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Delta Insights
a weekly commentary on investing

November 2, 2018

Sometimes Our Worst Fears Become Reality and It's Not So Bad

During this 10-year bull cycle, large capitalization technology stocks including Apple, Facebook, Amazon, Netflix and Alphabet/Google led the stock market higher. Investors feared the day when these very large technology company valuations might correct sharply lower. Large capitalization technology companies including Apple dominate the market indexes. In July of this year, the top five largest holdings of the S&P 500 (Apple, Microsoft, Amazon, Google, and Facebook) were worth more than the bottom 282 companies in the index combined.

Although the S&P 500 is tech heavy, the chart below shows the relative performance of the heavier tech NASDAQ 100 versus the S&P 500 from the lows of March 6, 2009 through October 1, 2018.

NASDAQ 100 vs. S&P 500, 3/6/09 – 10/1/18

On October 1, the S&P 500 and NASDAQ 100 were near or at all-time highs. For the most part, the fear of a technology sector valuation correction came true this October. For some of the large capitalization technology stocks like FaceBook, Netflix and Amazon, the correction began before October. From the highs to the lows, Facebook was down -35%, Netflix -32%, Amazon -25% and Alphabet/Google -20%. Apple and Microsoft were the standouts declining by only -8.5% and 9.5%, respectively.

Despite the tech wreck, the S&P 500 index was down -6.84% last month. Although the fear of a large tech stock pullback came true, the impact on the overall market was less severe than feared.

A re-valuation of large capitalization technology stocks is a healthy development for the overall stock market. The fundamentals of the sector are strong and now valuations are more sustainable. Google trades at about 22x forward 12-month earnings. Facebook is at about 20x earnings. Apple is trading at 15x earnings. Relative to other non-technology world leading companies, these valuations seem to be in-line. Coca Cola is at 21x earnings. Procter and Gamble is at 19x earnings and Walmart trades at 21x earnings. This valuation comparison makes no adjustment for the tremendous cash holdings of these large-cap tech stocks and very low levels of debt.

The P/E of the S&P 500 on the forward 12-month consensus earnings estimate is about a point below the 25-year average of 16.1x. Two weeks ago, FactSet's measure of consensus earnings growth for the third quarter was up 18.9%. Last week, the consensus earnings growth rate increased to 19.5%. This week, the growth rate climbed to 22.5%.

A reset of large capitalization technology stock valuations removes some risk from the stock market and sets the market up for potentially meaningful gains in 2019. Rather than experiencing a broad bear market, the current 10-year bull cycle has been refreshed by periodic sector and style corrections. Rolling corrections have allowed the bull to run a marathon.

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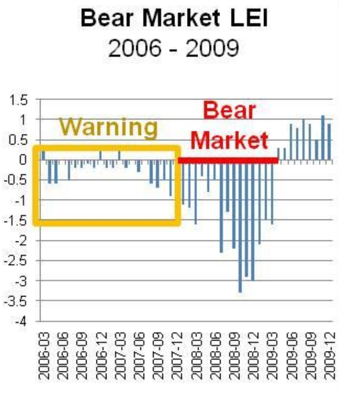
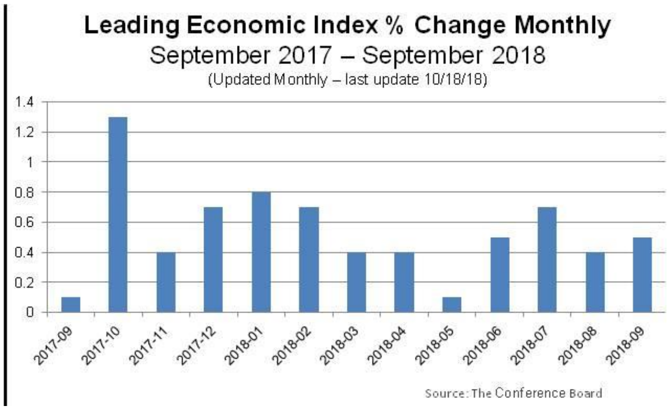
"Don't worry, honey. I'm just going for a walk. I'm not running a marathon."

Delta Stock Market Dashboard





MARKET SENTIMENT IS

BEARISH

THIS WEEK'S NUMBER IS

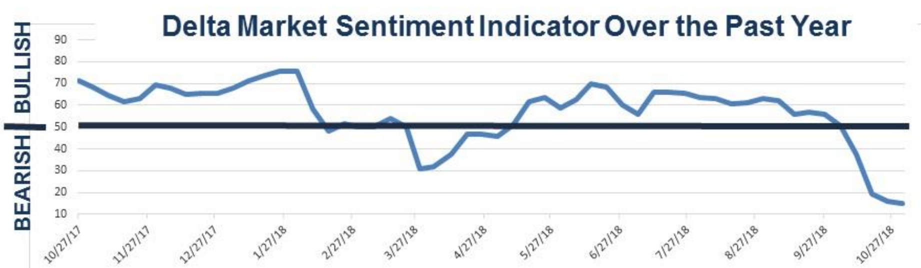
14.8

Our technical indicator decreased this week from 16.0 to 14.8

INDICATOR STATISTICS

Consecutive Bearish Weeks:	4
Cycle Inception Date:	10/11/2018
Range:	16.0 - 37.4
Mean:	21.9
Bullish Weeks YTD:	34
Bearish Weeks YTD:	10
*S&P 500	-2.7%
*DJIA	-1.9%
*NASDAQ	-1.6%

** Percentage change during current cycle*



(Delta MSI is published in ***Barron's***)

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