J&J Supplants Apple as Barron's Most Respected Company

Baby powder and band-aids beat iPhones this year in the eyes of professional investors. In other words, Johnson & Johnson, renowned for household brands as well as prescription drugs and medical devices, knocked Apple from its perch atop *Barron's* annual ranking of the world's most respected companies.

J&J (ticker: JNJ) jumped to No. 1 from No. 6 in 2015. Apple (AAPL), crowned the winner last year by U.S. money managers, slipped to No. 3.

Berkshire Hathaway (BRK.A), a perennial top-five finisher, stood at No. 2, up from third place in 2015. Online retailer Amazon.com (AMZN) advanced to No. 4 from No. 17, having finally proved it can generate cash after spending many years investing in its businesses. Rounding out this year's top five: Nike (NKE), the athletic footwear and apparel giant, which sprinted up from ninth place in 2015.

J&J jumped to No. 1 from No. 6 in 2015. Getty Images

J&J has ranked at or near the top of the list in 10 of the 12 surveys we've run. The company's deft handling of a recall of its Tylenol pain reliever after a cyanide-tampering scare still inspires, even though the episode occurred more than 30 years ago. Yet, as much as J&J deserves kudos for far more recent achievements, its mean respect score rose only slightly this year, to 3.83 from 3.67 (more on the survey's methodology in a moment).

J&J owes its No. 1 spot both to professional investors' growing respect for the New Brunswick, N.J.–based company, and diminished admiration for some of last year's top performers. Walt Disney (DIS) clocked in at No. 6 this year, down from No. 2. Alphabet (GOOGL), Google's corporate parent, fell to No. 9 from No. 5. Visa (V) dropped to No. 22 from fourth place.

Shifts in corporate fundamentals explain many changes in the ranking, but not all. Apple's decline, albeit modest, occurred as its stock dropped about 25%, due to growing worries about the tech giant's long-term ability to keep creating innovative, must-have products.

A volatile market and industry trends can also influence investors' perceptions. Take Wells Fargo (WFC), last year's seventh-place finisher, which plunged to No. 60 this year, a victim chiefly of the market's persistently bearish view of banks. That might change if interest rates start to rise, allowing banks to earn higher net-interest margins. This year, however, the banks that qualified for inclusion in the survey all ranked below No. 40.

While there is relative stability from year to year among the companies in the top 10, there are notable shifts in reputation and ranking throughout the list. In the plus column, McDonald's (MCD) is showing operating improvement after years of subpar performance, and investors have recognized as much. The company ranks No. 49 this year, up from No. 72 in 2015. Microsoft (MSFT), another turnaround story, rose to No. 14 from No. 27.

Investors say they base their respect for companies, at least in part, on their experience as consumers. It is little wonder, then, that four of this year's five winners sell hugely popular products or services; the fifth, Berkshire Hathaway, is run by Warren Buffett, one of the world's most revered investors.

What Inspires Respect?

Strong management was rated just ahead of corporate ethics in our survey.

Strong Management	30%
Ethical Business Practices	25
Sound Business Strategies	19
Competitive Edge	10

BARRON'S **HAS ASKED** money managers since 2005 to share their views of the world's largest publicly traded companies, as measured by total market capitalization. Over time, high respect scores both reflect and help lead to stock-market outperformance. Companies with low respect scores—this year's group includes Chinese and Japanese outfits, tobacco sellers, and telecom and energy names—often are ripe for improvement.

S&P Dow Jones Indices provided the list of companies eligible for inclusion in the survey, based on total market cap as of April 20, 2016. Reckitt Benckiser (RB.UK), the British seller of over-the-counter health and hygiene products, is the smallest company on this year's roster, with a stock-market value on that date of $73.5 billion. That's down from last year's cutoff point of $80 billion. The survey was conducted with the help of Beta Research in Syosset, N.Y., and drew responses from 90 professional investors.

As in years past, respondents selected one of four choices that best reflected their view of each company: Highly Respect, Respect, Respect Somewhat, or Don't Respect. A point value was assigned to each response, with the highest accorded to Highly Respect. A Don't Respect rating merited a deduction. A mean score was tabulated for each company; in the case of ties, the higher ranking went to the company with the most Highly Respect votes.

The finish between J&J and Berkshire is even tighter than it looks. Berkshire obtained the most Highly Respect marks in the survey: 53. However, it also received the most Don't Respect checks among the top 10, at five. J&J's victory was partly due to the fact that it received no Don't Respect scores—a rare feat—and therefore had no points subtracted. Had Berkshire received one less Don't Respect black mark, it would have edged out J&J this year.

There was no trend among industry sectors this year, unlike in 2015, when health-care companies, including biotechnology and drug concerns, medical-device makers, and pharmacy-benefit managers occupied 13 of the top 30 positions. Health-care stocks are down 8% as a group since last July, after many years of leading the market. That decline, which dented investors' wallets, is likely to have had a negative impact on respect scores, too.

SURVEY RESPONDENTS were also asked which of several factors is most important to them in determining respect for companies. (See table, below.) In addition, they were invited to contribute comments on individual companies.

Nearly one-third of respondents indicated that strong management is key to winning their admiration. "People make things happen, not corporations," says Peter Scholla, who runs Global Investment Adviser, in North Palm Beach, Fla. "IBM registered 7,355 patents last year. Where are they [management] turning this into a profit?"

As the comment suggests, he doesn't think much of the Big Blue executive team.

Strong management covers a lot of ground, and can be thought to include sound business strategy, notes Adrian Day, president of Adrian Day Asset Management in Annapolis, Md.

A smaller, but still significant percentage of respondents called ethical business practices the most critical factor in soliciting respect. Lloyd Khaner, president of Khaner Capital Management, says he respects a company that "treats customers with integrity and takes care of its employees as well as shareholders."

Charles Lieberman, chief investment officer of Advisors Capital Management, in Ridgewood, N.J., says respect for a corporation, in his mind, is derived from how its managers treat shareholders. Full stop. Is the company growing profits—and delivering them to shareholders?

J&J ISN'T PERFECT. In 2012 the company ranked No. 32 in our survey, after it had been hit by patent-infringement lawsuits, product recalls, and manufacturing troubles. Most of that is in the past now, although the company reportedly faces more than 1,000 lawsuits alleging that its talcum-powder products can cause cancer. Still, J&J continues to grow organically and through acquisitions. It has proved a dependable provider of rising profits and dividends, and a good steward of shareholder capital.

J&J consistently innovates and adds value, says John Boland, a principal at Maple Capital Management, in Montpelier, Vt. "It is focused on cash flow and understands it is the shareholders' cash that is being generated," he says.

David Hartzell, a portfolio manager at Cornell Capital Management, in upstate New York, agrees. "It has a great management and product mix, and always addresses its problems and resolves them," he says. "You have to be forthright and willing to take products off the shelf, and J&J is."

Hartzell says he has been buying J&J for clients since 1990.

Despite legal setbacks and some softness in results in its medical-devices unit, J&J raised its 2016 guidance for revenue and earnings per share, and lifted its dividend by 7%, the 54th consecutive annual increase. The stock yields 2.84%. Since the publication of our previous survey, J&J's shares are up 13%, while the market is down 2%.

BERKSHIRE HATHAWAY has finished in the top five in 10 of the past 11 years—a feat no other company can match. The one year it missed the cut, it was ranked a none-too-shabby No. 15. The company has prospered over the decades, and Buffett, its chairman and CEO, has been recognized for having made some of the savviest investments in history.

This year, as in the past, admirers laud Berkshire's business model, long-term orientation, and capital allocation. Yet Berkshire's strong respect score derives in large part from Buffett, who has gained rock-star status among investors and others. A common remark from respondents is that he strikes the right balance between ethics, profits, and common-sense investing.

For all his success, however, Buffett has also come under criticism, particularly now that he has become more vocal about politics, taxes, and income inequality. For that reason, some investors view him less favorably than in the past, and enough of them voted Don't Respect to cost Berkshire first place.

"One can't criticize Berkshire's performance," says Day, "But Buffett's folksy image is overdone."

When Buffett complains that the rich don't pay enough taxes in the U.S., he could always send a donation to the government, Day says. “There’s nothing wrong with minimizing one’s taxes,” he adds.

AND WHAT OF APPLE? Activist investor Carl Icahn sold his big stake earlier this year. Yet Berkshire thought well enough of Apple to purchase more than $1 billion of stock in the first quarter. Berkshire owns stakes in a number of companies on our list: Wells Fargo; Coca-Cola (KO), which finished at No. 34, up from No. 38; and IBM (IBM), at No. 63, down from No. 59.

Although Apple fell only two spots, the drop is indicative of rising investor skepticism about its ability to keep innovating successfully. Last year, 68% of respondents gave the iPhone maker a Highly Respect rating, but that has fallen to 52%. For years, investors worshipped Apple’s new products and technological vision. But in the latest survey, some said the Cupertino, Calif.–based creator of some of the world’s most popular gadgets can’t figure out how to grow, or is out of touch with the market. Ouch.

Says Craig Giventer, a managing director at Financial Partners Capital Management in New York, “Apple CEO Tim Cook deserves a lot of respect for steering a great company, post-Steve Jobs [Apple’s co-founder]. That said, all products, technology products especially, have their life cycles, and the iPhone isn’t immune.”

Cornell’s Hartzell was tougher: “You know what happens to a company with one big product? Eventually, it becomes a commodity. What is Apple’s next big product? It’s not the Apple Watch.”

THE KIND OF RAVE REVIEWS Apple used to get now go to Amazon.com, our fourth-place finisher. In the first quarter, the Seattle-based online seller of just about everything produced its fourth straight profitable quarter, and strongest ever, after years of spending billions on infrastructure and building itself into a behemoth. This year, in particular, the poor results at many department stores and apparel retailers demonstrate Amazon.com’s growing power. According to a recent Cowen & Co. report, Amazon.com will be the nation’s largest apparel retailer in 2017, surpassing Macy’s (M).

“Amazon has taken a lot of flak for failing to produce profits [in the past]. It looks long-term, invests for growth, and does it smartly,” says Lieberman, of Advisors Capital.

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Unless the company makes a surprising mistake, its shares could continue to rise.

Nike, which made it into the top five for the first time in its second qualifying year, is respected for having one of the best-known brands in the world. Its “swoosh” icon is omnipresent at many sports events and was even visible at the most recent Milan Design Week. Nike focuses on basics, performs consistently, and remains dominant year after year, says Maple Capital’s Boland.

ONE OF THE BIGGEST improvements this year was delivered by McDonald’s. Although it barely eked into the top half of the survey, it seems to have recovered from an earlier reputational hit. The company ranked No. 3 in 2012. Steve Easterbrook took the reins as CEO last year, and his turnaround plan is working. By the first quarter of 2016, the new all-day breakfast and value menu he instituted helped the fast-food company beat analysts' expectations for three straight quarters. U.S. same-store sales have turned positive after two negative years.

McDonald's isn't afraid to take risks and experiment, says Cornell's Hartzell. When it discovered "wraps didn't work," management said, "OK, let's try all-day breakfast. Brilliant," he says.

McDonald's stock has risen 26% since the previous survey.

Microsoft rose fewer spots this year, but made it into the top 15. For years, the Redmond, Wash.–based company has faced declining demand for personal computers and, consequently, for its operating software. Respondents said that CEO Satya Nadella, who took the top job in February 2014, has focused on Microsoft's core competencies, and that the company's Windows 10 operating system has proved more popular than expected. The move into cloud computing services is also paying off.

WELLS FARGO'S ABRUPT FALL is the biggest point decline in this year's survey, and the reasons for it are a bit of a mystery. The stock price of America's largest bank by market value has slid 15% since the last survey, but that is hardly a washout.

The San Francisco–based bank's huge mortgage unit has been the focus of recent regulatory scrutiny, and it agreed in February to pay $1.2 billion to the federal government to settle claims of "reckless origination and underwriting." Worries about the bank's energy loans are growing; Wells Fargo has increased its loan-loss provisioning.

Other financial companies, such as MasterCard (MA) and Visa, also fell. MasterCard slipped to No. 18 from No. 8, and Visa dropped to No. 22 from No. 4. As with Wells Fargo, the factors that trimmed their respect scores are difficult to parse, with their stock prices up 1% and 13%, respectively. There is some unease regarding the impact on both companies of growing cashless payment systems, and some investors wonder whether the two card companies can keep up. "The landscape of paying bills is changing, and corporate analysis [in the industry] has become a little less sure," says veteran money manager Matthew Mezmar with Wells Fargo Advisors.

It is possible, too, that both have lost some luster due to many credit-card breaches, and to consumer and vendor confusion at checkouts caused by new chip-card technology.

NEAR THE BOTTOM of *Barron's* list you'll find some other financial giants, including Citigroup (C) and HSBC Holdings (HSBC), still smarting from the financial crisis of 2008-09. The exception is JPMorgan Chase (JPM), down slightly to No. 42 from No. 37.

This year's Most Respected ranking has 13 new entrants, replacing companies that dropped off primarily due to a change in market value. Starbucks (SBUX) at No. 11, is a newcomer, given the surge in its market value. Goldman Sachs (GS) and Volkswagen (VOW.Germany) both exited the list, as their market value fell below the cutoff after big stock drops.

It is obvious why tobacco companies don't get much respect. As one respondent put it years ago, "they kill their customers." Chinese companies typically score poorly in investor esteem due to China's weak rule of law, poor corporate governance, and corporate opacity. No. 100 is China Construction Bank (939.Hong Kong), which arguably suffered a double whammy—as a bank and a Chinese company.

Of the 100 largest public companies, 45 are headquartered outside the U.S., not including companies like Medtronic (MDT), which have operating headquarters here but are domiciled abroad. Last year 44 companies were based outside the U.S. The most esteemed foreign firm? Nestlé (NESN.Switzerland), at No. 12, up from No. 14.

AS THE FREQUENT LEADERS on this list attest, companies that earn investors' respect generally reward shareholders over time. Conversely, corporate wrongdoing, once exposed, often leads to plunging stock prices. Troubled drug firm Valeant Pharmaceuticals International (VRX) is a prime example. Not too long ago, it might have qualified to be considered for inclusion on our list, based on its market value. With the shares down 85% following a raft of management mistakes, the company no longer does.

That's a lesson for all corporations wishing to stay in investors' good graces. Respect is hard to define, but easy to lose.

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