IMPERIUM CAPITAL

momentum

FANGtastic returns

Weekly Digest

24 September 2018

– Richard Stutley, CFA

The high performing FANG stocks – Facebook, Amazon, Netflix and Google parent Alphabet– have led the market higher over the past 12 months[1]. Their high valuations – Amazon is currently trading at a price-to-earnings ratio (PE) of 195 – and high-tech bent has resulted in inevitable comparisons with the Dotcom bubble at the turn of the century. We do not believe we are in for a repeat of this particular boom and bust cycle, and while we are cautious on the broader US market, we are happy for our managers to continue taking appropriate risks where they see opportunities.

To put this year in context, the MSCI All Countries World Index has added just over 3.5% year to date in US dollar terms; this compares to an average of 4.7% looking at data back to 1987. Hence this year has been slightly below par from a historical perspective. US equities on the other hand have added 10.3%, although it has been a narrow market led by the FANG stocks which have each gained almost 25% on average. Whether FANG or FAANGs with the addition of Apple, this group of stocks have produced fantastic returns in recent years.

It is easy to draw comparisons with 2000 and the Dotcom bubble. In the years preceding that crisis all a business needed to pique investors interest was the ".com" suffix in its name, and companies duly took advantage of this, selling stakes in unproven businesses at high prices and netting fantastic profits for their founders (on paper at least). In the five years preceding peak tech valuations in March 2000, annualised total returns from the S&P 500 index were 27%, half the whopping 54% return from the booming Technology sector. However, this proved unsustainable, resulting in technology shares falling , and underperforming the SPX ex tech and telecoms index by over 60 percentage points over the subsequent 12 months. Having dragged the market up, tech duly dragged it down. As with all major dislocations, investors didn't have to participate directly in the cause of the crisis to feel the impact of the subsequent sell-off, with half the sectors falling over the subsequent 12 months post the market's high.

There are indeed similarities between today and the 2000s. We believe the US stock market is expensive and have subsequently reduced exposure in our portfolios. While similar, conditions are not the same however, with valuations nowhere near the highs experienced during the Dotcom bubble. Furthermore, in the late 1990s high valuations weren't confined to the tech sector alone; the PE of the market was over 30 whereas today it stands nearer 22.

The FANGs are expensive on the basis of traditional valuation metrics, however, they are nowhere near the levels seen in 2000. Today's tech titans generate enormous free cash flow, have huge customer bases and still have growth potential. There is a large body of evidence to suggest that valuations are a good predictor of subsequent returns, with the average high multiple stock struggling to deliver good returns. Growth managers would counter this argument by pointing out that they are not in business to buy the average stock, but the few truly outstanding businesses. Several of our managers own one or more of the FANG stocks and we are happy with the stock selection processes that lead to their inclusion within their portfolios.

[1] All data to 19 September 2018

The **Marketplace**

- Brent crude oil was up 0.9% at $78.7 a barrel
- Gold finished the week up 0.2% at 1197.4 per ounce
- Trade war rumbles on
- Global equity markets rise on a slew of decent data

Market **Focus**

US

- The Dow Jones reached a record high, up 2.3% on the week at 26,743.5
- The Nasdaq was down 0.2% on the week closing at 7531
- The S&P hit another all-time high last Thursday and finished the week up 0.9% at 2929.7
- US jobless claims remain at a 48-year low at 201K versus 210K expected
- 10 year treasury yields breached 3% and have remained above that level

UK

- In Brexit talks, Michel Barnier has signalled that he is willing to alter the blueprint for avoiding a hard border between the UK and Ireland, though talks generally seem to be making little progress so far
- UK inflation accelerated unexpectedly in August to 2.7%, up from 2.5%. Driven mainly by the culture and recreation sector along with petrol prices
- The FTSE was up 2.6% to close the week at 7490
- The UK labour party may promise a second referendum on Brexit as policy if the majority of party members vote for it, unclear whether this will be contingent on there being another snap general election
- GBP rose to a 1.3206 high. Three-month implied volatility on GBP is up a third day to levels not seen since March 2017

Europe

- The Eurostoxx 50 rose 2.6% on the week to 3430.8
- The CAC40 was up 2.7%% at 5494
- Germany's manufacturing PMI for August fell to 53.7 from 55.9, missing expectations by two points
- Overall Euro-area composite PMI was at 54.2 versus 54.5 last month
- In France, business leaders are urging President Macron to cut public spending, which at 56.4% of GDP is the highest in the EU

Asia / Rest of The World

- China to retaliate the imposition of $200bn in tariffs from the US by imposing $60bn on US goods. This is likely to have inflationary effects. China have also indicated that they will not renew talks as long as President Trump threatens to impose further tariffs
- China is also planning to cut average tariff rates on imports with other trading partners
- Japan CPI for August beat expectations at 1.3% year on year
- The Hang Seng recovered this week, rising 2.5% to 27953.6

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 21 Sept. 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	0.9%	1.1%	10.7%	18.7%
United Kingdom	GBP	2.6%	0.0%	0.6%	7.1%
Continental Europe	EUR	1.8%	-0.1%	1.7%	2.4%
Japan	JPY	4.4%	3.7%	0.4%	10.4%
Asia Pacific (ex Japan)	USD	1.9%	-1.3%	-4.9%	0.5%
Australia	AUD	0.5%	-2.0%	5.6%	14.3%
Global	USD	1.6%	0.9%	6.1%	12.6%
Emerging markets equities					
Emerging Europe	USD	3.4%	3.9%	-9.6%	-5.1%
Emerging Asia	USD	1.7%	-1.4%	-6.1%	-0.9%
Emerging Latin America	USD	4.6%	4.5%	-8.0%	-12.0%
BRICs	USD	2.9%	-0.6%	-7.8%	-4.3%
MENA countries	USD	0.4%	-2.3%	5.9%	4.2%
South Africa	USD	5.3%	-0.1%	-20.4%	-6.1%
India	USD	-3.7%	-6.2%	-5.4%	0.2%
Global emerging markets	USD	2.3%	-0.4%	-7.4%	-2.9%
Bonds					
US Treasuries	USD	-0.4%	-1.1%	-1.9%	-2.0%
US Treasuries (inflation protected)	USD	-0.2%	-1.2%	-1.0%	0.2%
US Corporate (investment grade)	USD	-0.2%	-0.6%	-2.5%	-1.2%
US High Yield	USD	0.1%	0.4%	2.4%	3.2%
UK Gilts	GBP	-0.3%	-1.2%	-1.3%	1.0%
UK Corporate (investment grade)	GBP	-0.1%	-0.7%	-2.0%	0.3%
Euro Government Bonds	EUR	0.2%	0.4%	0.0%	0.5%
Euro Corporate (investment grade)	EUR	0.2%	-0.1%	-0.5%	0.2%
Euro High Yield	EUR	0.4%	0.5%	0.2%	1.1%
Japanese Government	JPY	-0.3%	-0.2%	-0.5%	-0.4%
Australian Government	AUD	-0.5%	-0.6%	2.1%	3.8%
Global Government Bonds	USD	0.0%	-0.3%	-1.9%	-1.4%
Global Bonds	USD	0.1%	-0.2%	-1.9%	-1.3%
Global Convertible Bonds	USD	0.5%	0.2%	0.7%	0.8%
Emerging Market Bonds	USD	0.7%	1.8%	-5.4%	-5.7%

Source: Bloomberg. Past performance is not indicative of future returns

Asset Class/Region	Currency	Currency returns			
		Week ending 21 Sept. 2018	Month to date	YTD 2018	12 months
Property					
US Property Securities	USD	-0.4%	-1.2%	2.6%	3.6%
Australian Property Securities	AUD	-2.2%	-2.1%	1.9%	9.8%
Asia Property Securities	USD	3.3%	0.9%	-3.8%	-1.1%
Global Property Securities	USD	0.3%	-1.3%	-0.9%	2.1%
Currencies					
Euro	USD	0.9%	0.7%	-2.3%	-1.6%
UK Pound Sterling	USD	0.1%	0.6%	-3.3%	-3.6%
Japanese Yen	USD	-0.5%	-1.2%	0.0%	-0.1%
Australian Dollar	USD	1.7%	0.2%	-6.8%	-8.2%
South African Rand	USD	4.3%	3.1%	-13.5%	-7.5%
Swiss Franc	USD	0.8%	1.2%	1.5%	1.2%
Chinese Yuan	USD	0.1%	-0.2%	-5.1%	-4.3%
Commodities & Alternatives					
Commodities	USD	1.9%	0.4%	2.9%	9.5%
Agricultural Commodities	USD	0.1%	-0.9%	-4.5%	-5.5%
Oil	USD	0.9%	1.3%	17.8%	39.6%
Gold	USD	0.2%	-0.2%	-8.3%	-7.4%
Hedge funds	USD	0.2%	-0.5%	-1.0%	0.6%

Source: Bloomberg. Past performance is not indicative of future returns

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