Heartwood Investment Management

20 July 2018

Investment Insight

Weekly Insight

Will FAANMG stocks drive tomorrow's markets?

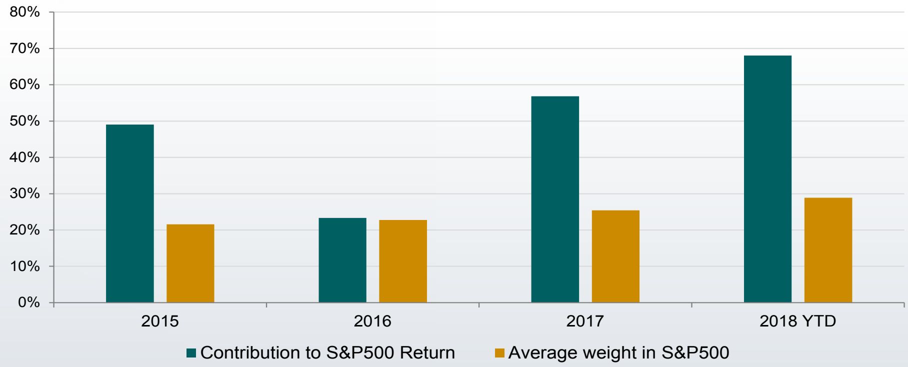
The tech sector is a significant driving force in today's markets. Its six stars – Facebook, Apple, Amazon, Netflix, Microsoft and Google (collectively known as FAANMG) – now have a combined market capitalisation larger than any of the S&P500's official 11 industry sectors.

So far this year, information technology and direct market retail stocks (the latter including Amazon and Netflix) have accounted for around 30% of the S&P500 in market-cap terms, but provided almost 70% of index returns, as demonstrated in the chart below. Meanwhile, Apple (at $937bn) and Amazon (at $890bn) are currently in a race to become the world's first ever trillion dollar company.

Beyond the US index, tech stocks have reached new market highs globally. Information technology alone accounts for just under 20% of the world index; in the late 1990s, with the tech bubble ready to burst, this figure was only a little higher (just above 20%). Should investors be wary?

Tech sector returns are punching above their weight

S&P500 - Information Technology & Internet and Direct Marketing Retail



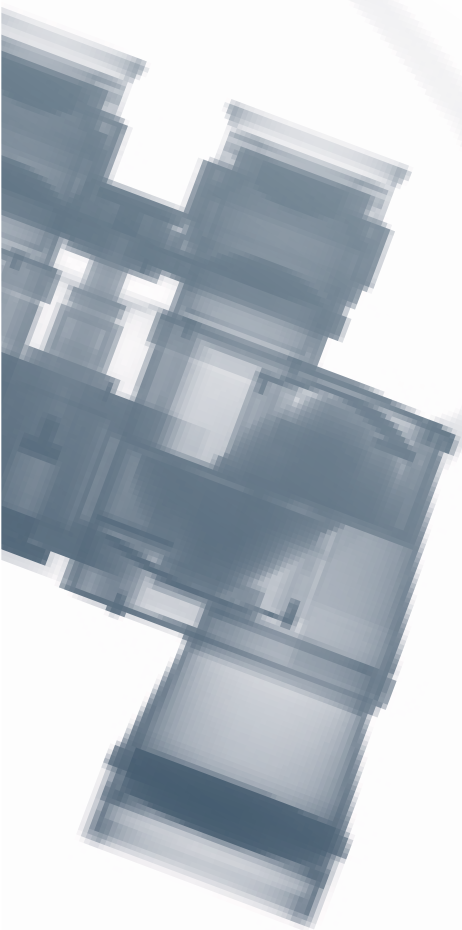
Past performance is not a reliable indicator of future results. Source: FactSet

Understanding tech sector risks

The underlying dynamics driving tech sector outperformance remain in place, built on strong demand from the broader adoption of internet-enabled activities, both personal and corporate. But while this secular trend is likely to continue, concerns around high valuations are growing.

In the wake of considerable outperformance of broader equity indices, current valuations are embedding expectations of strong and uninterrupted growth for the sector ahead. Amid such aggressive valuations, there is little room for disappointment. Given the recent regulatory attention paid to Facebook and Google, we are also cognisant of the potential for increased regulation of the tech sector, which could lead to decreased profitability.

Further, while the tech sector has long been perceived as a pure growth play (for which investors are willing to pay a premium in an anaemic recovery), in reality tech stocks have cyclical elements too. And although sales growth within the tech sector is undeniably stellar, low net income for at least one of the big five, (e.g. just 1.7% for Amazon in 2017) paints a less straightforward picture for investors. Put simply, for Amazon at least, then, growth is for now coming at the expense of profitability.



Contact

To find out more about the Heartwood strategies, visit our website or contact your local representative.

There is little evidence to suggest the current environment holds risks akin to the infamous tech bubble two decades ago, not least because investment markets have become more discerning. Additionally, many tech companies have genuine and profitable business models (unlike 1999), and a number of younger tech companies today are being privately funded rather than listed. Even so, some caution could be warranted.

Michael Stanes
Investment Director

Important Information

Registered Head Office: No.1 Kingsway, London, WC2B 6AN | Registered in England Number: 4132340
020 7045 2600 | heartwoodgroup.co.uk | Part of the Handelsbanken Group