STATE STREET GLOBAL ADVISORS

Active Quantitative Equity

FANG[1] Stocks: Still Overvalued

- Even with a significant pullback in March, we continue to hold a negative view of superstar technology and tech-enabled stocks as a group.
- In related sectors, we see better opportunities in auto, technology hardware and semiconductor manufacturers.

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The superstar FANG stocks—Facebook, Amazon, Netflix and Alphabet's Google—and their peers reached record highs in March, racking up compound returns of almost 40% per year since the end of 2015[2]. Then, they experienced a setback, losing around 15% of their value.

In August of last year, we wrote about the popularity, the valuation and the volatility of these stocks[3]. Our conclusion then was that better buying opportunities likely lay elsewhere. We believe the same is true today. Some may see recent pullbacks in this cohort of high-growth, high-tech "glamour" stocks as a "buy on the dip" opportunity. We think the equity markets continue to offer many better alternatives.

Expensive and High Risk

We formed our directional views on these companies by focusing on a proprietary set of attributes that are important indicators of performance, as compared with the entire investable equity universe:

- Value (i.e., whether the stock is expensive or cheap compared with the broader market);
- Quality (i.e., company performance on key financial measures versus the market);
- Sentiment (i.e., the prevailing attitude toward the stock and its pricing, whether poor or positive);
- Volatility (i.e., whether the company is high or low risk)

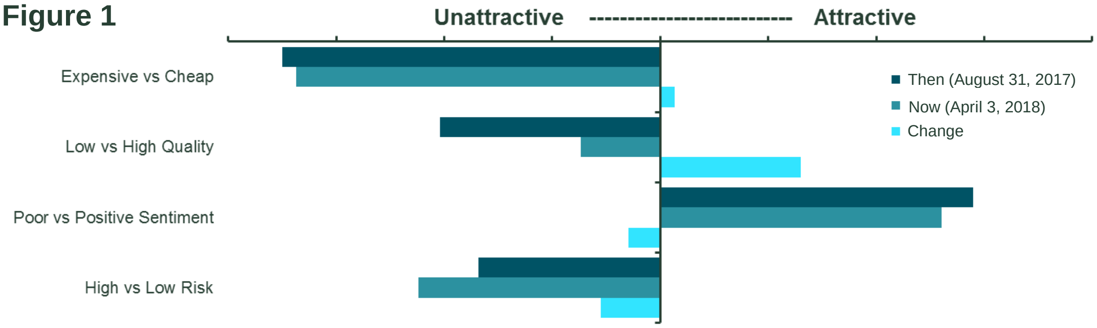
We also expanded the universe of stocks included in this analysis beyond the familiar FANGs to include other similar US companies—Microsoft, Apple, Nvidia, Twitter and Tesla—along with their emerging-market equivalents, the BATs: Baidu, Alibaba and Tencent.

[1] Facebook, Amazon, Netflix and Alphabet's Google
[2] Performance calculated using the NYSE FANG+ Index from December 31, 2015 to April 30, 2018, sourced from Bloomberg Finance LP. This group of stocks has proven so popular that the NYSE FANG+ Index—an equal-dollar weighted index consisting of highly - traded growth stocks of technology and tech-enabled companies—was created to track their performance. Past performance is not a guarantee of future results.

[3] **Link:** *Much Ado About No-FAANG*
August 31, 2017

Our assessment today is that this group, on average, continues to be expensive, high risk and of lower quality compared with the rest of the investable equity universe. *(See Figure 1.)* Investor sentiment does appear to swing in favor of these stocks, but this attribute exerts less influence on our views for several reasons. The slowness of information diffusion and the impact of herding behavior mean that sentiment and price momentum can persist in the market despite weaker fundamentals. Quality and value attributes eventually act as the anchors that bring prices back toward those fundamentals—which, on balance, are worse for this group compared with the average stock in our investment universe.

Figure 1



Source: State Street Global Advisors

Figure 1.
In our view, superstar technology and tech-enabled stocks from around the globe continue to be, on average, expensive, high risk and of lower quality compared with the broader equity universe.

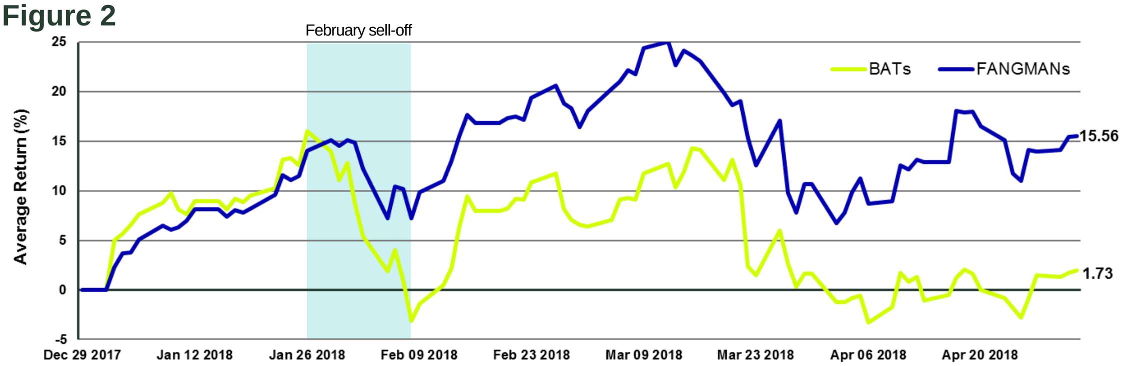
State Street's directional view of a group of 12 superstar stocks[6] across four proprietary attributes, relative to the broader market universe, as of August 31, 2017 ("Then") and April 30, 2018 ("Now").

If we compare our overall assessment of this group of stocks now to our views eight months ago, not much has changed. On average, our views on the value and quality attributes of these stocks are slightly more positive today than they were in August. These views are offset by slightly more negative views on sentiment and risk. And the overall direction of our views across all four sets of attributes remains the same.

Spotlight on BATs

If headlines serve as any guide,[4] the emerging-market BATS are even hotter than their US counterparts. Actual performance tells a different story. The BATs have experienced far greater volatility this year in the wake of market disruption. *(See Figure 2.)* During the February market drawdown, for example, the BATs saw average cumulative returns of around -16% while their US counterparts[5] experienced average cumulative returns of about -6%. (During the March sell-off, both groups fell around 14 percentage points.) As of May 2, average cumulative returns for this set of US-based FANGs and their peers stood at 15.56%, compared with the BATs, which are basically flat year-to-date with average cumulative return of only 1.73%.

Figure 2



Source: Bloomberg Finance, L.P. Past performance is not a guarantee of future results.

Figure 2.
Emerging-market BAT stocks have experienced far greater volatility this year compared with their US counterparts.

BATs versus US-based FANGs and their peers; cumulative average return from December 31, 2017 to May 2, 2018.

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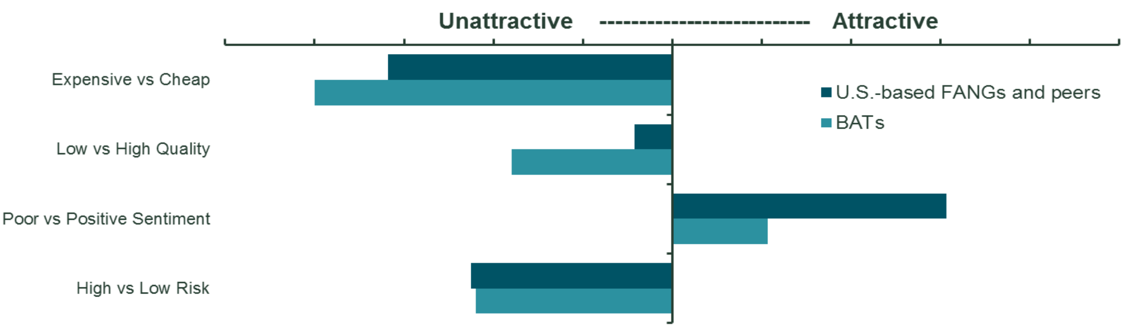
[4] The Motley Fool, June 2017: "Forget FANG; Buy BAT"; Barron's March 2017: "Alibaba, Tencent & Baidu Vs FANG: China Wins"; Investopedia, August 2017: "China's BAT Stocks Have More Bite Than FANGs."
[5] Facebook, Amazon, Netflix, Alphabet's Google, Microsoft, Apple, Nvidia, Twitter and Tesla.
[6] The group of stocks included in this analysis includes the following companies: Alibaba, Alphabet, Amazon, Apple, Baidu, Facebook, Microsoft, Netflix, Nvidia, Tencent, Tesla and Twitter.

Viewed through the lens of our proprietary sets of performance attributes, our overall view is that BAT stocks offer no advantage compared with other, similar developed-market stocks. In fact, on average the BATS are less attractive.

BAT stocks are of lower quality compared with their US counterparts, and the returns of BAT stocks have been much less consistent compared with the US group. The BATs have also shown less improvement in earnings or sales forecasts and much higher asset growth (an indicator we see as unattractive). Both groups appear to be equally expensive and equally risky according to our measures, while investor sentiment on the BATs is much less robust. *(See Figure 3.)*

Figure 3



Source: State Street Global Advisors

Figure 3.
Our assessment is that, like their developed-market counterparts, the emerging-market BATs are more expensive, higher risk and lower quality compared with the rest of the equity-market universe.

State Street's directional view of the stocks of US-based FANGs and their peers versus BAT stocks, across multiple proprietary attributes, relative to the broader market universe as of April 30, 2018

The Bottom Line

Even with a market pullback of around 15% for this category of stocks in March, we still have a negative view of these stocks as a group and prefer to invest in companies with much less extended valuations.

In related consumer discretionary and technology sectors, we see better opportunities elsewhere. In developed markets, we prefer auto and technology hardware companies with steadier growth and more reasonable valuations. In emerging markets, a number of Taiwanese and Korean semiconductor manufacturers appear much less expensive and have better operational profitability.

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