What Just Happened? FAANG Risk is Starting to Bite.

In July we warned that the FAANG portfolio was so risky that a 5-day drawdown of 10% should be expected once every 9 months.[1] During the past two months there have been 3 instances of losses of over 9% in a single week—the largest of them 9.9%. The worst week for the FAANG portfolio came in August 2015 when it dropped 15%. In July of this year our tail model said that a repeat of that loss should be expected once every 2.4 years. Now the tails are even fatter and the updated frequency is once every 10 months. FAANG drawdown risk is starting to bite.

The Second Tech Bubble?

The FAANG portfolio is the most well-known example of the extraordinary growth in the tech sector since the latest U.S. equity bubble started inflating in 2012. From the time of the Facebook IPO, an equal weighted portfolio of Facebook, Amazon, Apple, Netflix and Google had increased by over 1,000% at its peak. Over the same period the S&P 500 Index gained 140%.

But other U.S. tech stocks have also grown explosively over the same period. At its recent peak, XLK, the State Street Technology Select Sector ETF, was up almost 200% while a ProShares leveraged semiconductor ETF gained over 800% (Figure 1).

For anyone who can remember the original 'Tech Bubble' the eventual outcome may not be in doubt. It's just a matter of how large the corrections will be and how soon they will come.

Unstable Expansions Always Signal Overheating

Omega Analysis' risk measurement technology reveals predictable Risk Cycles that are leading indicators of asset price booms and busts. Unstable Expansions–unsustainable asset price increases–signal overheating and predict the correction level which will result.

In the case of an equal weight portfolio of FAANG stocks, and the U.S. Tech Sector more generally, a bubble has been inflating since 2016. The correction we predict will be enough to wipe out at least the past two years of gains.

Our Multi-Trend Analysis[2] has just raised the Alert Level for XLK from Yellow to Orange. It appears that a Red Alert, which has been an accurate historical indicator of significant bubble deflations, is not far off.

Drawdown Risk in the FAANG Portfolio is Now Extreme

October and November 2018 have proved difficult for the FAANG stocks. In July of this year[1] we warned that 5-day drawdowns of 10% in an equal weighted FAANG portfolio should be expected once in 9 months. Since the beginning of October there have been 3 instances of losses of more than 9% in a single week—the worst of them 9.9%. The tails have fattened so much since July that none of these losses was even a 99% VaR breach.

As of the middle of November, the drawdown risk has increased significantly over what we observed in July. A loss of more than 10% should now be expected every 3 months.

In July the prospect of repeating the worst 5-day loss to date in the FAANG portfolio (15% in August 2015) was far from remote with an expected frequency of once every 2.4 years. Now it should be expected once every 10 months*. The average 5-day loss in excess of 15% would be a horrific 23%. FAANG risk is definitely starting to bite.

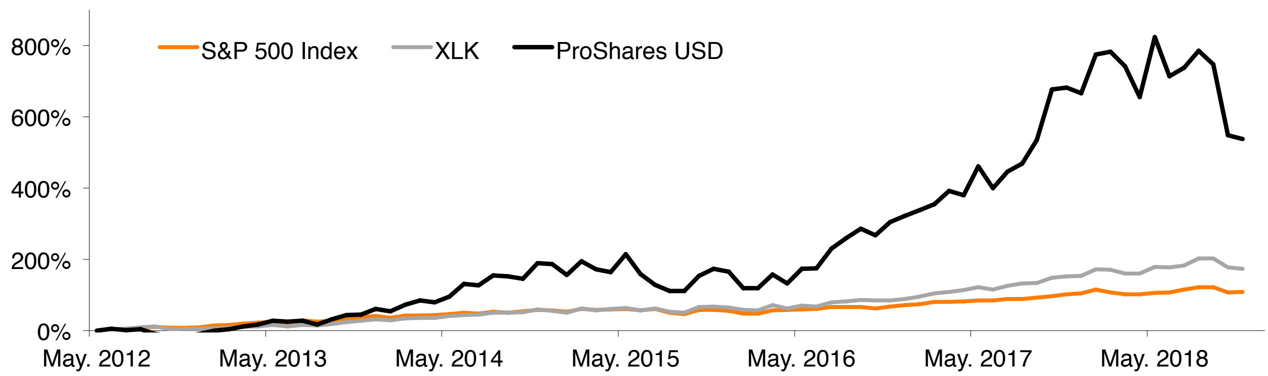

Figure 1. S&P 500 Index, XLK and ProShares USD in % from May 2012.

[1] *Fang Investors Running a High Risk of Being Bitten*, What Just Happened? 23 July 2018 https://www.omegaanalysis.com/new-research

[2] *The Future is Already Here Part 2*, What Just Happened? 24 October 2018 https://www.omegaanalysis.com/new-research

* *An earlier version of this article incorrectly reported this as 'once in 9 months'.*

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