"In Wall Street, the only thing that's hard to explain is next week."

Louis Rukeyser

A common storyline in the financial press has been the leadership provided by the FANG stocks - **F**acebook, **A**mazon, **N**etflix, **G**oogle (now Alphabet). More recently **A**pple has been included with that group (FAANGs) which we will do as we review their contribution to the market's gains and explore the potential for continued outperformance.

Are FAANGs mostly responsible for the stock market's advance?

The FAANGs, whose acronym, coined by CNBC's Jim Cramer, makes them memorable, are five mega-cap Consumer Discretionary and Information Technology stocks, familiar to average consumers (and investors) who use their products every day.

These five stocks have outperformed the market so far in 2017, rising between 17% and 31% through June 30, compared to a 9% gain in the S&P 500. They contributed 24% of the total market return in 1H17, despite representing just 9% of the market weight. However, if we ranked the top performers in the S&P 500, the best FAANG performer, Facebook, would not appear until the 40th spot.

Ticker	Company	YTD 2017 Return	Rank in S&P 500
FB	Facebook, Inc.	31.2%	40
AMZN	Amazon.com, Inc.	29.1%	54
AAPL	Apple Inc.	25.4%	72
NFLX	Netflix, Inc.	20.7%	100
GOOGL	Alphabet Inc.	17.3%	139
	S&P 500	9.3%	

Since the S&P 500 is weighted according to market capitalization, the FAANGs are significant contributors to the rise and fall of the overall market. In fact, four FAANGs (not NFLX) ranked in the top 10 for market capitalization, and all moved higher given their performance thus far in 2017.

Company	Market Cap Rank		
	Q2 2017	2016	Q2 2012
Apple Inc.	1	1	1
Alphabet Inc.	2	3	34
Amazon.com, Inc.	4	8	30
Facebook, Inc.	6	10	--
Netflix, Inc.	77	88	442

Whenever the stocks of fast-growing companies experience rapid advances, we question their valuation. As owners of AAPL, AMZN, FB, and GOOGL, we spend considerable time discussing the sustainability of their outperformance. Without delving too deeply into a valuation analysis, we would highlight some simple metrics related to FAANG performance versus the overall market. Investors expect the FAANGs to grow revenue and earnings far in excess of the overall market in the coming years. The factors driving their growth are expected to remain in place and their balance sheets are extremely strong, elements which should support the stocks in the event of a pullback.

Revenue Growth

Company	2012	2013	2014	2015	2016	2017E	2018E
Facebook	37.1%	54.7%	58.4%	43.8%	54.2%	39.5%	27.9%
Apple	44.6%	9.2%	7.0%	27.9%	(7.7%)	5.0%	12.4%
Amazon	27.1%	21.9%	19.5%	20.2%	27.1%	22.3%	21.6%
Netflix	12.6%	21.2%	25.8%	23.2%	30.3%	27.8%	20.4%
Alphabet	38.9%	17.7%	10.4%	15.5%	21.2%	19.7%	16.8%
S&P500	4.0%	3.4%	3.8%	(2.8%)	2.3%	5.0%	

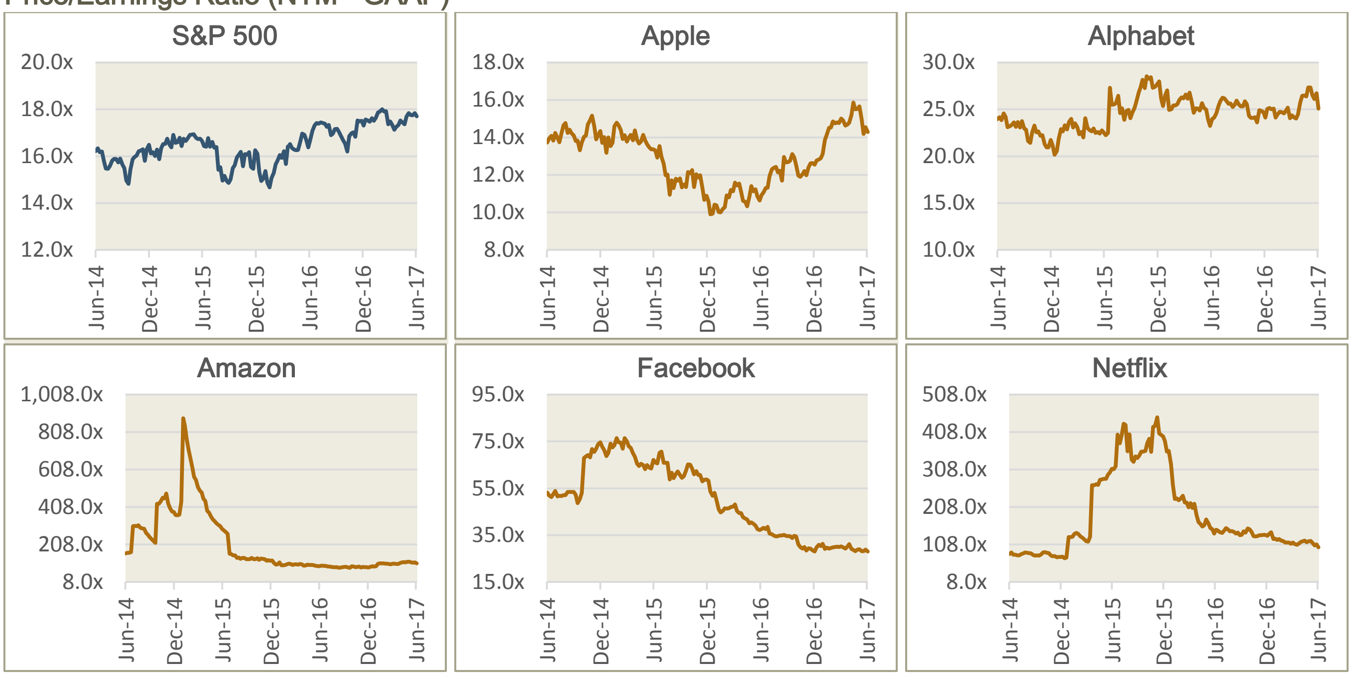
Exceptional revenue growth and earnings growth relative to the overall market.

EPS Growth (GAAP)

Company	2012	2013	2014	2015	2016	2017E	2018E
Facebook	(97.7%)	5,900.0%	83.3%	17.3%	170.5%	39.0%	23.3%
Apple	59.5%	(10.0%)	13.6%	42.9%	(9.9%)	7.0%	18.1%
Amazon	(106.6%)	(755.6%)	(188.1%)	(340.4%)	292.0%	36.5%	70.8%
Netflix	(93.2%)	537.9%	133.5%	(54.6%)	53.6%	145.6%	82.9%
Alphabet	8.6%	18.0%	10.1%	8.7%	21.9%	22.4%	18.0%
S&P500	3.8%	6.4%	10.7%	0.2%	6.5%	4.6%	7.9%

Finally, price-to-earnings multiples for the FAANGs are expected to decline over the next few years because of their solid growth. This is in stark contrast to the market multiple, which has been gradually rising over the past two years. This means that the increase in FAANG stock values has been driven by earnings growth, with the declining multiple reflecting expectations for lower growth in the future. Generally, when investors debate whether a stock is "getting expensive", it is because the multiple has been rising.

Price/Earnings Ratio (NTM - GAAP)



So should we expect the FAANG leadership to continue? If the market pulls back, it is likely the FAANGs will be large contributors to the decline, simply because they are large market constituents and the stocks have been very strong this year. When we examine the portfolios of Aureus clients, we note that only one of these (Facebook) was included in our top 10 contributors to performance for the first half of the year. Market breadth and diversification have actually been broad as stocks in such fields as consumer goods & services, health care, manufacturing and finance have had strong advances.

Stock market leaders vary not just over long periods but even from year-to-year and we need to be prepared for a shift in leadership. We continue to believe that diversification across market sectors combined with a deep understanding of company-specific fundamentals is the best approach to better long-term performance and managing portfolio risk.