FEBRUARY 2022

Focus —

Are the days of treating the "FAANGM" as an asset class over?

The stock prices of the web giants (Alphabet, Facebook, Netflix, etc.) used to move in tandem. But for several months now, they have been diverging. Is this the end of big tech stocks being in synch, or is it an aberration?

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Analysis: Tech giants’ stock prices have been in lockstep for many years, but this seems to be changing.

The tech-related FAANGM - Facebook (Meta Platforms), Apple, Amazon, Netflix, Google (Alphabet) and Microsoft - have been driving Wall Street for more than 10 years. At the end of December 2021, the combined market capitalization of these web giants exceeded $11 trillion (or nearly one quarter of the US stock market).

Thanks to their immense economic success, these companies, most of which are barely 20 years old, have become the largest market capitalizations in the world. Between them, the FAANGM are valued more than the GDP of Japan, Germany or France. What do these American star companies have in common? First, the fact that they are all part of our daily lives because so many of us are connected to them for several hours a day. So much so that they risk becoming a threat to our privacy.

Another common point: their founders are iconic references of the successful entrepreneur, which encourages investors to bet on the sustainability of their business models and competitive advantages.

Until then, investors have tended to invest in FAANGM stocks as a single group, sometimes even in “packaged” form. Many analysts point to a strong resemblance to the “Nifty Fifty”, this group of around fifty American stocks which were the darlings of savers in the second half of the 1960s. McDonald’s, Walt Disney, Coca Cola and other Xerox securities each embodied a piece of the “American dream” and were nicknamed “one decision stocks”: there was only one decision to be made, buy these shares and keep them. Their valuations had then soared to stratospheric levels.

The similarity of the FAANGM with the “Nifty Fifty” was reinforced during the Covid-19 pandemic. With the lockdowns, the FAANGM became even more essential and dominating. They financially “benefited” from “Stay-At-Home” and “Work-From-Home” and their valuation multiples had then soared concomitantly. Over the past ten years, FAANGM prices have mostly moved in sync and outperformed not only the main international stocks index but also the S&P 500 and the Nasdaq.

FAANGM stock performances begin to diverge

However, the homogeneity of their stock market performance suddenly seems to be over. While Alphabet (Google), Apple and – to a lesser extent – Microsoft are trading near record highs, Facebook, Amazon and Netflix have seen their bull markets come to a halt. For investors, it is therefore a question of becoming much more selective.

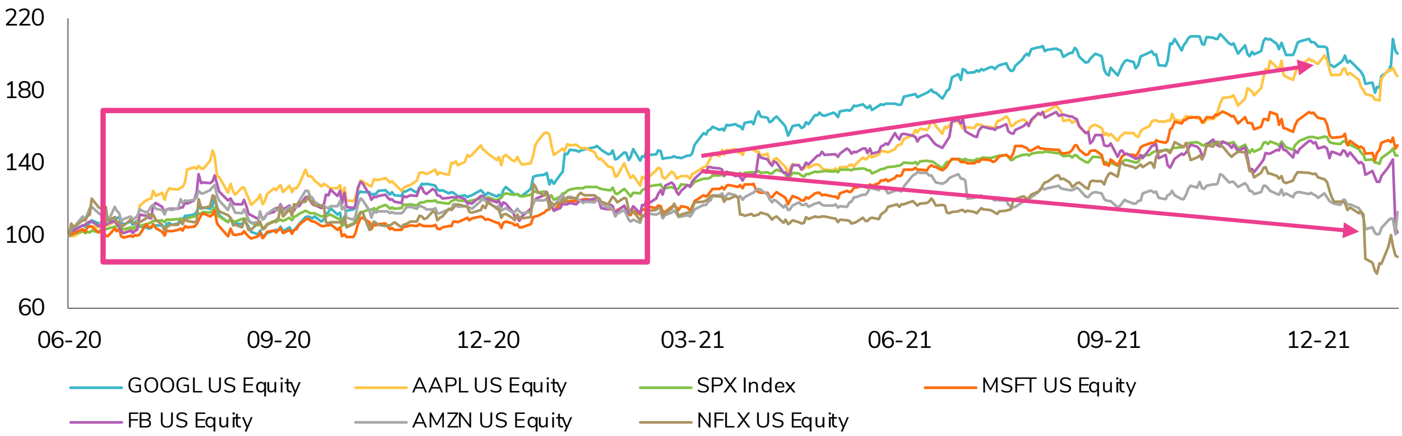
Admittedly, idiosyncratic elements may explain this divergence in financial and stock market performance.

Netflix recently published quarterly earnings results that greatly disappointed the market and therefore amplified the stock’s downward trend (the stock is trading at prices 40% below the 2021 highs). The main reason for the miss: growing competition from platforms such as Disney+, the slowdown in the growth of new subscriptions in a market which is gradually reaching saturation but also the post-Covid effects (end of the “stay-at-home”).

In the case of Amazon, the revenue growth rate is slowing down in part because consumers are a little less inclined to favor e-commerce after leaving confinement. Profitability is also suffering from the still very high capital expenditures but also from the costs related to their “1Day delivery” campaign, which requires some refinement to their supply chain.

Meta Platforms, the parent company of Facebook, Whatsapp and Instagram, saw its net profit decline in the fourth quarter and the number of users on its platforms stagnating at the end of the year, which is unprecedented for the social media giant. The company’s executives have repeatedly mentioned competition from TikTok but also from other platforms, as they face numerous investigations and complaints for abuse of a dominant position. Investments related to Metavers also weighed on the company’s profitability. The stock price fell 22% following the announcement of the earnings results, a decline of more than $250 billion in its market capitalization in a single day, a new record on Wall Street. The stock is trading at its lowest level in 18 months.

FAANGM (as of 4th of February 2022)



Source: Banque Syz, Bloomberg

The performance of FAANGM stocks have diverged sharply over the past 12 months. It now seems difficult to consider them as a homogeneous group.

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But this divergence in performance cannot only be explained by the idiosyncratic and temporary reasons aforementioned.

The online advertising war

A much less specific element seems to explain the various fortunes encountered by the internet giants. This is the fierce competition between the FAANGMAN. Indeed, these companies are far from showing solidarity with each other – quite the contrary. And a single offensive from one of these behemoths can have very significant repercussions on the other giants.

A very recent example: Apple's new App Tracking Transparency (ATT) feature. In April 2021, Apple finally rolled out iOS 14.5 and its dreaded ad tracking control mechanism. ATT allows iPhone users to limit app tracking by cutting off their access to the IDFA (IDentifier For Advertisers), a unique identifier linked to the phone that different apps could previously exchange freely to build a specific advertising profile.

A new feature that has very significant implications for online advertising companies – including the two largest, Facebook and Google.

Indeed, Facebook's applications depend almost entirely on Apple and Google for their distribution. So when Apple changed its privacy policy last year limiting the ability of app developers to target users through the ATT, Facebook was suddenly deprived of one of its greatest assets.

Google also relies on ad targeting to connect marketers and users on many of its sites, but search advertising is a unique strength: users tend to "self-target" when they make a search query that explains exactly what interests them at that moment.

When it comes to targeting, Google has Android, the most popular operating system in the world, which allows it to set its own rules. And if Google still needs the distribution of iOS, it has a more "intimate" relationship with Apple than with Facebook. And for a "good" reason: Google pays Apple billions of dollars a year to be the default search engine for Apple's Safari browser.

Experts believe that Apple's changes to iOS have resulted in Facebook losing market share in online advertising - to Google. In other words, advertisers who can no longer get the level of targeting they want on Facebook spend more on Google.

The quarterly results seem to corroborate this view. Last week, Facebook said that Apple's new App Tracking Transparency (ATT) feature caused it to lose $10 billion in revenue last year (or nearly 10% of the $115 billion it made on Facebook). Alphabet, Google's parent company, meanwhile, released exceptional results for the fourth quarter. Full-year 2021 revenue hit $257 billion, up 41% from 2020. Google forecasts 23% growth rate in Q1, while Facebook forecasts expansion only 3% to 11%.

A loss of momentum for Facebook which comes as other internet and technology giants achieve record results in the field of advertising. Amazon made $31 billion in ad revenues last year, TikTok $12 billion, Microsoft $10 billion, Snap $4.1 billion, Pinterest $2.6 billion, etc.

What lies ahead for Meta Platforms (Facebook)?

Mark Zuckerberg has been aware of this threat for a long time. Without owning the device or the operating system, Facebook is not master of its destiny and remains at the mercy of other Internet giants. Here is what he said in 2012: "We depend on Facebook's interoperability with mobile operating systems that we do not control, such as Android and iOS, and any changes to these systems that degrade the functionality of our products or give preferential treatment to competing products could negatively impact the use of Facebook on mobile devices".

In 2014, Facebook acquired a virtual reality headset company called Oculus for $2 billion, giving the company a chance to manufacture the next generation of hardware and integrate its own software.

The acquisition is the basis for Zuckerberg's envisioned future — hence Facebook's renaming to Meta Platforms late last year.

For Zuckerberg, the answer to his real-world problems could be the virtual world. Above all, he wants to free himself from Apple and Google, so that his company is able to set its own rules. A bold but risky bet, which seems to have investors worried – at least for now.

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