



Sell The FANG's

I expect comparisons between the FANG stocks and [Dr. Evil](#) of the *Austin Powers* film series to be an ongoing investment storyline over the next year given these digital gatekeepers' increased dominance over the U.S. economy. This idea might receive a lot more play in U.S. political and antitrust circles -- and produce more legal challenges -- than most investors currently presume. For those unfamiliar with *Austin Powers*, Mike Myers' character Dr. Evil is a parody of the James Bond villains. He hatches schemes to take over the world with his sidekick [Mini-Me](#) and his cat Mr. Bigglesworth. He's also assisted by Number 2 (*played by Robert Wagner*), who fronts for his evil corporation, Virtucon Industries. **A natural businessman, Number 2 is often more concerned about the financial aspects of world domination than in world domination itself.** That sounds a lot like the FANG stocks -- Facebook, Amazon, Netflix and Alphabet/Google. Now, the FANG shares have been slipping recently despite Wednesday's strength. However, investor sentiment remains almost universally optimistic as it relates to the intermediate term for these names. Here are just two examples of that enthusiasm:

- Based on expectations of the FANGs' glorious future and continued popularity, the Intercontinental Exchange this week announced an early November launch of a ["FANG+" ETF](#). This will combine the FANGs with other hot stocks like Alibaba, Nvidia and Tesla.
- Some, like my pal Tom Lee of Fundstrat Global, remain ecstatic about the FANGs' future prospects. In an [early June CNBC appearance](#), Tom explained why, despite having an overall bearish market view, he thinks the FANGs can add nearly 50% over 2017's second half -- and then continue to soar in 2018 and beyond.

Most investors and traders are generally unconcerned about the FANGs' recent weakness, seeing near-term declines as just another brief speed bump towards an investment pot of gold.

Why The FANGs Might Lose Their Bite

"So, is this it? The end of FANG and company? I can tell you the news clip files are filled with FANG obituaries and each one seems as cogent as the previous epitaphs. That's why I like to have one foot in the rocket ship and another in the terrestrial. Call me old-fashioned, but when the stock of Facebook gets crushed as it did today, I am more attracted to it than when it's soaring. I feel the same way about the stock of Alibaba or Nvidia or Electronic Arts (EA). Sure, they might be cheaper tomorrow. That's the risk you take. But these stocks didn't get where they were a week ago by alchemy. They got there because the companies are doing phenomenally and I don't see anything that tells me they won't. I just see profit-taking in the winners and a love of the losers. Own some of both, in a portfolio not just diversified by sector but by riskiness, and you'll do just fine." — Jim "El Capitan" Cramer, [Rocket-Ship Stocks Look Better When They Return to Earth](#), Sept. 25, 2017

While I've recently shorted both FB and AMZN, I've never been a serial basher of FANGs. I'm not one of those who have (as Jim related above) issued frequent FANG epitaphs. As George Lindsay said on *Wall Street Week* with Louis Rukeyser decades ago, *"I am not one of those 600 boys."* (You can listen to him [here](#) at the 2:15 mark.) **I realize that calling market tops (or bottoms) for individual stocks, specific sectors or the market as a whole is generally an audacious pursuit and a fool's errand.** It's also mathematically dangerous, and next to impossible, as there will only be one *"generational low"* every few decades, and zero *"generational tops."* Time is not on forecasters' side when it comes to projecting a stock's top. Generally speaking, stocks also have a gravitational pull higher over time as population and output rise in a secular sense. And while stocks often get out of sync -- particularly to the downside -- they have a knack at recovering. As the late great Louis Rukeyser once noted:

The robins will sing, The crocuses will bloom, Babies will gurgle, And puppies will curl up into your lap and go to sleep. Even when the stock market is temporarily insane. -- Louis Rukeyser, [Wall Street Week](#)

My pal Byron Wien of the Blackstone Group often expands on Rukeyser's view by frequently reminding me that contrary to Lord Keynes (*"in the long run, we are all dead"*), *"disasters have a way of not happening."* And of course, investors these days are more conditioned than ever to buy any dip thanks to market's massive liquidity injections and the increased role of passive and machine-based investing (*i.e., ETFs and quants*). **It's also important to remember that the FANGs aren't one stock, but four separate companies serving different customers and end markets.** But these companies have grown so dominant and disruptive -- to competitors, entire industries and real-estate and the labor markets -- that their political and antitrust touch points represent an ever-growing threat to their growth plans and business models.

Concern Abounds

I've recently turned more negative on two FANG components -- Amazon and Facebook, as well as the Nasdaq and technology in general. That's why I'm shorting AMZN and FB and have gone long on both the ProShares UltraShort QQQ and the ProShares UltraPro Short QQQ, which are 2x and 3x inverse plays on the Nasdaq 100. Here are my current views and game plans for each of the FANG components:

- **Facebook.** I see more government intervention and regulation ahead. **Recommendation: Short on a trading basis.**
- **Amazon.** AMZN's growth plans might be stifled going forward by government regulation. Political and antitrust forces represent an existential threat to the company's horizontal- and vertical-expansion plans. Click [here](#) and [here](#) to see more of my views. **Recommendation: Short on an investment and trading basis.**
- **Netflix.** I would avoid NFLX, but high short interest precludes selling it short. Remember, Adam Sandler will eat before Netflix shareholders do. **Recommendation: Avoid.** [Here](#) and [Here](#).•
- **Alphabet/Google.** Alphabet's dominance in the search-engine space (coupled with consumer reliance on Google) leaves the company vulnerable to government interference. I'm negative on the stock, but not short. **Recommendation: Avoid.** • •

Still, as Jim "El Capitan" Cramer wrote in a [thoughtful piece on Monday](#), it's possible that the FANGs are simply falling back to Earth (*as they have in the past*) and might be poised to rebound. Others opine that different sectors or stocks might pick up the slack for the market if the FANGs don't. In fact, there's a growing view that even if I'm correct on the FANG being vulnerable, that won't impact the overall market. This reminds me of something Helene "The Divine Ms. M" Meisler recently wrote:

"TV folks say the market is healthy without the FANG names. Of course, they said it was healthy when it was just the FANGs."

However, I suppose that's a subject for another day. Suffice to say, the consensus sentiment on the market and the FANG remains very upbeat. But remembering that consensus market views need not be wrong (as the crowd usually outsmarts the remnants), let me outline my deeper concerns for the FANGs.

Existential Threats Abound

Amazon is the titan of 21st century commerce. In addition to being a retailer, it is now a marketing platform, a delivery-and-logistics network, a payment service, a credit lender, an auction house, a major book publisher, a producer of television and films, a fashion designer, a hardware manufacturer and a leading host of cloud-server space. Although Amazon has clocked staggering growth, it generates meager profits, choosing to price below-cost and expand widely instead. Through this strategy, the company has positioned itself at the center of e-commerce and now serves as essential infrastructure for a host of other businesses that depend upon it. Elements of the firm's structure and conduct pose anticompetitive concerns -- yet it has escaped antitrust scrutiny. -- Lina M. Khan, [Amazon's Antitrust Paradox](#), *Yale Law Journal* I used to make presentations to CFA societies in various cities, and the one chart I always presented was called "Characteristics of a Good Stock." These included growth, free cash flow, barriers to entry and the hope that the government would leave the firm alone. This is pretty much "Buffett 101," with the caveat that you had to buy a good stock on the cheap. Now, while Amazon and Netflix have had

free-cash-flow and valuation issues, they and the other FANGs have had consistently dynamic top-line growth -- and steadily produced deepening competitive "moats" that have expanded the barriers to entry in their markets. And until recently, government interference wasn't a major concern. But that might be about to change. The FANGs' profound innovation and pervasive influence over the economy have rendered a lot of antitrust laws antiquated. Stated simply, these companies are ahead of the regulators -- but that, too, might be about to change. Moreover, the FANGs have no friend in the White House, as seen most recently by this tweet Wednesday from President Trump:

Facebook was always anti-Trump. The Networks were always anti-Trump hence, Fake News, [@nytimes](#) (apologized) & [@WaPo](#) were anti-Trump. Collusion?

? Donald J. Trump (@realDonaldTrump) [September 27, 2017](#)

Now, after meeting with several politicians and bureaucrats more than three decades ago, I wrote in a research note that Washington *"is too pessimistic a place for one person to follow."* That probably still applies. When Uncle Sam gets involved, it's impossible to predict an outcome or its magnitude. But one thing is certain -- with rare exceptions, government involvement with an industry won't be positive for the companies that are impacted.

Backlash From Washington

Now, a well-received recent book by Franklin Foer called *World Without Mind* details some nasty effects of the FANGs' relentless growth. One that I've previously discussed in my diary is that every competitor who collects ad dollars is playing a less-than-zero-sum game with the FANGs. As Foer writes in his book:

"Back in the seventies, Herbert Simon, the Nobel-winning economist, took these inchoate sentiments and explained them rigorously: 'What information consumes is rather obvious. It consumes the attention of its recipients. Hence a wealth of information creates a poverty of attention.'" — Franklin Foer, *World Without Mind: The Existential Threat of Big Tech*

I suggest reading this book if you own any FANG stocks, as the companies' conflicts with competitors and regulators are now arising. For example, Facebook under intense scrutiny for perhaps helping Russia manipulate the 2016 U.S. presidential election. Similarly, the push by Amazon into food retailing, prescription-drug distribution and auto-parts sales is also attracting interest. These businesses are all very employment intensive, and competitors' employees all have senators, House members and votes. Perhaps that's why AMZN has quietly hit a correction mode and has pulled back some 11% from its high. Now, it's important to remember when analyzing government policies that there are typically three lags involved:

- *The Recognition Lag*
- *The Action Lag*
- *The Impact Lag*

We are now at the Recognition Lag, but we could be moving into the Action Lag -- and might see the Impact Lag in the fullness of time. If the FANGs are destined to face regulatory problems, we might only be in the early innings of such an issue. It seems like politicians are slowly recognizing that there's a problem with the FANGs. If so, new interpretations of antitrust laws (*possibly coupled with new antitrust laws as well*) seem like they're on tap. London officials' recent decision to ban Uber could well be the FANGs' *"canary in the coal mine,"* as was Bear Stearns' failure in March 2008. I certainly don't have all of the answers here, but I hope I've presented some good ways to frame and consider these issues. Getting the answers right could be *the* investment issue of the

next few years.

The Bottom Line

To summarize:

- *FANG valuations are elevated and incorporate the general perception that there's little threat to the companies' business models. However, the FANGs and other leading tech companies are likely to get caught in the government's crosshairs in the years ahead.*
- *The FANGs now face existential political and antitrust threats that could inhibit, slow down and/or make growth more expensive and less profitable.*

Personally, I would avoid the FANGs until the issue of government intervention (*which is likely only in the early innings*) gets sorted out. To paraphrase Dr. Evil,

"The billions that the consensus expects to make on FANGs may turn into millions."

So, I'd use this week's market strength to consider reducing exposure to Facebook, Amazon, Netflix and Alphabet/Google. **Position:** Long QID, SQQQ (large); Short AMZN, FB, QQQ