Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

Is Tech Slowly Taking Over the Entire Market?

By Mitch Zacks
Portfolio Manager

The biggest market headline last week came from Amazon's $13.7 billion acquisition of Whole Foods. The transaction left many investors scratching their heads. Wasn't Amazon supposed to be in the online retail and cloud business? Why are they buying a high-end grocery chain?

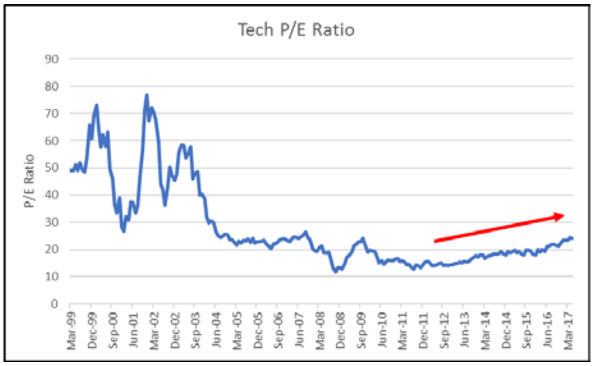
Amazon's acquisition speaks to a broader trend amongst mega-cap technology companies: the desire to be a one-stop shop for consumers. Facebook wants users to log-in daily and get all of their news from the site; Google wants users to consolidate email, workflow, and search all in one place; Netflix wants to be the go-to source for at-home entertainment; Apple wants loyal customers to only buy their hardware and software; Amazon wants, well, they want everything it seems.

These mega-cap companies have two distinct advantages in the marketplace: high visibility and astronomical amounts of cash. It begs the question I posed with the title of this week's column: *is tech slowly taking over the entire market?* And as an investor, does that mean you should be bulking up the technology holdings in your portfolio? I'll explore those questions here.

Where Does Technology Fit into Your Overall Investment Portfolio?

Make no mistake – tech has surged so far in 2017. The NASDAQ Composite Index closed above 6,000 for the first time *in its 46-year history* in late April, and it kept moving higher in May. You may have also heard of "FANG's" influence on broad market returns (that's Facebook, Amazon, Netflix and Google). Microsoft and Apple are also arguably part of that equation. The recent performance of these companies, taken together, is in some cases far outpacing that of the broader S&P 500.

But, that does not necessarily mean you should actively be rebalancing towards technology now. For one, valuations in the space are elevated and creeping higher. For instance, even though Amazon's earnings have been impressive and growing, it still trades at ~180x trailing twelve-month earnings. That number drops to around 80x if you consider forward earnings, but by any measure, that's still pricey. Netflix is right up there with it, while Google and Facebook are more reasonably priced but still nearly twice as expensive as the broad S&P 500.



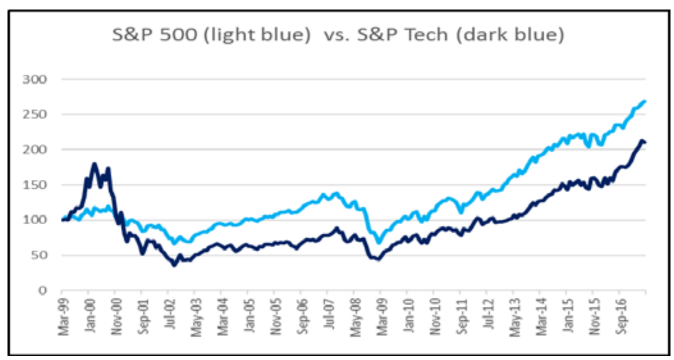
Source: Bloomberg

Having tech be a significant part of your overall investment strategy is important, but there is also a case for being selective and cautious in the current environment, considering steep valuations and a late-cycle economic expansion. In our view, the upside may be more limited than the narrative lets on.

That being said, there are still plenty of opportunities in tech with a measured approach to stock picking. At Zacks Investment Management, our independent research capabilities from our parent company (Zacks Investment Research) truly distinguish us from other wealth management firms and investment firms. Powered by decades of research, development, and testing, we created the highly regarded 'Zacks Rank' method to stock selection, while also pioneering the earnings surprise and estimate revision factors. By using our own databases, software, models and completely unbiased research, we are able to create custom stock portfolios "in-house," which will likely include technology names we think can do well in the current environment. You can learn more about our unique approach and what segments/companies within the technology sector we like now, by just reaching out to us.

Bottom Line for Investors

As excitement builds around tech in the current environment, we think it important to remind investors that even with this recent run in prices, *the technology sector has not been as good as the broader S&P 500 over the long-term*—a crucial point that is often overlooked. If there is a point to drive home here, it is *not to let the enthusiasm over technology cloud the long-term benefits of owning a diversified portfolio:*



Source: Bloomberg

There may be room to run yet for tech, but investors should not get too caught up in the "FANG" (Facebook, Amazon, Netflix, Google) story, in my view. Better to diversify in tech, and to remember that it is not the only patch of strength in town. A broadly diversified approach is still warranted, and there are plenty of other opportunities in the market that are fundamentally sound and in some cases, cheaper.

-**Mitch**

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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