The Famous Five Save Global Markets

Few investors amongst us won't have heard of the exploits of the Famous Five, a group of four school friends and their faithful dog Timmy. This iconic group of lifelong friends, whilst on summer holidays in the English countryside would embark on a series of adventures which either resulted in the uncovering of buried treasure or the foiling of whatever criminal exploits were taking place around them.

Now, whilst the stock market is not the Dorset countryside and stocks and shares don't need rescuing from erstwhile smugglers, today's equity markets are arguably in trouble. It just so happens we do have an intrepid gang of five who are coming to its rescue.

Many investors following global markets will have, by now, seen the acronym "FAANGs" popping up. For those who have not, the FAANGs are a group of mega large stocks listed on the US equity market. Individually they are "Facebook, Amazon, Apple, Netflix and Google" and in the financial press of late it's a rare day when this gang of five stocks is not hitting the headlines. These five stocks have established themselves as the very essence of what's driving this current market.

So, as an alternative to the age-old adage of "buy low sell high" the market has continued to pile capital into these 5 large capitalised growth stocks called FANNGs. With the S&P 500 being calculated on a market cap basis the more these companies' value expands the larger the proportion of the total market they occupy. This results in the fact that when Apple (the first company to reach $1 trillion in market capitalisation) has a bad day, its impact on the S&P 500 is such that it drags the entire US market down with it. The total market cap value of this exclusive club totals more than $3.25 trillion! To put that in perspective that's $1.15 trillion more than the entire value
of the UK FTSE 100.

Let's wrap some figures around this to illustrate. If you take the MSCI World Index which represents the 23 largest developed equity markets in the world from January 2018 to July 2018 the index has risen 3.93%. If you strip out the entire US equity portion from the MSCI World index and recalculate total performance, then this return figure drops to just 0.02%. In short without the US equity market contribution the entire aggregated performance of the global stock market has essentially gone sideways. Its pretty clear from this that the US market in 2018 has been the engine of performance for global markets.

Looking under the hood of the US equity rally we can see it's coming from a very select corner of the index. The FAANG stocks are currently being accredited with over 80% of the performance of the S&P 500 in 2018 - with Amazon's share price at $1,876 a share and up 50% year to date and Apple taking first past the post for a $1 trillion market cap company.

It's alarming how just 5 companies within a global index of over 1,000 are driving 80% of the total performance. We think the 1944 instalment of he Famous Five titled "Five run away together" best sums up what we have been seeing from the FAANGs.

Our intrepid group of stocks have come to the rescue of not only the US market but the global stock market which, without the FAANGs' help, would be doomed to suffer at the hands of trade war rhetoric and politics to finish up trading flat and very possibly negative by the end of the year.

Sadly, story books don't make stock market returns, so what does this state of affairs mean for portfolio managers? Well simply put, managers who have spent years constructing diversified portfolios of global investment opportunities have found themselves at the mercy of this concentrated rally because, in short, unless a portfolio is invested meaningfully into the US market and meaningfully into these 5 stocks (essentially an ETF) it's a good bet that that their portfolio is going to be underperforming.

We stress that just because a portfolio appears to be underperforming on a headline level (fortunately TAM is up with its benchmarks this year) that doesn't mean what it's invested into are poor investments by any means. If anything, it just illustrates how short-term investor behaviour doesn't always follow what's logical if you take a long-term perspective. Good companies remain good companies irrespective of where the market is moving in the short term. On the flip side, with this level of performance concentration coming from five stocks it could be said we are going through a period of dysfunctional market behaviour in which investors ignore fundamentals in favour of simply chasing what's doing well with little regard for how much they are paying for the privilege. The phrase "the bigger they are the harder they fall" springs to mind?

As history reliably shows us, dysfunctional markets, will, at some point correct themselves but do often first get horribly overextended. When this happens owning a well-constructed basket of diversified, global investments will rise to the top as these five names could suffer.

Much as "Five run away together" sums up the FANNGs' position in today's markets we need to be careful the next fitting title isn't from the 1958 instalment "Five get into a fix"!

The big question is who is "Timmy", faithfully following on behind… we can only guess - the UK equity market.

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