The Good Governance of the Magnificent 7
Are They All Born Equal?

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1. Introduction

Our good governance investment initiatives are based on the principle that good governance is a key driver of superior company performance. Our academic stewardship model, which has been in operation for over eight years, has consistently shown that well-governed companies tend to outperform the S&P 500 Total Return Index by an average of 5% gross per year.

On 12 February 2024, the S&P 500 reached a new high, passing the 5000 mark. This impressive rise in the index is not a broad-based rally. Instead, it is driven primarily by a small group of outstanding performers, the so-called "Magnificent 7". The pertinent question, therefore, is whether all of the Magnificent 7 companies exhibit strong governance characteristics.

The Magnificent 7 stocks are Apple (AAPL), Alphabet (GOOGL, GOOG), Microsoft (MSFT), Amazon (AMZN), Meta (META), Tesla (TSLA) and Nvidia (NVDA). They are key players in areas such as artificial intelligence, electric cars, cloud computing and online services. Together, these tech giants have surpassed a staggering $13 trillion market capitalization. The Magnificent 7 now account for almost a third of the S&P 500. In the tech-heavy Nasdaq 100, they are even more dominant, accounting for more than half of its value. The Magnificent 7 stocks have really caught the eye of the investment community.

Some of the Magnificent 7 stocks have been central to our model, although this has not always been the case and may change in the future. Our model has been instrumental in identifying key governance characteristics, helping to avoid governance crises (such as the SVB situation) and consistently picking winners (such as Microsoft) over the past 15 years. This research note examines the governance characteristics of these companies, the types of personalities identified and possible future scenarios. The aim of this analysis is to show how our investment strategy effectively predicts both the successes and potential challenges that these companies have, could or will face.

2. Our Filters for Selecting and Not Selecting the Magnificent 7 Stocks

Our investment strategy is systematic, with a strong emphasis on stewardship and governance, and the ESG analysis that follows. These elements are fundamental to the construction and optimization of our portfolios. We use machine learning to analyze the annual reports (10-Ks) of S&P 500 companies published at the beginning of the calendar year to identify indicators of corporate culture and behavior. This process enables us to select the 100 "best managed" companies from the S&P 500 in April.

At the heart of our approach is the way we categorize words and phrases, using a comprehensive dictionary of over 8,000 words, to extract meaningful elements of good governance. While good governance does not always mean that a stock will soar indefinitely, we believe that well-governed companies are likely to stand the test of time and outperform their less well-governed counterparts over the long term.

A) Our tools: Three filters - Good Governance Model and Stewardship Orientation Model

In our selection process, we regularly update and apply three key filters:

Resilience and Agility: We use different word lists to assess how well a company handles crisis, manages risk and demonstrates prudence.

Classical: This uses word lists designed to capture a company's beliefs, attitudes, values and actions. Our aim is to get an honest, up-to-date assessment of the company.

Modern: We update our word lists every year to reflect the evolution of vocabulary and the latest and best practices. This is about keeping pace with societal and market developments and having a forward-looking approach.

Part of our model is Stewardship Orientation, which focuses on understanding a company's beliefs, attitudes, values and actions. This in-depth analysis is closely linked to, and sometimes overlaps with, the classical scores. We've provided definitions below that explain the stewardship qualities of companies (see Table 1). In the following sections, we apply our filters and focus on stewardship to conduct an in-depth analysis of the Magnificent 7 companies.

Stewardship Orientation		
Beliefs	Accountability	Obligation or willingness to promote good governance and take responsibility
	Purposefulness	Sense of purpose for greater achievement and social good
	Long-term focus	Commitment to safeguard the future through a long-term perspective
Attitudes	Care	Willingness to take care of customers
	Trustworthiness	Ability to win trust from employees
	Harmony	Propensity to act harmoniously with other stakeholders
Values	Passion	Strong passion to drive stewardship and lead with positive impact
	Positiveness	Sense of positive well-being to promote a vision of the future
	Identification	Sense of psychological ownership or oneness to identify with the company
Actions	Innovativeness	Emphasis on innovation and creativity
	Proactiveness	Proactive and anticipatory approach to risk management
	Prudence	Tendency to be conservative and prudent toward debt financing

Table 1

B) The Selection and Non-Selection of the Magnificent 7

Over the past 8 years since our model went live (see Table 2, where a calendar year represents April to April, e.g., "2016" spans April 2016 to April 2017), our filters have successfully captured the distinctive governance DNA of the Magnificent 7, highlighting their potential for outperformance based on their governance characteristics.

	2016	2017	2018	2019	2020	2021	2022	2023
APPLE INC			AAPL	AAPL	AAPL	AAPL	AAPL	AAPL
AMAZON.COM INC			AMZN	AMZN	AMZN	AMZN	AMZN	AMZN
META PLATFORMS INC	FB	FB	FB					
ALPHABET INC	GOOGL	GOOGL	GOOGL	GOOGL	GOOGL	GOOGL		GOOGL
MICROSOFT CORP	MSFT	MSFT	MSFT	MSFT	MSFT	MSFT	MSFT	MSFT
NVIDIA CORP	NVDA	NVDA	NVDA	NVDA	NVDA	NVDA		NVDA
TESLA INC								

Table 2

Based on the 10-Ks available as of April 2023, we see a recurring trend that suggests history often repeats itself in certain patterns. The table below shows how the Magnificent 7 performed in three areas - Agility, Classical, and Modern - in April 2023, when we last selected them (see Table 3). Our model selected 5 of the Magnificent 7 companies, leaving out Tesla and Meta. The five companies stood out because they scored much higher than the S&P 500 average.

Ticker	Name	SECTOR	Agility	Classical	Modern
MSFT	MICROSOFT CORP	Information Technology	1.75	2.01	1.05
AAPL	APPLE INC	Information Technology	2.37	0.76	1.49
NVDA	NVIDIA CORP	Information Technology	1.79	1.65	0.71
AMZN	AMAZON.COM INC	Consumer Discretionary	0.94	1.41	1.18
GOOGL	ALPHABET INC	Communication Services	1.75	1.23	0.03
META	META PLATFORMS INC	Communication Services	1.4	0.8	-2.06
TSLA	TESLA INC	Consumer Discretionary	-0.76	0.49	0.24

Table 3

Table 3 shows that the Magnificent 7 companies each have unique elements in their DNA. The negative scores explain why META and TESLA were not included in our model. In addition, several key insights emerge from the analysis of our model:

Microsoft has a consistent track record of excellence in several key areas, including strategy development and execution, stakeholder management, and employee engagement. Similarly, Apple and Amazon were included in our model in 2018, reflecting their newly evolving corporate cultures with a strong focus on employee well-being.

Conversely, META has consistently faced challenges in stakeholder relations and in integrating robust ethical standards into its corporate ethos. Despite the fact that the model chose Meta in 2018, it has not been selected since 2019 due to the lack of improvements. The main reason the model did not select Meta last year is its low Modern score of -2.06 (see Table 3), which is well below its peers and the S&P 500 average. If META makes progress in improving stakeholder relations and strategic developments, there is a good chance that it will be reinstated in our Top 100 model.

Tesla did not make the Top 100 due to its limited emphasis on strategic and cultural elements in its corporate statements. Specifically, Tesla was excluded due to its low Agility score of -0.76 in 2023, which indicates risk management concerns and caution in its management approach. This score reflects various risks faced by the company, including challenges in maintaining its market share. For example, in January 2024, BYD, a Chinese company, made headlines by surpassing Tesla to become the world's leading seller of electric vehicles. This is consistent with Tesla's lower scores in resilience and agility, factors that may have contributed to the company losing its position as the world's leading EV manufacturer.

2. Our Filters for Selecting and Not Selecting the Magnificent 7 Stocks

For Nvidia, its consistent high ranking in our model is no surprise, as it has been a top performer since our model's inception. Nvidia has been in our Top 100 portfolio since 2016, when our model went live. The only exception was in 2022, when it briefly left our portfolio during a significant downturn in technology stocks. During this period, Nvidia's share price fell dramatically from $289 in March 2022 to $108 in October 2022. The reason for Nvidia's exclusion in 2022 was its Modern Score of -0.64, which was below the S&P 500 average (see Table 4). However, in 2023, Nvidia's Modern score improved, leading to its reinstatement in the Top 100 portfolio. The decline in its Modern score in 2022 was primarily due to the language used in its communications, which raised concerns about its business continuity capabilities, particularly with respect to supply chain risks.

NVIDIA CORP	Agility	Classical	Modern	Average
2023	1.79	1.65	0.71	1.38
2022	1.66	1.56	-0.64	0.86

Table 4

Alphabet, like Nvidia, was briefly removed from our portfolio in 2022 due to a lower modern score. This score reflected the company's struggles with regulatory issues (such as data privacy), tax authorities, and maintaining market share. Nonetheless, Alphabet's robust overall governance performance and culture of innovation (particularly in AI) were key reasons for its inclusion in our portfolio in all other years.

The entry and exit of the Magnificent 7 stocks from our portfolio underscores the dynamic and responsive nature of our investment model. By continually re-evaluating companies, the model is designed to respond to both short-term fluctuations and long-term trends. This approach allows for adaptation to changing market conditions and company characteristics, ensuring that the portfolio remains aligned with evolving economic landscapes and governance dynamics.

3. What’s Next for Tech Giants? Governance and Insights from Our Model

In this section, we delve into the stewardship dimensions of the Magnificent 7 companies. This analysis sheds light on their individual strengths and weaknesses, allowing us to better assess their potential for future performance.

A) Governance aspects

Based on 2023 10-K filings, the Magnificent 7 companies in our analysis all outperform the S&P 500 average (see Figure 1). Typically, technology companies outperform sectors such as energy and utilities, particularly on ESG metrics. They are also known for their innovation and attractiveness, which sets them apart from sectors like finance and real estate. Tech companies are magnets for highly skilled professionals and often focus on employee well-being, setting them apart from industries such as consumer staples, consumer discretionary, materials, and industrials.

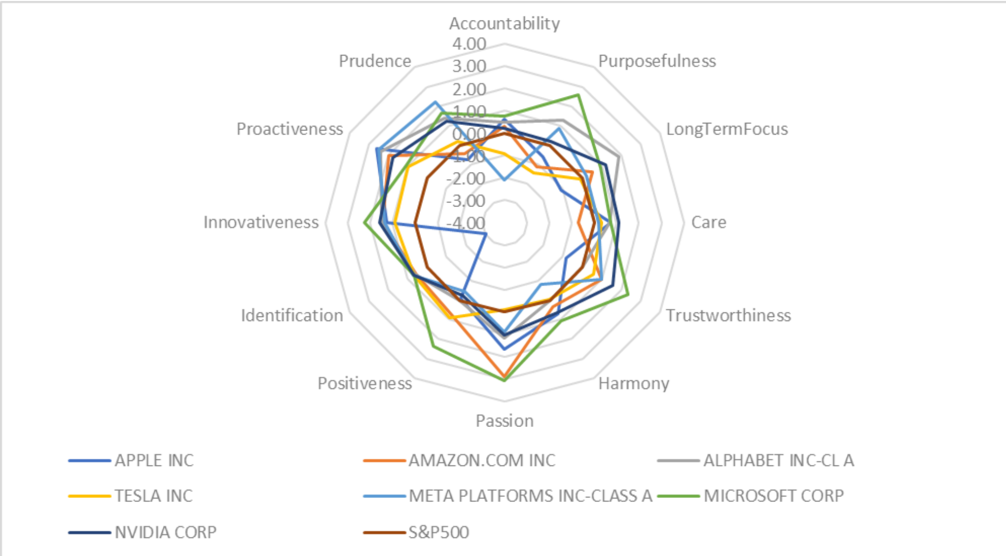

Figure 1

Let's take a closer look at the dimensional scores to identify the top performers and the laggards. It is important to note that these stewardship scores come from the language used in their annual reports, which can vary from year to year. Our analysis here focuses on governance and stewardship. We do not include their Modern and Agility scores, nor do we compare them to other sectors or competitors, domestic or international.

Accountability assesses a company's leadership team's commitment to good governance. On the positive side, Microsoft, Apple, Alphabet, Amazon, and Nvidia stand out, with Microsoft leading the way. In contrast, Tesla and Meta fall on the negative side, with Meta scoring the lowest. Interestingly, the language analysis seems to make sense: Meta's challenges, particularly around privacy, have been significant. For example, the company resolved the Cambridge Analytica scandal with a $725 million settlement. The case involved allegations that the company allowed third parties to access private user information and misled users about its privacy practices. The fallout from this significant scandal continues to reverberate today.

Purposefulness measures a company's commitment to contributing to the greater social good. Microsoft, along with Alphabet, Meta, and Nvidia, scores positively on this aspect and leads the group. However, Amazon, Apple, and Tesla are at the bottom of the list, with Tesla scoring the lowest of the Magnificent 7. Tesla's ranking may come as a surprise given its mission shift to "accelerate the world's transition to sustainable energy”. While this is a significant change from "sustainable transportation," it still seems narrowly focused on the product. In contrast, Microsoft's mission to "empower every person and organization on the planet to achieve more" may be perceived as having a broader, more socially focused impact.

Long-term focus assesses whether a company's management is committed to securing its future through a long-term perspective. Alphabet leads the Magnificent 7 in this dimension, while Apple is at the bottom. It is noteworthy that the other six companies are either run by or strongly influenced by their founders, in contrast to Apple. Apple, under professional management, seems to have lost some of its edge in maintaining a long-term focus.

Care is about how well managers take care of their customers. Nvidia is the leader in this area, while Amazon is the only one with a slightly negative score. As the only broadline retailer in the group, Amazon deals with a massive customer base of 310 million worldwide. This makes customer care a significant challenge for them.

Trustworthiness reflects a company's ability to gain the trust of its employees. In this category, Microsoft once again leads the pack, while Apple is the only company with a negative score. Traditionally seen as a top tech employer, Apple faced some hurdles in 2022. For many years, it was consistently ranked as one of the best places to work. But in Glassdoor's 2023 100 Best Places to Work report, which coincides with our 10-K form period, Apple was notably absent. Interestingly, in the 2024 edition of Glassdoor's Best Places to Work, Apple made a comeback to the list.

Harmony measures how well a company manages its stakeholder relationships. Microsoft is the top performer in this respect, while Tesla scores slightly negatively and Meta is at the bottom of the list. Meta's involvement in significant legal controversies and fines indicates that it struggles to maintain harmonious relationships with stakeholders, including customers and regulators. For example, in 2023, Meta was fined a record €1.2 billion by European Union regulators for violating EU privacy laws by transferring Facebook users' data to U.S. servers. In addition, on February 29, 2024, Meta was accused by European consumer groups of engaging in "massive, illegal" data processing.

Passion measures a leader's unwavering commitment to making a positive impact. Microsoft is the leader in this regard, while Tesla is the only company with a slightly negative score. Despite Tesla's obvious passion for transforming energy consumption, Elon Musk's unconventional behavior has contributed to a remarkably high annualized executive turnover rate of 44% for those who report directly to him, according to a 2019 Bernstein report.

Positiveness measures a company's outlook for the future. Microsoft leads here, while Meta is at the bottom with a slightly negative score. This is not surprising given that in 2023, when Meta's annual report was published, the company had just laid off 11,000 employees, or about 13% of its workforce. Understandably, the tone of Meta's annual report at the time was far from positive.

Identification measures the level of psychological ownership and association that individuals feel with a company. Nvidia ranks highest on this dimension, while Apple falls on the negative side. Apple's lower score could be due to its writing style in communications, which may not align well with our criteria for this measure. Another factor could be a weakening of the individual's association with the company, a trend that our model astutely identified.

Innovativeness is a key area in which all of the Magnificent 7 companies excel, each scoring one standard deviation above the S&P 500 average. Microsoft is the leader in this dimension, while Tesla is at the bottom. Interestingly, this is consistent with Tesla's R&D spending in Q3 2023, which was the lowest of the Magnificent 7 at 4.97% of revenue. While R&D spending as a percentage of revenue is not a direct measure of innovativeness, it seems to correlate well with our assessment in this case.

Proactiveness measures a company's forward-looking approach to risk management. Each of the Magnificent 7 companies scores impressively in this area, ranging from one to three standard deviations above the S&P 500 average. The technology sector, known for its rapid evolution, demands agility, and these leading companies demonstrate an exceptional ability to manage risk proactively. Apple truly stands out in this regard, and its highest score closely matches its actions. In February 2024, after a decade of secretive work and substantial investment, Apple decided to halt its "Project Titan" car venture. Instead, the company shifted its focus to artificial intelligence. This decision is a prime example of proactive strategy in action, illustrating how a forward-thinking company can pivot from a highly competitive market like automotive to an emerging field like generative AI.

Prudence reflects a company's cautious and conservative approach, especially when it comes to debt financing. On this dimension, Meta, Microsoft, Nvidia, Tesla, and Alphabet score positively, with Meta at the top. Conversely, Amazon and Apple score slightly lower, with Apple at the bottom. Interestingly, of the seven, Apple has the highest ratio of long-term debt to total assets. This data is consistent with the results of our textual analysis and underscores Apple's more aggressive approach to debt leverage.

B) Aspects of Competitive Advantage

The Magnificent 7 companies are leaders in their respective industries, constantly introducing new products and services that capture the interest of consumers and businesses alike. They stand out for their ability to gather rich customer data, develop cutting-edge hardware and software, and effectively use AI.

Known for their strong brands and broad customer bases, they have the advantage of penetrating diverse markets and capitalizing on opportunities for international growth. This broad reach ensures a steady flow of revenue and success in launching new products.

By investing heavily in R&D and cutting-edge technologies such as big data and AI, these companies are at the forefront of innovation. Their agility in responding to market shifts and shaping consumer trends sets them apart.

From a financial perspective, all seven companies have strong free cash flows, low debt levels, and significant earnings and revenue growth. This financial robustness, combined with their growth potential, makes them very attractive to investors. Our model suggests that these companies are likely to continue to maintain their competitive strengths and advantages over other S&P 500 companies.

C) Risks and Challenges Aspects

Investing in the Magnificent 7 stocks, like any investment, involves risks and challenges. Although they have solid market positions and a history of technological innovation, the future performance of these seven stocks could vary significantly in a changing environment.

It is important to recognize the intense competition in the tech industry. Domestically, innovative startups like OpenAI are shaking up the industry. Internationally, the competition is even fiercer. We see battles like TikTok challenging Meta, BYD going head-to-head with Tesla, and giants like Huawei and Samsung competing with Apple. In e-commerce, players like Alibaba, JD.com, Shein, and Temu are taking on Amazon. This increased competition from both global heavyweights and emerging startups poses a threat to the market share of several of the Magnificent 7 companies.

These companies' global operations also expose them to geopolitical risks such as trade wars or tariffs, which can affect their global supply chains and market access. A case in point is the U.S.-imposed trade barriers that have accelerated China's push to build an independent semiconductor industry. This move is aimed at reducing China's dependence on Western technology and addressing security concerns. Given these developments, it may only be a matter of time before China's chip industry creates competitors that could challenge Nvidia's leadership in AI chips.

Because of their size and influence, the Magnificent 7 companies are subject to significant regulatory risks, which Google regularly and prominently highlights. Tech giants are often scrutinized for antitrust issues, privacy concerns, and their tax practices. Changes in regulations can have a major impact on these companies. Many have already been investigated for monopolistic practices. As they seek to expand their dominant market shares, they are likely to face even more regulatory scrutiny.

Global economic factors such as interest rates, exchange rates, inflation, economic growth and consumer confidence play a significant role in shaping consumer spending and business investment. These factors can directly affect the sales and growth prospects of the Magnificent 7 companies. In addition, broader market shifts such as recessions or downturns can affect these companies due to their large market capitalization. High market valuations often come with high expectations. Failure to meet these expectations can result in significant corrections in their stock prices.

The success of the Magnificent 7 companies depends on their technological prowess and, in some cases, their charismatic founders or leaders. However, the technology sector is inherently dynamic and rapidly changing. These companies must constantly innovate to maintain their core competencies. If they fail to adapt to new technologies or market trends, they risk damaging their reputations. Being at the forefront of technology also makes them prime targets for cyber attacks. A significant security breach could result in significant financial and reputational losses. Moreover, the strong association of some of these companies with their founders or key executives means that any change in leadership could affect investor confidence and the strategic direction of the company. All of these factors have the potential to affect the reputation and performance of these companies.

4. Buy and Sell Signals Generated by Our Model

Our methodology focuses on how a company's language reflects management's attitudes, priorities, and activities, which are key to predicting financial performance in the coming year. Of course, the stock market is not just about numbers; it is also influenced by psychology and many other factors. Financial performance is only one piece of the puzzle, and is only remotely related to future stock performance with a certain degree of probability. So on an individual level, our model's ability to pick stocks can vary. It can pick winners or miss them, and it can either successfully avoid poor performers or pick them incorrectly.

A) Nvidia: Picking Winners and Timing the Market

When we examine Nvidia's stewardship qualities, it is clear that they are among the elite in the S&P 500. The only area where Nvidia does not quite hit the mark is in their Positiveness score, as shown in Figure 2. This suggests that their 2023 annual report may have had a slightly less positive tone compared to the S&P 500 average. However, this slight dip in positivity is well offset by their strong performance in the other areas. This balance suggests that the slightly less positive tone is unlikely to have a significant impact on their stock performance.

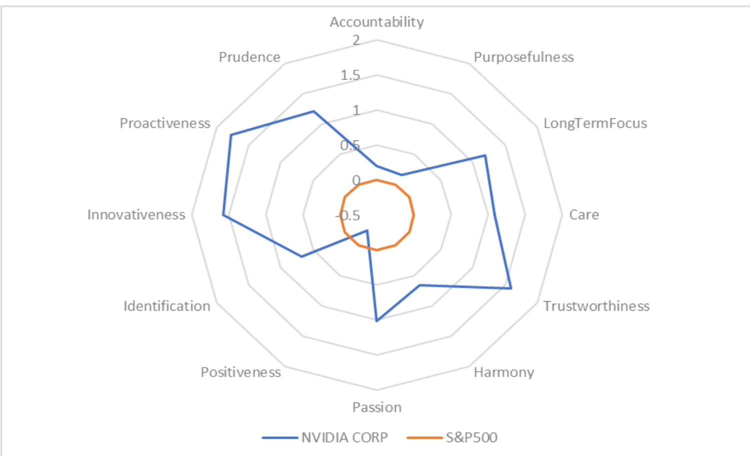

Figure 2

We first picked it when we tested our model with paper trades in 2016 (see Figure 3). When our fund launched in 2019, Nvidia was a consistent favorite through 2022. Back then, it was dropped due to one of its scores. This could have been just luck, or our model saw early warning signs in 2022 that pointed to a big drop that year. In 2023, our model picked Nvidia again, which turned out to be a smart move.

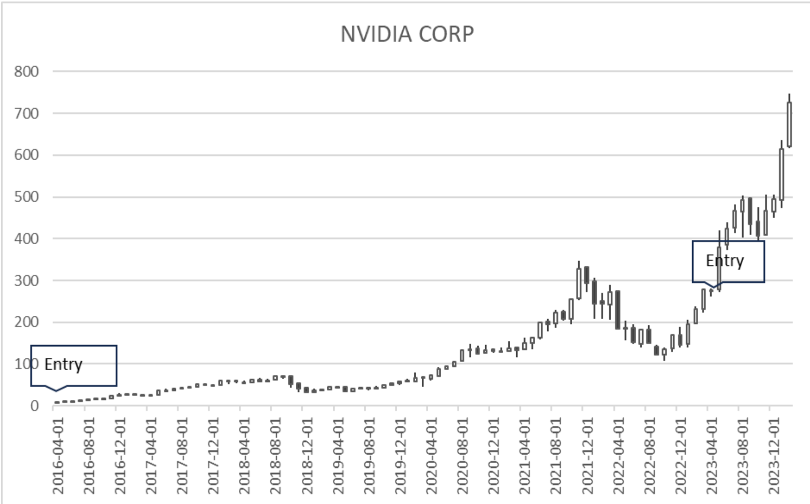

Figure 3

B) Tesla: Avoiding Underperformance

Tesla serves as a case study of how our model helps avoid underperforming stocks. While Tesla stock is not a bad investment, up more than 800% in five years, it has not been picked by our model since joining the S&P 500 in December 2020. In 2023, Tesla had a low Agility score of -0.76, below the S&P 500 average of 0 (see Table 3). Its average score is significantly lower than the other six stocks. Looking more closely at Tesla's scores across the various stewardship dimensions, it falls short of the S&P 500 average in several areas (see Figure 4), including Accountability, Long-term Focus, Harmony, Passion, and Purposefulness.

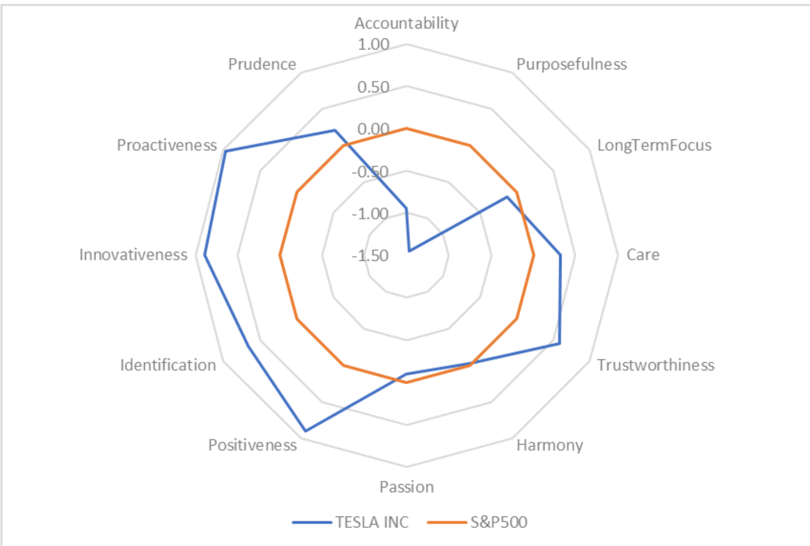

Figure 4

Furthermore, since joining the S&P 500, Tesla's stock has lagged its peers (see Figure 5). It is important to note that over the past three years, Tesla's stock has not grown significantly.

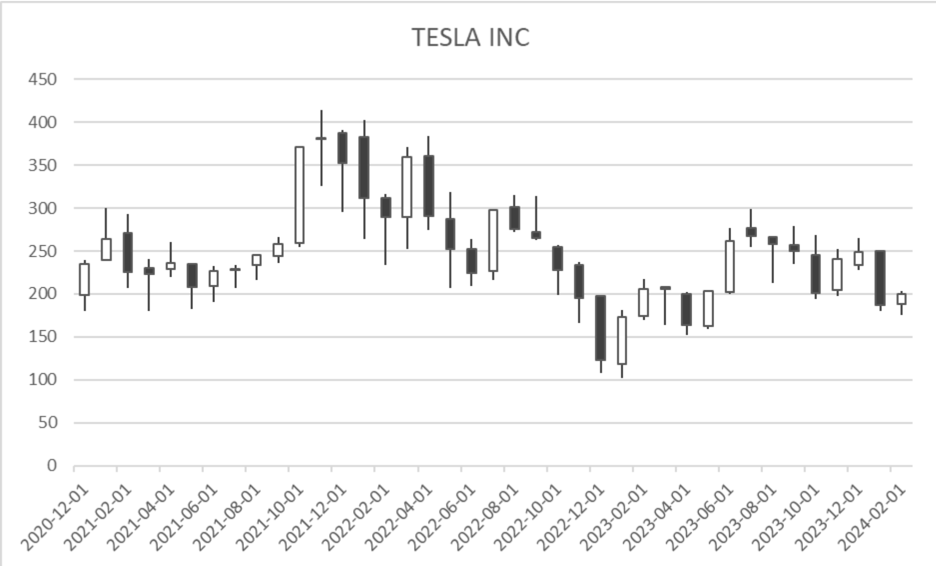

Figure 5

C) Apple: Teetering on the edge

Apple has been a key component of our model since 2018, contributing significantly to alpha generation over this period. We have been impressed with Apple's strengths, such as proactive risk management, agility, strong branding, market leadership, accountability, customer care, and passion. Despite these positives, it is important to note some areas where Apple falls short, which could pose challenges to its future growth.

Our analysis suggests that Apple's professional management has led to a reduced sense of psychological ownership and individual connection to the company (see Figure 6). While founders or owner-managers often prioritize the longevity of the company and foster positive relationships with all key stakeholders, professional managers may be more inclined to meet the demands of investors, since their job security often depends on investor satisfaction. This can lead to decisions such as layoffs to reduce costs, which can undermine employee trust. In addition, professional managers may focus more on short-term goals, which are often aligned with the duration of their stock options, rather than long-term strategies. They may also try to appease investors by using borrowed funds for share buybacks or paying special dividends, which can be seen as prioritizing immediate returns over the future growth and stability of the company.

As investors, our ideal scenario is to hold a winning company indefinitely. However, the reality is that companies can eventually fall under the influence of short-term focused investors who prioritize immediate profits over good governance and stewardship. While we have seen some early warning signs in the company, we are not rushing to recommend a sell. Apple recently abandoned its car project to focus more on AI, a strategic shift that will be evident in this year's annual report. It is possible for the company to pivot quickly and refocus its strategies.

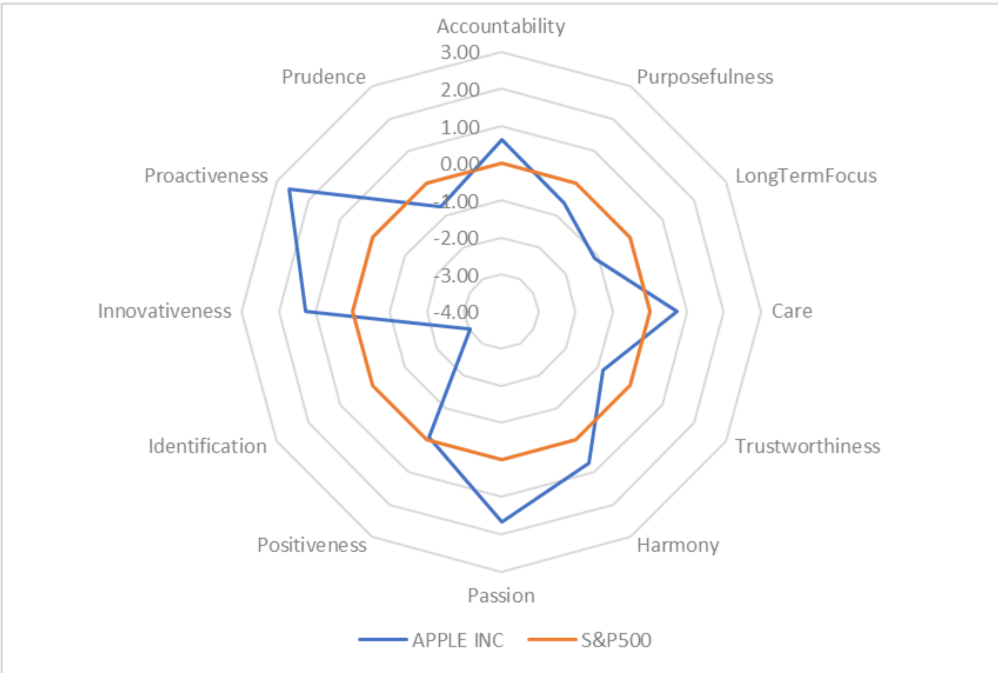

Figure 6

Apple's less-than-stellar governance and stewardship scores have been reflected in its stock performance. After its last inclusion in our portfolio in April 2023, the stock initially outperformed the index through December 2023. Since then, its performance has lagged, negatively impacting the performance of our portfolio (see Figure 7).

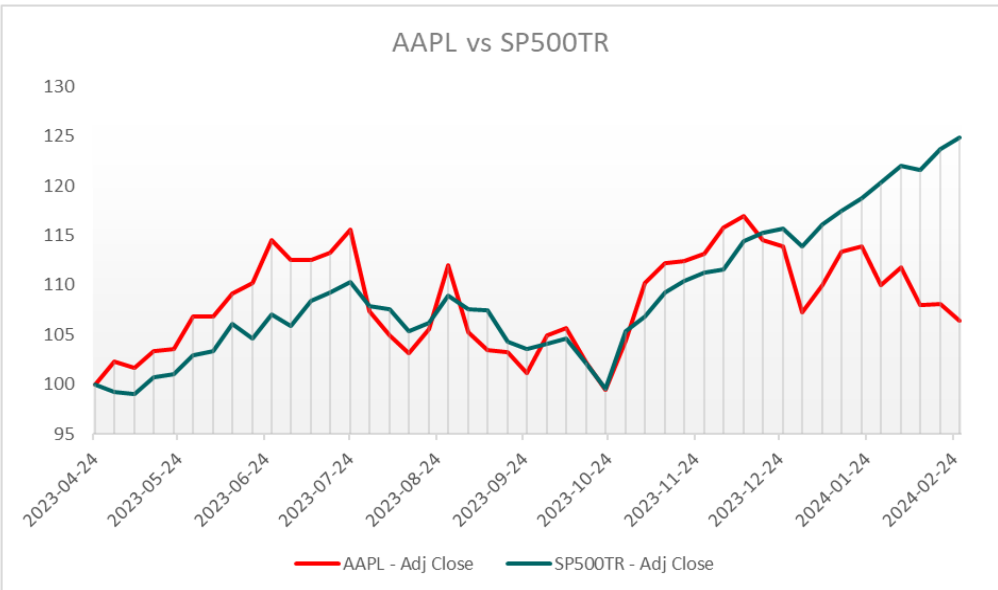

Figure 7

Our priority has always been to invest for performance, not loyalty to any particular company. As a result, it is important for us to remain objective and not become overly attached to any stock position. Experienced investors may recall how General Electric's story changed from the Jack Welch era to the Jeff Immelt era. Therefore, we must be prepared to act if the company loses the qualities that made it exceptional. If Apple fails to meet our performance filters in the future, we are prepared to make the difficult decision.

5. Model Effectiveness and Risk Reduction and Return Enhancement Strategies

A) Model Effectiveness

Experienced investors know that there is no such thing as a sure bet in investing; it is all about playing the odds. From the S&P 500's inception in 1928 through December 31, 2023, the average annual return is 9.90%. Since the index expanded to 500 stocks in 1957 through the end of 2023, the average annual return is 10.26%. By consistently selecting a group of stocks from the S&P 500 that outperform the index, we increase our probability of achieving long-term returns above 10%. The efficiency of our method is therefore easy to assess. We compare its current alpha generation to the results of our back-testing, paper trading, and historical data. Currently, our model is performing in line with our predictions, delivering alpha of approximately 4% to 6%, varying with the trading period. This consistent performance underscores our model's ability to identify promising investment opportunities early.

Sometimes our model may miss a winning stock or accidentally pick one that underperforms. When this happens, it is usually a sign to check the data we are using. There are scenarios where text data analysis may not accurately reflect a company's performance. Companies may omit important information, or they may change the writing style or tone of their annual reports to be overly positive or negative. We understand how companies can shape their language, which is why we choose 10-K forms over glossy annual reports. Compared to the latter, 10-Ks tend to be more straightforward and less susceptible to manipulation. It is also important to remember that 10-Ks are legally binding, standardized, and comprehensive documents. They are prepared by senior management, approved by the board of directors, certified by auditors, and regulated by the SEC. With this in mind, we believe that fraud among S&P 500 companies is rare, although it may occur from time to time.

Our portfolio is rebalanced once a year. However, unforeseen events or shocks can occur between these periods that our model may not be able to predict. In fact, companies are required to report all risks and crises in their 10-K filings, and we take these disclosures into account when analyzing their risk, prudence, agility, and other factors. This approach helps us screen out many high-risk stocks. However, even with a thorough screening process, some companies may slip through the cracks, particularly in the event of unforeseen shocks. As a result, there is always the possibility that we may miss promising stocks or inadvertently pick stocks that underperform. Recognizing these limitations, we have developed several strategies to mitigate risk and enhance returns.

B) Strategies to Address Potential Inefficiencies, Reduce Risk and Enhance Returns

As active market participants, we inevitably face challenges related to model limitations, data quality, and shocks that increase short-term volatility. To address these issues, we use four key remedies.

Our first remedy is to continually update the dictionary and refine the model. By doing so, we keep our model up to date with the latest economic and political trends, regulatory changes, new products and services, changing psychological perspectives, and new business strategies. This regular refinement is key to maintaining the model's relevance and accuracy in a rapidly changing business environment. Without these updates, the model would lose its forward-looking edge. Our strategy strikes a balance - we maintain the model without overfitting or overengineering it. There is often a temptation to tweak and refine every aspect of a model to improve its performance. However, if this is done using historical data, it can lead to overfitting. In such cases, the model may perform well in theory but fail in the real world. Therefore, our philosophy is to incrementally improve and update the model, following the "if it ain't broke, don't fix it" principle.

Our second remedy focuses on diversification, where we select a broad set of 100 stocks from the S&P 500. This approach takes advantage of the law of large numbers and the power of diversification. Essentially, this means that any negative impact from unexpected market shocks, less-than-ideal stock picks, or sudden price swings is likely to be offset across the broader portfolio.

Our third remedy is to create a market-cap-weighted portfolio. This method naturally favors large companies such as the Magnificent 7. As market leaders, they tend to offer a balanced mix of profitability and growth potential, and they are less likely to mislead investors and regulators. In addition, large companies tend to be more resilient to shocks, resulting in less volatile share prices. In a market-cap-weighted portfolio, the impact of poor selection, biased data or shocks affecting small-cap stocks is proportionately reduced. However, it is important to recognize that if large-cap stocks are affected by a negative shock, our portfolio and the index itself would feel the impact at the same time.

The fourth remedy is our rebalancing strategy. Although we tend to take a long-term, buy-and-hold, value-oriented approach to investing, we can still take advantage of market momentum through quarterly rebalancing. Since all available information is reflected in stock prices, adjusting our holdings based on recent price movements can help us take advantage of this momentum. Quarterly rebalancing is very effective, especially if we don't sell any stocks during the year. It allows us to increase the proportion of our better-performing stocks while decreasing the proportion of those that have underperformed. This minimizes the impact of any initial selection problems, biased data or shocks.

6. Conclusion

Our analysis of the Magnificent 7 - Apple, Alphabet, Microsoft, Amazon, Meta, Tesla, and Nvidia - provides a comprehensive understanding of the complex relationship between governance and market performance. Our analysis shows how good governance is linked to market winners. Over the past eight years, our investment approach, which pays special attention to resilience and agility, classical and modern governance thinking, has been spot on in predicting market shifts. Take companies like Nvidia and Tesla, for example - our methodology was nimble and gave us smart tips on when to buy and when to sell.

We follow these companies closely, using our "good governance" lens. That means looking at things like how proactive they are, how innovative they are, and whether they're trustworthy. This gives us a clear view of where these companies shine and where they might need a boost. By keeping an eye on different aspects of governance, we are ready for whatever changes may come in the tech world. The results of our model can be summarized as follows:

1. Microsoft stands out as a leader among the Magnificent 7 because of its exceptional governance characteristics. Across the 12 dimensions of stewardship, Microsoft excels in 7 key areas: Accountability, Purposefulness, Trustworthiness, Harmony, Passion, Positiveness, and Innovativeness.
2. Nvidia is emerging as a strong contender for the top spot. Currently, this founder-led company excels in two critical dimensions: taking care of customers and fostering a strong sense of identification with the company.
3. Alphabet continues to be exceptionally well-managed and strongly influenced by its two founders. The company leads in the dimension of long-term focus more than any other in the Magnificent 7 group.
4. Amazon has made remarkable improvements in its relationship with its employees. However, as a global retailer, it faces the challenge of satisfying its vast global customer base.
5. Apple stands out for its proactiveness in managing risk. However, it lags in several critical dimensions, including long-term focus, employee trust and company identification, and prudence. If these areas remain weak, Apple's competitive advantage could be compromised.
6. Meta presents a contrasting picture. On the one hand, the company is exceptionally prudent in its use of leverage, but on the other, it faces significant stakeholder challenges, as evidenced by its low ranking on dimensions such as accountability, harmony, and positiveness. Much like Amazon's struggles with customer care, Meta's status as a social media company is naturally fraught with controversy, particularly in areas such as privacy.
7. Tesla lags behind the other six companies in the Magnificent 7. Compared to the world's best-run companies, such as Microsoft and others, Tesla ranks lowest on key dimensions such as Purposefulness, Passion, Innovativeness, and Proactiveness.

It is important to note that investing in such volatile and competitive sectors can be tricky. There are risks and challenges, such as fierce competition and changing regulations, that can affect the performance of these big names. That is why we are always on our toes, tweaking our three filters - good governance model and stewardship orientation model - to stay on top.

This research isn't just a pat on the back for us; it shows the power of focusing on governance when investing. While there is no foolproof method, our approach, which tracks market trends and corporate actions, has a solid track record of picking winners over the years. This study underscores why good governance matters - not just for the companies themselves, but for building a strong portfolio and making smart investment decisions.

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