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Weekly Commentary

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Earnings Season for the FAANGs

The period from October 18 to October 28 marked the busiest period of earnings reports from mega cap technology companies including those known collectively as the "FAANG" stocks: Facebook parent Meta Platforms (NASDAQ: META), Apple (NASDAQ: APPL), Amazon (NASDAQ: AMZN), Netflix (NASDAQ: NFLX) and Google parent Alphabet (NASDAQ: GOOG/GOOGL). Remarkably, the FAANG stocks account for approximately 30% of the weight in the NASDAQ100 Index, which is a market weighted index.

Analysts and strategists across Wall Street have been anxiously awaiting these results and perhaps more importantly, the tone and direction of forward-looking guidance from management that customarily accompanies the announcement of quarterly numbers. Many observers believe that earnings weakness would be the "next shoe to drop" during the bear market given the impact that extreme pessimism and rising rates are having on consumers.

First out of the gate was Netflix, releasing Q3-2022 results after the close on Wednesday October 18. For the quarter NFLX reported revenue that slightly exceeded expectations, mostly due to a 5% increase in average paid memberships and attractive original programming, while foreign exchange was a headwind given the strength of the U.S. dollar. Looking forward to 2023, new revenue streams related to paid sharing and advertising revenues have been received positively. NFLX shares rallied on the news and were higher by 22% by last Friday. However, it's worth noting that NFLX shares are down by 57% since peaking in November 2021.

Next up was Alphabet (Google) reporting Q3-2022 results last Tuesday. Revenues were higher by 6% versus last year with CFO Ruth Porat highlighting that "healthy fundamental growth" in Search and momentum in the cloud business were strengths while foreign exchange had a negative impact. Shares of GOOG/GOOGL tumbled 9.6% in Wednesday's session and as of Friday shares are down by 36% since the February 2 high.

Meta Platforms, owners of Messenger, Instagram, WhatsApp and Facebook, reported results on Wednesday. Earnings of $1.64 per share missed analysts' consensus estimates of $1.90 and the reaction was swift with shares plummeting by 24.5% on Thursday. As of Friday, shares are down by over 70% for 2022. Increases in total costs and expenses (+19% year-over-year), Head Count (+28% year-over-year) and Capital Expenditures continue to accelerate as the Metaverse virtual reality project (Reality Labs) moves forward. The recent

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quarter was the second consecutive revenue decline and along with increased competition, lower advertising revenues, and foreign exchange challenges, another losing quarter is forecast for Q4. Much of the investor consternation is centered on substantial investment being committed to META's virtual reality division (the Metaverse) which has lost over $9 billion through its first three quarters.

FAANG earnings season closed on Thursday with Amazon and Apple. While revenue at AMZN grew 15% in Q3, the results fell short of analysts' expectations. Macroeconomic factors (inflation, interest rates, foreign exchange) are impacting the core retail business. Operating income was almost halved and while shares plummeted in afterhours trading. AMZN rallied throughout the day on Friday as markets were strong. By the close, AMZN was well off the day's lows and only down 10.6% from the prior day - a relative victory.

Closing out the parade was Apple. The world's largest tech company reported fiscal Q4 earnings per share ($1.29 vs. $1.27) and revenue ($90.2 billion vs. 88.9 billion) that beat Wall Street expectations despite a shortfall in iPhone sales. It's important to note that the new iPhone14 and iPhone 14Pro models were not available to buyers for a majority of Q4. In what has become a common theme, revenues from outside of the U.S. were impacted by the strong dollar. On the upside, the cost of chips used in an iPhone are decreasing as supply issues mitigate, and the company was able to successfully increase prices to consumers. Despite some volatile afterhours trading that saw AAPL shares dip into the red, by Friday's bell AAPL shares had rallied by 7.6%, saving the day for the FAANGs!

The market capitalization of the five FAANG stocks combined is a whopping $5.17 trillion. The FAANGs are widely favored by investors given their status as dominant global companies that have historically outperformed the indices by a long shot. These companies' shares are broadly held by pension funds, mutual funds, exchange traded finds and individual investors. Their influence on the performances of market indices, particularly the tech heavy NASDAQ 100 Index, are obvious. Hence, the rationale for why the performance of the FAANGs is so important and why these companies are so widely followed by market participants.

The market's reaction to last week's FAANG earnings reports was a "mixed bag" with investors in META, AMZN and GOOG getting punished while holders of AAPL and NFLX were rewarded. The strong U.S. dollar, which negatively impacts the bottom line for companies that generate revenues in foreign currencies but report in U.S. dollars, has impacted earnings. Logically, it's important to follow the U.S. dollar as any weakness in the "Greenback" is a positive catalyst for future earnings. Bad news for the dollar is good news for multinationals. Perhaps more encouraging is the manner in which broad indices like the Dow Jones Industrials, the S&P 500 and the S&P/TSX Composite have bucked the trend by outperforming the tech sector in recent weeks. This is a sign of broader strength that's developing across multiple sectors. This is good news for investors in equities markets.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$8.33	-9.20%
Palos Equity Income Fund - RRSP	PAL101	$6.48	-9.53%
Palos WP Growth Fund - RRSP	PAL213	$12.29	-34.81%
Palos-Mitchell Alpha Fund [3]	PAL300	$8.43	-17.92%
S&P TSX Composite (Total Return with dividends reinvested)			-5.93%
S&P 500 (Total Return with dividends reinvested)			-17.10%
S&P TSX Venture (Total Return with dividends reinvested)			-36.38%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			4.01%
Canadian Government 10-Year			3.24%
Crude Oil Spot			US $87.90
Gold Spot			US $1,644.80
US Gov't10-Year/Moody BAA Corp. Spread			238 bps
USD/CAD Exchange Rate Spot			US $0.7355

[1] *Period ending October 28th, 2022. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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