

## Key Questions

# Have Tech Stocks Become “De-FANGed”?

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### The privacy woes of the FANG stocks are not likely to derail the tech sector, nor the ongoing bull market.

Over the past few years, investors have become accustomed to seeing Information Technology stocks drive the broader market higher, with a familiar quartet of names providing leadership: Facebook, Amazon, Netflix and Google. The sector is nearing 25% of the benchmark S&P 500 Index, mirroring levels last seen during the height of the 2000 bubble. Some are asking: "Is the move overdone?"

In our view, the fact that Information Technology has been the best performing sector throughout the nine-year recovery from the Great Recession should come as a surprise to no one, as it has been driven by superior fundamentals. In fact, the sector has delivered twice the market's return since mid-2016 alone, with all industry groups outperforming. Revenue growth is expected to surpass the broad market for all industry groups in 2018, and while the sector P/E looks relatively expensive, it remains attractive on a free cash flow basis. Old Tech (Hardware and Semiconductors) is currently trading at a discount to the S&P 500 Index and return of capital to shareholders is likely to rise given elevated cash balances, a good combination.

On the other hand, the New Tech “FANG” stocks have recently come under strong selling pressure, much of

it warranted. Events suggest that users are becoming uncomfortable with the ways these firms are monetizing personal data, and the response by the management teams have raised the specter of potential regulation, injecting uncertainty into the forward outlook. Where investors once saw blue sky, now they see storm clouds on the horizon.

The historical analog here is Microsoft, which suffered a period of multi-year underperformance after coming under regulatory scrutiny in the early 2000's. The company lived to fight on and remained a force, but the stock languished and investors found better returns elsewhere. We find the parallel intriguing and would suggest that as privacy concerns grow, investors should be more discriminating when investing in the New Tech group.

Finally, are the troubles of the FANG stocks likely to derail the ongoing bull market? In our view, the answer is “not likely.” The old Wall Street adage is that bull markets “climb a wall of worry.” If the decline in Facebook and Amazon has you worried, then Mr. Market is doing his job! Bull markets also tend to rejuvenate themselves by changing leadership as they progress and we will be watching closely to see if new leadership that benefits from loose, reflationary fiscal policy and increasing capital expenditures asserts itself, suggesting that the correction is over.

For questions, **please contact your Key Private Bank Portfolio Manager.**

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