

FANGs bite back: A view on Q1

I am sure you already knew this but, unlike humans, almost all snakes with fangs can regrow these when they get damaged or knocked out. This innocuous example of reptilian Darwinism is, in 2023, apparently now shared with the US major stock index, the S&P500!

After a shocking 2022 for growth stocks, 2023's Q1 market will go down in history as one of the most potent rallies in the history of growth investing. Specifically, the rally was sharpest in the small clutch of mega cap growth stocks coined "FANG" stocks. So, much like snakes, the S&P500 has managed to regrow these potent growth stocks back into the spotlight in 2023.

Let's look at why. Recession and rates, the two big Rs in 2023, reign supreme when it comes to market volatility. These two factors have almost exclusively been governing the movement of the stock market each day in 2023. I must say, in my entire career I have never seen all market movements being explained by one central topic – inflation and its effect on interest rates. It seems like I am not alone, however. The market has not been this sensitive to interest rates since the crash of Lehman Brothers in 2008.

As this blistering growth rally takes a breather early in Q2 let's have a look at the numbers; take the S&P500 index (the main US stock market) and subtract tech stocks. It's up 3.5% in 2023, not bad all things considered. Then take the FANG stocks which are essentially just Facebook (Meta), Amazon, Netflix and Google. They are up nearly 35% this year alone. That's x10 performance in three months from a very small clutch of growth stocks… that's more like a casino than a stock market.

Looking at the growth rally in detail it's not just the FANG stocks which have been in vogue. A bonkers 90% of the gains in the US benchmark (S&P500) year to date come from just 20 names all under the banner of "big tech". Nvidia the chip maker is up 83%, Facebook up 76%, Apple up 30%, Amazon up 20% and it wouldn't be a good old growth recovery without Tesla which is up over 70%.

The downside for most in the market who manage a diversified portfolio for clients in 2023 is that even if you owned a good amount of the US equity market, as many do, you would have still underperformed this quarter if you were not overweight these specific stocks, which many very good managers, after a 2022 growth rout, do not.

In short, it's been a tricky start to Q1 for those managers refusing to enter the casino that is the big tech growth market. Likewise, those multi-asset managers who stuck to their guns and watched their growth positions get battered in 2022, have suddenly gotten a performance reprieve for their inertia when it came to rotating or not rotating their portfolios to meet this higher rate environment which we are now entering.

The message from this rally, as we prepare for a potential recession, is "big is best". Right now, the losses these mega cap tech notched up in 2022, combined with the deep cost cutting drive these behemoths went through in 2022, has positioned these companies to fare relatively well in a recession, or so that's the story doing the rounds.

The collapse of Silicon Valley Bank (SVB) and Credit Suisse did little to halt the rally. If anything, it actually served to pour petrol on it! Why? Ostensibly SVB's collapse occurred because of the stress the economy is under from the current high level of interest rates. The market narrative which formed in the SVB aftermath was that US central bankers were surely going to cut rates before the end of the year to ease pressure on the US financial system
(which supports the entire economic fabric of the US) to prevent total disaster hitting the US economy. As always in 2023, any talk of rate cuts prompted the massive buying of growth stocks.

My two cents on this banking crisis is: if its collapse was down to higher rates then they will be cut, but any flicker of sticky inflation is going to cause the US central bank some serious issues because it's going to be very reluctant to lower rates until inflation comes back south of 3%, and that is far from a done deal right now. On the flipside, if this was not the fault of rates and instead was down to some idiosyncratic SVB directors making foolhardy investment decisions with their clients' deposits, which I think is, on balance, the more likely scenario, then the FED are going to remain unfazed and won't want to cut rates to fix a US wide banking issue which isn't really an issue at all. This casts doubt on the market's current belief that rates will be coming down by the end of the year. Neither of these outcomes spells an environment in which one would want to pile full bore into the equity market despite what the current

growth stock performance would suggest. Yes, there are clearly opportunities for active managers to generate some alpha and TAM has been doing exactly that but tremors in the US financial system don't spell out the foundations for a strong market rally.

Despite our thinking that this market might have gotten ahead of itself when it comes to chasing growth stocks higher, there is scope for this to continue into 2023. Why? Well go back to my original comments that this market is ruled by the direction of inflation. If we see all elements of inflation coming back towards 0% and a smidgen of gentle, soft economic data, then you'll have people making the inevitable inference that we have achieved "immaculate disinflation" and interest rates set to come gently back to 0% boosting growth back into a bull market. That's absolute gangbuster territory for growth investing and we have already gotten a taste of this in 2023.

The obvious danger to jumping on this bandwagon and riding off to the races once again is the risk that this very rosy scenario has already been priced into the market with the strength of growth stocks as they stand today. AKA, the horse has already bolted. Don't get me wrong, that's not a call for switching into a portfolio of cheap value stocks but it's certainly a cautionary note about doubling down on the current strength in these mega cap growth stocks. The phrase "diversification is king" once again has an air of dependence about it.

I will finish with the flipside to this growth coin even though you already know it.

If inflation doesn't play ball and proves sticky, as many think it will, central bankers will want to keep rates higher for longer. This should erode the strength in this growth rally which is priced for perfection. It will, as an aside, begin to degrade many businesses in the global economy which are built to survive on interest rates at sub 2%. These have been aptly coined "zombie" companies.

The deeper risk is that if economic weakness does come through in global economies whilst inflation remains stubbornly high (AKA stagflation), this will box central bankers into a corner having to face the dilemma of keeping rates high to kill inflation or cut them to stimulate the economy as it slows, yet run the risk of inflation surging back like it did in the 70s.

Make no mistake, the rally we have seen and participated in to the benefit of our clients has thus far priced in a 2023 road map in which inflation slows steadily, with a little economic slowdown forming a perfect scenario for central bankers to slowly cut rates to stimulate a slowing economy without any risk of sparking a resurgent inflation rise. That's the playbook as it currently stands and, even as I write this, economic data is starting to pull the shine off that
trade.

Whilst my erudite CEO might be able to refute me, I will finish this note to you with another first in my career. I have never seen a market unfold in exactly the way it's predicted or priced to. That's certainly not to say there isn't an opportunity to generate capital gains for clients. We see big opportunities in emerging market equities, high quality bonds from rock solid AAA companies, precious metals benefiting from a weakening dollar and very encouraging growth numbers coming out of a reopening Chinese economy.

On balance, whilst it's hard to watch a market rallying without our portfolios being able to capture all of it, we as always favour strength in defending and preserving clients' assets, when the wider market doesn't make a whole lot of sense. From talking to our clients, the defensive shield we built in times of stress is very much a comfort in these volatile times and we intend to keep that in place. Nevertheless, at times, when opportunity presents itself in a
pressurized market, we will move to buy well-priced, long-term opportunities.

TAM maintains its defensive parameters for its clients with healthy levels of protection against volatile markets, funds focusing on high quality stocks, precious metals and absolute return funds seeking to diversify volatility across the board.

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