THE DANA VIEWPOINT

July 30, 2018
Dow: 25,307

Large Tech is Not a One Way Trade

Facebook released disappointing earnings news last week and now their twelve month return is nearly flat, which leaves it trailing the S&P 500 Index by about 10%. Growth stocks have outperformed value stocks this year, but now five of the mega-tech companies are the largest five companies by market capitalization in the S&P 500 Index. Apple, Microsoft, Amazon, Facebook and Google make up over 15% of the S&P 500 Index. Although Facebook is taking serious flak right now, of these five, it still seems to have the best combination of value and growth metrics. Facebook's 2019 revenue is projected to grow at a rate above its current P/E ratio of 21 on 2018 earnings. While some think the old economy is slowly dying, most of the change has already happened if you use the stock market as your indicator.

There is a new danger that these companies face now that they are the titans of the new economy – taxation and regulation. Microsoft was sued by both the U.S. and the European Commission and lost. Google just agreed to a fine of $5 billion with the EU, coming on the heels of a $2.8 billion fine last year. The Supreme Court ruling in South Dakota vs. Wayfair this summer established that companies that sell goods without a physical presence in a state must still collect sales taxes from those customers living in the state. Certainly governments believe the collection of revenue in the pursuit of fairness is a noble task.

The second quarter GDP growth of 4.1% was a strong number and very close to expectations. It was good to get a report that was close to consensus, as a weak number probably would have hurt the equity market and a much stronger number would have spooked the Fed and bond investors. It could have been even stronger, and may be in the future, as personal consumption firmly rose and inventories declined during the quarter.

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Inventory drawdowns mean that additional growth has to replenish them in the future. The Treasury bond market reacted with a yawn and hardly moved for the week. Gold, inflation protected treasury spreads, and commodities also showed little movement, even after the good economic news. This was good news for bond investors as stable inflation means they can likely enjoy higher current yields without the fear of rapid price volatility.

As we have said before, growth without inflation is the holy grail of the markets, and about half of S&P 500 companies have reported second quarter earnings. Like the first quarter of this year, growth expectations are high (above 20%), and so far companies are meeting the high bar. There are always some headline disappointments (Facebook), but overall execution and sales are as strong as other recent quarters. If the equity market is going to show double digit gains again this year, companies will have to continue delivering strong earnings performance with good sales growth visibility.

The S&P 500 came within 1% of its all-time high on July 25th, so we'll see what continued strong earnings can generate next month.

Random Thought for July 2018: "Technology is a useful servant, but a dangerous master"

- Christian Lange, Nobel Peace Prize acceptance speech, 1921

20700 SWENSON DRIVE • SUITE 400 • 53186 • P.O. BOX 1067 • BROOKFIELD, WI • 53008-1067 • 262.782.3631 • FAX 262-782-0581
365 ERICKSEN AVENUE.N.E. • SUITE 312 • SEATTLE, WA • 98110-1888 • 206.855.8781 • FAX 800.560.6227

E-Mail: dia@danainvestment.com
Web Site: www.danainvestment.com