MORNING BRIEFING
May 2, 2019

FANGs' Rivalry Heating Up

See the pdf and the collection of the individual charts linked below.

(1) FANGs eyeing each other’s turf. (2) Hey, when you’ve gotta grow, you’ve gotta grow. (3) FANGs’ rivalry hasn’t fazed investors much so far. (4) Collectively, FANGs make up a tenth of the S&P 500’s market cap. (5) Facebook’s next act: e-commerce and payments. (6) Amazon’s non-retail businesses—e.g., web services and advertising—growing faster than the core store. (7) Google elbows into video streaming à la Prime and Netflix. (8) Only Netflix is sticking to its knitting.

FANGs: In Everybody’s Business. There is a downside to success. After becoming super-large and successful, companies often need to find new sources of growth. Of the so-called FANGs (Facebook, Amazon, Netflix, and Google’s parent Alphabet), only Netflix has stuck to its knitting, so far. On the other hand, Facebook, Amazon, and Google each seem well on their way to finding second, third, and sometimes fourth acts to propel their businesses. Trouble is, they are finding some of that growth in each other’s backyards.

Facebook and Google are Internet advertising giants, but that hasn’t stopped Amazon from getting into the business of selling ads. Amazon may be the online retailing king, but that hasn’t prevented Facebook from entering the fray by offering shopping on Instagram. Netflix may have developed the market for streaming videos, but Amazon, Alphabet, and Apple each have developed video offerings to help entertain the masses. And everyone wants to be in payments: Apple and Amazon are there, and Facebook seems headed in that direction.

So far, investors have been unfazed by the Internet giants’ stepping on each other’s toes. Joe reports that the FANGs’ combined market cap reached a record high at the end of last week for the first time since August, after bouncing back 40% from its low on 12/21 (Fig. 1). For the first time since late August, the Fabulous Four once again contribute more than 10% of the S&P 500’s market capitalization (Fig. 2). The strong rally has pushed FANG stocks’ forward P/E back up to 53.6, the highest level since last September (Fig. 3).

The FANG members recently updated investors on their expansion plans while reporting Q1 earnings. I asked Jackie to take a look at their conference calls and see whether the search for new sources of growth is turning FANG members into frenemies. Here are her findings:

(1) Facebook goes shopping. Facebook’s next act is undoubtedly commerce and payments. Don’t misunderstand. The existing Facebook grew Q1 revenue by an enviable 26.0% y/y, but there are signs that the company is maturing. US and Canadian daily average users plateaued at 185-186 million over the past five quarters, while international users continue to grow. Despite flat user numbers, Facebook’s North American revenue jumped 29.6% y/y in Q1. Facebook needs to keep selling its customers more products if it hopes to continue growing revenue in North America.

Along those lines, in March the company announced Checkout on Instagram. Users can click on a
product in a brand’s shopping post and buy it without leaving Instagram. Users’ purchasing information is saved on Instagram, and notifications about shipment and delivery are sent via Instagram, too. In the past, users might have clicked on an item shown on Instagram and be sent to that retailer’s website to purchase the item. Twenty-five retailers—including H&M, Nike, Prada, and MAC Cosmetics—are participating in the program, which is only available in the US.

“While this is a very small closed beta and we know this will take a long time to develop, we’re excited about this next step for shopping on Instagram,” said COO Sheryl Sandberg on the Q1 conference call. “Obviously, if people learn about things through our ads and then close the loop all the way to purchase, it’s very strong for proving ROI.”

Facebook is also involved with commerce through Marketplace. Introduced about four years ago, the service lets you post items for sale or browse through listings from nearby sellers. The service was described as a “kinder, gentler Craigslist,” because with Messenger you can see more information about the sellers; if they have a robust profile with friends, it’s less likely they’re scammers.

“We’re seeing millions of interactions between buyers and sellers in Marketplace every day. Last quarter we expanded Marketplace ads to more countries and are seeing positive early results. For example, Succulents Box, an online subscription plant business, generates 18% of its total sales from their listings on Marketplace,” Sandberg said.

With Facebook generating loads of cash, it’s offering shopping services to customers at cost or for free. CEO Mark Zuckerberg hopes that if more users buy things on Facebook, that will make the site even more valuable to advertisers, prompting them to pay more for advertising.

Facebook also mentioned its intention to enter the payments arena, which could be used when making purchases on Instagram, Marketplace, or when using the private social platform that the company is developing. “We’re going to build more tools for people to buy things directly through the platform,” Zuckerberg said on the call. It’s currently testing a payments service in India over WhatsApp.

(2) Amazon.com: Hello, Hollywood. Amazon started life selling items online, and as that business has matured, the company has moved into advertising, subscriptions, and web services. Amazon’s online retail sales still represent the company’s main business line. Online retail sales kicked in almost half of the company’s $59.6 billion of Q1 revenue, and after all these years it still grew sales a respectable 12% y/y last quarter.

As others look to enter the online retail business, Prime subscriptions have helped Amazon build a moat around its business. Amazon is investing $800 million in Q2 to offer free one-day shipping to Prime customers. Prime customers also receive free movie streaming, putting Amazon in direct competition with Netflix since 2011. Altogether, Prime’s benefits create “stickiness” and offer customers “the best deal in retail.” Prime is housed in Amazon’s subscription segment, in which Q1 sales jumped 42% y/y, but it contributed only $4.3 billion to total company revenue.

Amazon has also gone on offense with web hosting and advertising. Both may make smaller contributions to the top line, but they are growing much faster than Amazon’s online retail business. Web Services contributed $7.7 billion of the company’s Q1 sales (12.9% of the total), and its revenue grew by 42% y/y.

Amazon’s “other” revenue, which primarily comes from advertising, was $2.7 billion (4.5% of sales), and it too is growing speedily, 36% y/y. On the conference call, CFO Brian Olsavsky said the company is focused on serving up the most relevant ads possible to consumers, to provide customers and
advertisers with the best experience.

Olsavsky explained: “[M]ost of our focus has been on … adding more functionality, adding more products and adding reporting for businesses and advertisers, so they can understand the incremental customers they’re seeing on Amazon through advertising with Amazon.” Doesn’t that sound just a bit like something executives at Facebook and Google would say?

(3) **Google: Rolling dice on other bets.** Alphabet is playing defense when it comes to Google’s advertising business, but it is expanding into many other business lines. The company’s prescient acquisition of YouTube in 2006 gives Alphabet exposure to video streaming and helps it compete with Amazon’s and Netflix’s video-streaming businesses.

Alphabet plans this year to launch Stadia, a video-gaming business that would let users play video games online from any device. It would theoretically tap into the many gamers who watch and post video-gaming sessions on YouTube, a phenomenon we discussed in the 3/8/18 *Morning Briefing*.

Alphabet also has Google Home, which faces off against Amazon’s Alexa, and Nest, acquired in 2014. Another Alphabet division, Other Bets, contributed only $170 million of the company’s $36.3 billion Q1 revenue, but it’s the segment that often creates the most buzz.

Other Bets houses Waymo, which is in a race to develop an autonomous car faster than General Motors, Ford, Tesla, Uber, and others. The division also includes Calico, which is researching life expansion, Capital and GV, which are investment funds, and Verily, a company that researches healthcare and disease prevention. There’s also X, a lab for what the company calls “moonshots” that include research into drones and high-altitude balloons delivering internet connections to the developing world.

Very little clarity on each business line’s contribution was provided on the call. Nor was there much disclosure about why Alphabet’s Q1 revenue decelerated to 19%, down from 23% a year ago, excluding the impact of foreign exchange. Actually seeing growth from some of Alphabet’s new ventures will be helpful in assuaging analysts’ concerns.

(4) **Netflix: Staying the course.** Unlike its FANG colleagues, Netflix is sticking to its original business line: video streaming. The company has moved from its domestic roots into the international arena, but it hasn’t added any new business lines.

Domestic subscription additions are slowing, but they remain positive, and there’s no sign of slowdown in international subscriptions. Netflix added 1.7 million domestic subscribers in Q1 versus 2.3 million a year ago. Overseas subscribers surged by 7.9 million in Q1, a much faster clip than a year ago, when 6.0 million subscribers were added, a 4/16 *WSJ* article reported.

Netflix, which has 148.9 million subscribers, faces increasing competition from the likes of Amazon, Apple, AT&T, Comcast’s NBCUniversal, and Disney. Yet Netflix raised prices in January, by $2 to $13 a month on its most popular plan. Disney plans to charge $7 a month.

Netflix also has a uniquely weak balance sheet, with $3.3 billion of cash and equivalents and $10.3 billion of long-term debt in Q1. Compare that to Amazon’s $13.5 billion in cash and marketable securities net of debt or Facebook’s $45.2 billion of cash and marketable securities and no debt. Meanwhile, Google sits on the largest pile of cash: $109.5 billion of cash and marketable securities net of debt.
(5) **Balancing buybacks.** FANGs, like other tech companies, rely heavily on stock-based compensation. So unless they have the ability and willingness to execute stock buybacks, their total share counts tend to climb over time. Among the FANGs, Facebook and Alphabet have massive stock-based compensation programs, but they also have large stock buyback programs in place. Net net, both companies reduced their outstanding shares modestly in Q1 y/y ([Fig. 4](#) and [Fig. 5](#)). Facebook spent $521 million in Q1 to reduce its share count, and Alphabet spent $3 billion.

Amazon has plenty of cash, but didn’t use any of it to repurchase shares in Q1. The company’s shares outstanding have grown since 2012 ([Fig. 6](#)). Netflix also hasn’t repurchased shares, presumably because the company has $7 billion of net debt and is free-cash-flow negative. But its stock-based compensation program is much smaller than the other FANGs’, so its share count has increased only gradually over time ([Fig. 7](#)).

**CALENDARS**

**US. Thurs:** Jobless Claims 218k, Nonfarm Productivity & Unit Labor Costs 1.2%/2.1%, Factory Orders 1.4%. **Fri:** Nonfarm Payroll Employment Total, Private, and Manufacturing 185k/180k/10k, Unemployment & Participation Rates 3.8%/62.9%, Average Hourly Earnings 0.3%/m/3.3%/y/y, Average Weekly Hours 34.5, Advance Merchandise Trade Balance -$73.0b, ISM & IHS Markit NM- PMIs 57.0/52.9, Wholesale Inventories 0.2%, Baker-Hughes Rig Count, Williams, Bullard, Bowman, Clarida, Evans. (DailyFX estimates)

**Global. Thurs:** Eurozone, Germany, France, and Italy M-PMIs 47.8/44.5/49.6/47.7, Germany Retail Sales -0.5%/m/2.9%/y/y, BOE Bank Rate & Asset Purchase Target 0.75%/£435b, BOE Inflation Report, Carney. **Fri:** Eurozone Headline & Core CPI Flash Estimates 1.6%/1.0% y/y, UK C-PMI & NM-PMI 50.6/50.4. (DailyFX estimates)

**STRATEGY INDICATORS**

**Stock Market Sentiment Indicators** ([link](#)): The Bull/Bear Ratio (BBR) jumped above 3.00 this week for the first time since early October. The BBR climbed for the fifth straight week, from 2.52 during the final week of March to 3.17 this week; it was at 0.86 at the end of last year—which was the lowest since mid-February 2016. Bullish sentiment has increased all but three weeks so far this year, jumping from 29.9% at the end of last year to a new high for this year of 56.4%—a 26.5ppts surge. It’s the 11th reading above 50.0%. Meanwhile, bearish sentiment sank to 17.8% this week (the fewest bulls since mid-June 2018); it bounced in a range between 20.4% to 21.5% from late January through late March. For most of 2018, bearish sentiment was below 19.0%, including just 12.6% that January. The correction count fell to 25.8% after rising from 26.0% to 28.2% last week, not far from its 25.5% reading six weeks ago—which was the lowest since early October. The AAII Ratio slipped for the second week to 25.8% after rising from 50.0% to 21.5% from late January through late March.

**S&P 500 Earnings, Revenues, Valuation & Margins** ([link](#)): Consensus S&P 500 forward revenues edged up w/w to 0.2% below its record high in early April, but forward earnings rose 0.7% and improved to 0.7% below its record high in early December. Analysts expect forward revenues growth of 5.6%, unchanged from a week earlier. Forward earnings growth remained steady too, at a 14-week high of 6.7%. Forward revenues growth is down 0.7ppt from a seven-year high of 6.3% in February 2018, but is up from a 31-month low of 5.0% in mid-February. Forward earnings growth is down 10.2ppts from a six-year high of 16.9% last February, but that’s up from a 34-month low of 5.9% in late February. Prior to the passage of the Tax Cuts and Jobs Act (TCJA), forward revenues growth was
5.5% and forward earnings growth was 11.1%. Turning to the annual growth expectations, analysts expect revenues growth to slow from 8.3% in 2018 to 5.1% in 2019 and 5.5% in 2020. They’re calling for earnings growth to slow sharply from 24.1% in 2018 to 3.4% in 2019 before improving to 11.4% in 2020. The forward profit margin remained steady w/w at a 12-month low of 12.0%, and is down 0.4ppt from a record high of 12.4% in mid-September. Still, that’s up from 11.1% prior to the passage of the TCJA in December and compares to a 24-month low of 10.4% in March 2016. The S&P 500's forward P/E has moved higher in 15 of the past 17 weeks, and rose 0.1 point w/w to an eight-month high of 17.0. That’s up from 14.3 during December, which was the lowest reading since October 2013 and down 23% from the 16-year high of 18.6 at the market's valuation peak in January 2018. The S&P 500 price-to-sales ratio rose 0.02 points w/w to a seven-month high of 2.05 and is up from 1.75 during December. That was the lowest since November 2016, when the ratio was down 19% from its then-record high of 2.16 in January 2018.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (link): Consensus forward revenues rose w/w for five of the 11 S&P 500 sectors, and forward earnings rose for eight sectors. Consumer Staples, Health Care, Tech, and Utilities were the only sectors to have both measures rise w/w. Forward revenues and earnings are at or around record highs for 4/11 sectors: Consumer Discretionary, Health Care, Industrials, and Tech. Energy’s forward earnings is beginning to edge higher now after tumbling about 25% from November to February. Forward P/S and P/E ratios are now well above their multi-year lows during December 2018 for all sectors, and are near or above their 2018 highs for four sectors: Communication Services, Real Estate, Tech, and Utilities. Due to the TCJA, the profit margin for 2018 was higher y/y for all sectors but Real Estate. The outlook for 2019 shows higher margins are expected y/y for just 3/11 sectors: Consumer Discretionary, Financials, and Industrials. The forward profit margin was at record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Since then, it has moved lower for nearly all of the sectors, but early signs of a bottom are appearing. During the latest week, the forward profit margin fell 0.1pt for Materials, but rose 0.1pt for four sectors: Communication Services, Financials, Real Estate, and Tech. Here’s how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.2%, down from 23.0%), Financials (18.6, down from 19.2), Real Estate (15.5, down from 17.0), Communication Services (14.8, down from 15.4), Utilities (12.9, down from 13.0), S&P 500 (12.0, down from 12.4), Health Care (10.4, down from 11.2), Materials (10.2, down from 11.6), Industrials (10.1, down from a record high of 10.4 in mid-March), Energy (7.0, down from 8.0), Consumer Discretionary (7.5, down from 8.3), and Consumer Staples (7.3, down from 7.7).

S&P 500 Q1 Earnings Season Monitor (link): With nearly two-thirds of S&P 500 companies finished reporting revenues and earnings for Q1-2019, the y/y growth rates in revenues and earnings have slowed substantially from Q4. The revenue surprise metrics have weakened substantially, but earnings continue to beat forecasts. Of the 312 companies in the S&P 500 that have reported through mid-day Wednesday, 77% exceeded industry analysts’ earnings estimates. Collectively, the reporters have averaged a y/y earnings gain of 3.6%, and exceeded forecasts by an average of 6.8%. On the revenue side, just 58% of companies beat their Q1 sales estimates so far, with results coming in 0.2% above forecast and 3.9% higher than a year earlier. Q1 earnings growth results are positive y/y for 67% of companies, vs a higher 73% at the same point in Q4, and Q1 revenues have risen y/y for 69% vs a higher 76% during Q4. These figures will continue to change as more Q1-2019 results are reported in the coming weeks, but less markedly. Looking at earnings during the same point in the Q4-2018 reporting period, a lower percentage of companies (72%) in the S&P 500 had beaten consensus earnings estimates by a lower 3.8%, but earnings were up a higher 14.9% y/y. With respect to revenues at this point in the Q4 season, a higher 61% had exceeded revenue forecasts by a higher 0.9%, and sales rose a greater 7.9% y/y. The results so far for Q1 indicate a slowdown in revenue and earnings growth from Q4, but that comes as no surprise to investors. It now appears Q1-2018 will mark the 11th straight quarter of positive y/y earnings growth and the 12th for revenue growth. Looking at the
Q1 results ex-Financials and Real Estate, the earnings surprise improves to 7.2% from 6.8% and growth falls to 2.8% from 3.6%. The ex-Financials and Real Estate revenue surprise would drop to 0.1% from the 0.2% rate with all sectors included, but revenue growth excluding Financials and Real Estate would improve to 4.2% from 3.9%.

**US ECONOMIC INDICATORS**

**ADP Employment** *(link)*: “The job market is holding firm, as businesses work hard to fill open positions. The economic soft patch at the start of the year has not materially impacted hiring. April’s job gains overstate the economy’s strength, but they make the case that expansion continues on,” according to ADP’s April report. Private industries added 275,000 to payrolls last month, the most since last July, and there were upward revisions to March (to 151,000 from 129,000) and February (220,000 from 197,000) advances, for a net gain of 45,000. This month, service-providing industries boosted payrolls at a 34-month high of 223,000, while goods-producing companies added 52,000 to payrolls after subtracting 1,000 in March—which was the first decline since the end of 2016. The strength in service-providing industries was broad-based: Professional & business services (59,000), leisure & hospitality (53,000), health care & social assistance (46,000), and trade, transportation & utilities (37,000). Meanwhile, within goods-producing industries, both construction (to 49,000 from 3,000) and manufacturing (5,000 from -6,000) industries improved from March’s weak performance, while changes in natural resources/mining employment (-2,000 from 2,000) continued to bounce around zero. Medium-sized companies (145,000) once again posted the largest gain in April, while small businesses (77,000) moved up to the number-two spot, after posting its smallest gain since September 2017 in March (20,000). Meanwhile, large companies (53,000) increased payrolls at roughly the same pace as they did in March.

**Manufacturing PMIs** *(link)*: Manufacturing activity in April slowed dramatically according to the ISM measure, and barely budged from March’s depressed level, according to the IHS Markit gauge. The ISM M-PMI (to 52.8 from 55.3) was the weakest since October 2016—just before the election—reflecting trade tensions between the US and China and a weak global economy. The new orders (51.7 from 57.4) measure plummeted 5.7 points to its second-weakest reading since August 2016 as demand for exports contracted. The new export orders (49.5 from 51.7) sub-index fell below the breakeven point of 50.0 for the first time since February 2016. Meanwhile, the production (52.3 from 55.8) and employment (52.4 from 57.5) measures both deteriorated last month, with the former showing its weakest growth since August 2016 and the latter basically matching February’s 27-month low of 52.3. Meanwhile, the supplier deliveries (54.6 from 54.2) gauge was little changed from March’s 26-month low, while inventories (52.9 from 51.8) continued to accumulate at a sluggish pace. The IHS Markit’s M-PMI ticked up from 52.4 to 52.6, but was the second-slowest reading since June 2017—March being the slowest. Expansions in output and new orders picked up from March’s recent lows, though the former was among the softest seen in the past two years, while the latter was slower than the 2018 average; job creation was the slowest since June 2017. Meanwhile, expectations about the coming year were relatively subdued and down to the lowest seen so far this year.

**Construction Spending** *(link)*: Construction spending in March fell for the first time in four months, with both private and public building in the red. Overall spending slumped 0.9% in March, after a three-month gain of 1.6%, with investment down 3.2% from last May’s record high. Spending on private construction projects fell to the lowest level since August 2017, dropping 0.7% in March and 1.8% ytd, while public investment retreated 1.3% in March after a 9.2% surge during the first two months of the year to a new cyclical high—boosted by state & local government building. Construction on federal buildings remains in a volatile flat trend around recent lows. Within private construction, residential investment has contracted 11.1% since reaching a cyclical high in April, to its lowest level since December 2016. Over this 11-month period, home-improvement and single-family investment tumbled...
20.0% and 8.2%, respectively, while multi-family construction jumped 7.3% to a new record high. Meanwhile, private nonresidential building has increased 2.7% over the four months through March to a new record high.