Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

Is It Too Late to Invest in FAANG Stocks?

By Mitch Zacks
Portfolio Manager

Technical day traders may look at the FAANG stocks (Facebook, Amazon, Apple, Netflix, Google) today and say, "no way." Charts indicate a bull run that looks too good to be true, and steep valuations argue for limited upside ahead. Chartists have noted that Amazon was in the midst of a huge "head-and-shoulders" topping pattern, and that it was due for an 11% plunge if it confirmed the pattern (it didn't). Analysts also noted that Microsoft, which beat its earnings expectations last week, climbed through 'overbought' conditions – making a "reversion to the mean" decline imminent, if not likely.

So far, neither predicted decline has materialized.

Here's my point: technical trading patterns try to use past price movements and geometrical shapes to predict future price movements. But in my view, it's a loser's game in the long-run. For all of the accurate predictions, there are probably an equal or greater number of inaccurate ones – not to mention all of the transaction costs an investor may incur by trading so often.

At Zacks Investment Management, we keep an eye on technical factors, but it is the *fundamental factors* that drive our decision-making over time: earnings, earnings revisions, revenue growth, profit margins. For investors wondering if it is too late to invest in tech, or who think based on technicals that there is no bull case, the fundamentals may in fact tell a different story (at least for now).

Here's how the FAANG companies fared in the last quarter, which as you will see, indicates strong earnings and profit momentum across the board.

Amazon, Inc.

Investors were expecting lower profits since the third quarter has typically been a heavy investment period for Amazon, ahead of the holiday season. But, strong growth in North American sales and Amazon Web Services offset the big spending increases, and Amazon delivered a positive outlook for the fourth quarter (generally its largest quarter of the year with holiday shopping).

The numbers were strong across the board for Amazon:

- **Revenue**: $43.7 billion vs. $42.14 billion
- **Earnings per share**: $0.52 per share vs. $0.03 cents per share, a huge beat
- **Web services revenue**: $4.58 billion vs. $4.51 billion

Amazon's figures mark a revenue increase of 34% from last year, with help from the $1.3 billion in sales from Whole Foods, which Amazon acquired in late-August. Operating profit remains a sticking point for some investors when looking at Amazon, with operating margins of just 0.8%. Massive sales growth tends to overshadow tiny profit margins.

Apple, Inc.

Apple impressed the market across the board in sales of iPhone, Mac, iPad and services. Its strong quarter led to a posted quarterly revenue of $52.6 billion, an increase of 12% from the year-ago quarter, which is big growth. Apple's quarterly earnings per diluted share was $2.07, which marked a 24% jump. International sales accounted for 62% of the quarter's revenue, which is quite relevant given the robust growth we're seeing outside of the U.S.

Facebook Inc.

Facebook reported third-quarter earnings of $1.59 per share, which handily beat the consensus estimate of $1.28 per share. Revenue also climbed a whopping 47% to $10.3 billion, which also well outpaced expectations of $9.84 billion in sales. There are a couple of sticking points with Facebook, however. For one, government scrutiny intensified quite a bit over the last few weeks, as Facebook attending hearings in Congress over its handling of news and information during the 2016 election. Any whiff of regulation could be a negative for earnings going forward, and will be something to watch closely.

Netflix, Inc.

Netflix also reported a strong quarter. The company net added 5.3 million new subscribers versus an expected 4.5 million, bringing its grand total to 109.3 million subscribers worldwide. That marks a 49% jump in subscription additions year over year. On the revenue and earnings front, Netflix beat street expectations, which matters to stock prices. It reported revenue of $2.98 billion vs. $2.97 billion expected, and earnings per share of $0.37 versus the expected $0.32.

Alphabet, Inc. (Google)

Google also continues to rake-in huge amounts of free cash flow. The internet search giant reported revenue of $27.77

billion versus an expected $27.2 billion, which marks a solid 24% increase year-over-year. Google's earnings per share also surprised to the upside, with a reported $9.57 per share versus the $8.34 expected.

Bottom Line for Investors

If you notice one thing from the earnings summary of the FAANG companies, it's that they all beat street expectations and delivered double-digit revenue growth. That data is not insignificant, and should that type of growth continue, it is difficult to make the case against these companies simply on a valuation basis.

What's more, the U.S. just logged the best back-to-back quarters of GDP growth since 2014, and with more than half of S&P 500 companies reporting, earnings have risen 8.4% and sales are up 6.3%. I think there is more runway ahead.

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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