
From: jeffrey E. [jeevacation@gmail.com]
Sent: 9/17/2018 7:12:25 PM
To: Thomas Jr., Landon [REDACTED]
Subject: Re: Smart analysis on big tech -- Apple section highlighted

its the leader for the next years .

On Mon, Sep 17, 2018 at 2:35 PM, Thomas Jr., Landon <[REDACTED]> wrote:

China's big tech stocks have fallen into a bear market at the same time that regulatory threats against U.S. big tech companies are gaining momentum. Can U.S. big tech stocks soldier on alone or is this a harbinger that the group as a whole is losing its tremendous leadership position?

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In recent months, China's BAT collapse has demonstrated how costly the expectation of invincibility can be—**Baidu, Alibaba, and Tencent are all down more than 24% from their year-to-date closing highs.** Citigroup's head of Asia strategy, Mohammed Apabhai, told *CNN* an apt analogy about the investor sentiment that led to BAT's collapse, likening "the exuberance for tech stocks to the Looney Tunes cartoons in which Wile E. Coyote chases Road Runner over a cliff." **Given they've more or less moved in tandem for years, will FAANG follow the same path as BAT?**



Source: *Stockcharts.com*

The BAT collapse was triggered by subpar earnings and a shifting regulatory environment in China. Facebook's miss in 2Q18—which drove a \$120 billion single-day market cap loss, the biggest ever for a U.S. company—showed how decisive a turn could be if more U.S. tech darlings stumble this quarter.

There are mounting fundamental reasons to question the 3Q18 earnings prospects of FAANG, from the accelerating user backlash against Facebook to Apple's trade war exposure to Amazon's rapidly-intensifying workforce revolt that could see the e-commerce giant left with no option but to raise wages and improve workplace conditions for its warehouse and Whole Foods employees.

However, as Apabhai suggests, the message BAT is sending is less about earnings, and more about the cost of exuberance. And FAANG exuberance faces threats that go beyond fundamentals. **A flurry of regulatory announcements last week signaled the political tide has turned in the U.S. Across every branch of government, the message was consistent: the U.S. no longer trusts tech giants to self-police. And the public agrees—according to a Gallup poll last month, 79% of Americans now believe “tech companies should be regulated the same way the news media is.”**

Regardless of political will, threats may not turn to action in the near term. Nonetheless, FAANG appears increasingly vulnerable to a decisive sentiment shift. At some point, the relentless barrage of bad news will force investors to begin pricing in regulatory risks. Any sustained stumble by FAANG's leadership could cripple exuberance, and cause an unraveling of passive and algorithmic strategies that are heavily overweight tech (see *WILTW* April 7, 2018 for more). **We will continue to watch closely to estimate timing, but given BAT's collapse, today more than ever, acute scrutiny of tech giant leadership is required.**

Through August 28, Amazon, Apple and Microsoft had accounted for greater than 35% of the S&P 500's total return this year, according to S&P Dow Jones Indices data. It took Amazon just 165 trading days to grow its market value from \$600 billion in January to \$1 trillion. The combined market cap of FAAMG (Facebook, Apple, Amazon, Microsoft, and Google) now sits over \$4 trillion, or roughly equal to the combined market cap of the 283 smallest S&P 500 members.

Tech's continued market leadership means investors have largely discounted the mounting risks tech giants face. We have been warning about the downsides of tech giant monopolism for more than two years in these pages, from surveillance/data security concerns to anticompetitive behavior and their role in escalating inequality. **For the political establishment, for the media, for the public, this year has seen a broad awakening—the Cambridge Analytica scandal, the backlash against Jeff Bezos' astonishing wealth, and tech's ever-skyrocketing market caps were all warning signs. The past month signals a new phase has begun: from a distant rumbling of change to preparation for action.**

The number of significant tech-related regulatory developments that have emerged from the U.S. and the E.U. in recent weeks is nothing short of staggering. Here is an abbreviated list:

- President Trump attacked Google for liberal bias, and claimed Google, Facebook, and Amazon represent “a very antitrust situation”.
- **Attorney General Jeff Sessions convened a meeting of Republican state attorneys general** to discuss whether tech giants “may be hurting competition and intentionally stifling the free exchange of ideas on their platforms.”
- Facebook, Twitter, and Google were called to testify in front of the House and Senate about election interference, political bias, etc. Google declined to attend.
- The FTC has begun a series of **hearings on Digital Age antitrust**, the first such hearings since the 1990s.
- The FTC revealed the hiring of Lina Kahn—heralded for authoring a groundbreaking antitrust argument against Amazon—as an advisor. (See section 5 for more.)
- **Republican Senator Orrin Hatch asked the FTC to reopen a 2013 antitrust case against Google.**
- Democratic Senator Mark Warner released a six-point policy proposal on regulating the tech industry.
- Democratic Senator Bernie Sanders proposed the “BEZOS Act”, which would tax corporations one dollar for every dollar low-wage workers receive in government health-care benefits or food stamps.
- **The E.U. Parliament voted 438 to 226 to back a draft proposal of copyright reform** that will impose unprecedented liability on information platforms.
- **France is pushing to have “Right to be Forgotten” laws applied globally, which Google is now fighting in court.**
- Reports emerged that the E.U. is considering investigating Google’s location-tracking practices on data privacy grounds.

We will continue to watch each development in the U.S. and E.U. closely to understand if and when debate turns to action. For now, we agree with the analysis of NYU Stern professor Scott Galloway, who told CNBC last week after the congressional hearings:

*I don’t see anything meaningful coming out of this panel, much less Washington...**D.C. lacks the domain expertise or the will to go after big tech. Where you may see it is, one, out of Brussels and, two, out of [the FTC, the DOJ, or] a red state whose attorney general sees the brightest path between the AG’s mansion and the governor’s mansion is a populist argument against big tech.***

Evidence of fundamental weakness could exacerbate the investor reaction to escalating regulatory news. **By all accounts, Facebook has continued to bleed users.** According to Pew Research poll results released earlier this month, more than a quarter of U.S. Facebook users claim to have deleted the app from their phones over the past year:



Source: Recode

Then there's Apple. The trade war combined with China's slowing economy present a significant short-term threat to the company's profits. As we note in section 1, **smartphone handset sales in China in August were reported at 32.6 million units, a decline of 20.9% year-over-year and 11.8% month-on-month. Moreover, no firm could suffer more if China decides to target tech supply chains in retaliation to Trump's tariffs.**

Yet, the risks extend beyond Asia. On Wednesday, Apple announced its newest generation of iPhones. It is following the same strategy as last year, releasing ever-more expensive phones as it tries to keep profit growth on pace despite a largely-matured smartphone market. As *The Wall Street Journal* reported this week, projections suggest last year's \$1,000 iPhone X underperformed previous launches: **"Even for Apple and its devoted fans, the art of the upsell appears to have some limits...**Analysts believe the iPhone X has accounted for about 30% of iPhone unit sales in the recent nine-month period...That is below the share the company's newest models typically get in a given cycle." Will a \$1,200 iPhone cross the limits of what the market will tolerate?

We have roughly a month until 3Q18 earnings season begins. For years, big tech's remarkable profit trajectory has generated an air of invincibility. BAT's earnings miss combined with Facebook's earnings miss has cracked that expectation. **As news reports of regulatory threats continue to flood in and as tech giant profit doubts mount, the weeks to come could see that crack turn to a fissure.**

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http://topics.nytimes.com/top/reference/timestopics/people/t/landon_jr_thomas/index.html

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