The e-Commerce boom has produced a major bubble in its six most prominent companies, Amazon, eBay, Google, Facebook, Netflix and Twitter. In the past two years, an equal dollar weighted portfolio of those stocks gained over 120% while the S&P 500 rose 'only' 35% and the Nasdaq 100 'only' 59%.
Over the last 6 months the drawdown risk in that e-Commerce portfolio has exploded. We expect to see a correction that will wipe out at least the past two years of gains.

Even the Sell Side Recognises the Equity Bubble Now

Recently, analysts from major banks have warned that the equity bull market is over-extended. Indeed, the current US equity bull market is the second longest ever and tied for absolute return with the rebound from 1932 to 1937 that followed the 1929 Crash[1].

Within this market boom e-Commerce stocks stand out as what Michael Hartnett from BoA Merrill Lynch characterised as "the third largest bubble of the past 40 years" and "set to become the largest bubble of all time" assuming no major drops in the major six stocks[2].

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 the six major e-Commerce stocks this signal has been flashing red throughout the past two years. The correction which it predicts will be large enough to eliminate all of the gains that have been made since March 2016.

Drawdown risk has exploded in e-Commerce

Omega Metrics® Value at Risk (VaR) and Expected Shortfall (ES) estimates have proved accurate in measuring drawdown risk across asset classes. In the case of the e-Commerce portfolio, the 99% VaR and ES levels for 5-day returns have exploded over the past six months–well in advance of the recent Facebook related drops in e-Commerce stocks.

The equal weight e-Commerce portfolio dropped by 9% in the third week of March but this was merely a 99% VaR breach. The 99% ES for 5-day returns was already over 10% by the first of January.

At that time our tail model said that a 5-day drawdown at least as large as the e-Commerce portfolio went through last month should have been expected once every 10 months. The predicted frequency now stands at once in just over 4 months–and the average excess is 14%. There's a sting in the e-Commerce tails.

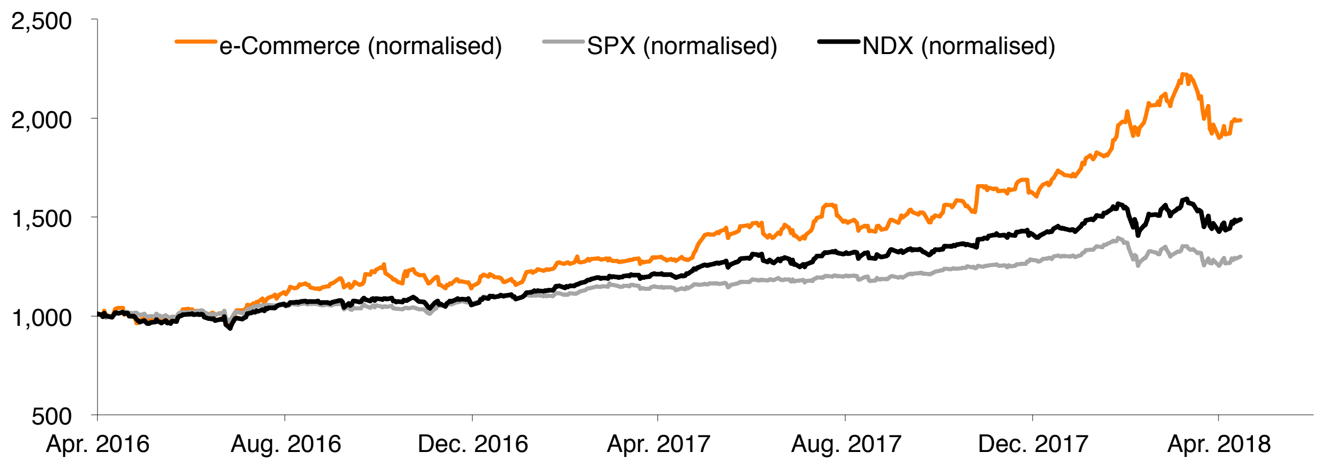

Figure 1. e-Commerce NAV against SPX and NDX, normalised from March 31, 2016.

[1] https://www.zerohedge.com/news/2018-03-26/bofa-we-are-witnessing-third-biggest-assset-bubble-created-central-bank.
[2] https://www.zerohedge.com/news/2018-04-09/bubble-about-burst-bofas-10-reasons-sell-tech-stocks.

Omega Analysis

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