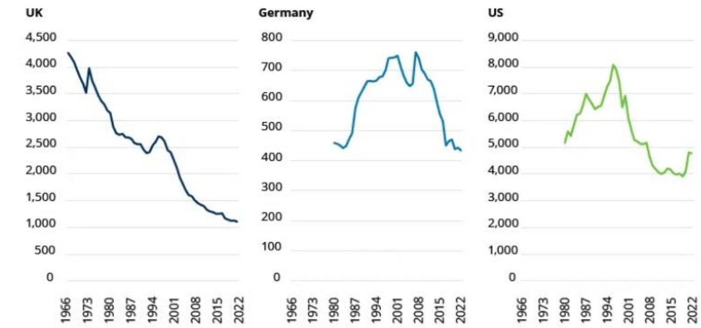
Over the past couple of years, news headlines have focused on the magnificent seven leadership of the public equity markets and the concentration of the equity indices. But if you look under the hood, you'll find a different market landscape with a smaller universe of publicly listed companies.

The Public Equity Market

The Wilshire 5000 index was created in 1974 to represent the investible U.S. market and was named based on the number of constituents. In 1998, the index hit its high in number of companies, over 7500, but since that time, the number has fallen to around 3400 as of December 2023. That's over a 50% drop in the number of companies since its high and a 30% drop since its formation.

And this isn't just a U.S. phenomenon; it's happening around the globe as the number of listed public companies has fallen as shown below.

Number of companies listed on major stock exchanges



Source: Schroders. "How should investors respond to the stock markets' dwindling status?" July 24, 2023

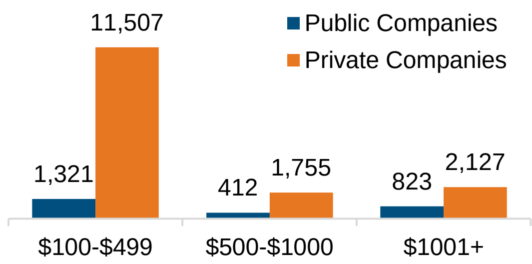
So Where Are the Companies Going?

Mergers and acquisitions have been responsible for some of the reduction in the number of companies. Larger companies are buying their smaller competitors or adding additional capabilities to their stable.

However, the largest driver of fewer public companies is that many firms are choosing to stay private for longer or go private due to the availability of capital. Just looking at the data on the number of Initial Public Offerings (IPOs), we see a large fall over the past 20 years and companies taking longer to complete an IPO. Since 2000, on average, 129 companies have gone through IPO with an average age of 11 years. Compare that to over 300 with an average age of 8 years between 1980 and 1999.

As the number of companies listed on stock exchanges reduced, the number of private companies expanded. The chart below shows that public companies accounted for less than 15% of the largest firms in the U.S. in 2020.

Number of companies by Annual Revenues ($M)
September 2020



Source: Russell Investments, 'Power Tool: Why Private Markets Are No Longer Niche'

One reason for the change is that capital is now more accessible with the growth of the private equity industry. The private equity industry has grown substantially from around $500-600 billion in the early 2000s to $7.5 trillion by 2022. Add to that the significant costs associated with required regulatory and reporting for public companies, and management teams no longer feel compelled to be listed on a stock exchange.

Public & Private Equity Coexist

The returns of private equity can be attractive, but they have typically only been available for institutional investors, and they do come with some costs. Private markets are less liquid, less regulated, lack transparency, and can include high levels of leverage. The manager of the private equity fund is critical, not only for picking the right companies but also for having access to deal flow and information.

In comparison, public markets provide liquidity, transparency, and allow a broad base of investors to benefit from company ownership. Even with a smaller universe of listed companies, there are still plenty of investment opportunities, and investors have the ability to own the broad stock market through passive funds or be more selective through the use of active managers.

There is no doubt the private market has become a significant part of the financial ecosystem, but public markets still play a critical role. Investors need to consider whether they are comfortable with the conditions that come with the higher premiums found in private markets or whether they prefer the transparency and easy access found in public markets.

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