# 1 Reason Why 2018 Could be The Year of The Bear

## Description

The bull market which has run since the financial crisis has been hugely profitable for a number of investors. Share prices have generally recovered and then risen from their 2009 lows, which means that many investment portfolios are significantly in the black.

However, one set of companies appears to have been the ‘engine room’ of much of the growth since 2009. The so-called FAANG companies in the US (**Facebook, Apple, Amazon, Netflix** and **Google**) have seen their share prices soar. This has had a hugely positive impact on the S&P 500’s performance, but it could all be about to change.



## Rising prices

The rise in the values of FAANG stocks has been astounding. For example, in 2017 their average capital gains were 50%. This compared with a rise in the S&P 500 of 19% during the same timeframe. This gives them an average market cap of around $560bn, which means that together they make up around 12% of the S&P 500’s market cap of approximately $24tn. As such, when their share prices move, they have a significant impact on the performance of the entire index.

In fact, in 2017 they accounted for around 24% of the S&P 500’s capital gain. Without their growth, the index would have risen by around 14% in 2017. While still an impressive result, it is far less so than with the five companies included. And now that they are 50% larger than they were at the start of last year, they will have an even bigger impact on the S&P 500, since it is a market-cap weighted index. This means that its price level is impacted to a greater extent by larger companies, rather than smaller ones.

## Potential price falls

With FAANG stocks having risen significantly in a relatively short timeframe, they could be overvalued at the present time. While Apple trades on a relatively modest price-to-earnings (P/E) ratio of 15, other FAANG stocks seem to be hugely overvalued. For example, Facebook has a P/E ratio of 27, Google's P/E is 28, Netflix trades on a P/E ratio of 97 and Amazon has a rating of 164.

The ratings of at least four of the five companies suggest that investors may have become overly optimistic about their future prospects. Certainly, they are dominant in their respective industries and could generate strong profitability in future, but consumer trends will ultimately change and they may not always be as popular as they are today. As such, their share prices may be at risk of falling, which could prompt a bear market.

## Regulatory risk

One possible risk to the five companies is regulation. History shows that whenever there is a dominant company within an industry, or a highly concentrated industry, governments tend to implement regulatory action. While there may be no immediate threat of this, companies with near-monopoly status can become unpopular among consumers and governments in the long run.

Alongside the possibility for higher tax rates being levied on them, this may make FAANG stocks worth avoiding at the present time. It could also mean that they could prompt a bear market over the medium term.



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