Five Reasons Stock Pickers Are Off to a Fast Start: Facebook, Amazon, Apple, Alphabet, Microsoft
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It is one of the least creative trades of the year�and one of the most profitable.

Many stock pickers that have beaten the market in the early months of the year have five of the best-known technology companies to thank: Facebook Inc., FB 0.48% Amazon.com Inc., AMZN -0.00% Apple Inc., AAPL -0.23% Google parent Alphabet Inc. GOOGL -0.09% and Microsoft Corp. MSFT -0.42%

Those five stocks have accounted for 41% of the S&P 500�s market-capitalization advance this year. Of the 101 top-performing actively managed U.S. stock funds this year, 84 count two or more of those technology firms in their top five holdings, according to Morningstar Inc.

The best-performing funds by definition pick the best-performing stocks. While funds in the past have had large holdings of big tech firms, what�s unusual about 2017 is that the biggest stocks are doing particularly well, meaning investors must make more outsize bets to beat their benchmarks.

The average price gain for the S&P 500�s 10 largest U.S. stocks was 12% through the first five months of this year, the second-highest mark for that group over the past two decades, according to WSJ Market Data Group. The S&P 500�s tech sector had gained 20% this year through May, compared with the broader index�s 7.7% advance.

Yet gains by big tech companies have left some investors uneasy, concerned that prices have run up too far, too fast but also reluctant to pare holdings on the market�s strongest performers. Facebook, Apple and Amazon all climbed at least 32% this year through May; Alphabet was up 25%, while Microsoft had tacked on 12%.

A survey of nearly 200 fund managers last month by Bank of America Merrill Lynch found that money managers view the tech-oriented Nasdaq Co mposite Index as the world�s �most crowded trade.�

�These stocks are up 30% [this year], and so are they getting pricey? Yeah,� said Michael Lippert of the Baron Opportunity Fund, which owns big slugs of Amazon, Alphabet, Facebook and Netflix Inc. and is up 29% this year through Tuesday. �But ask yourself: What else do you want to own five years from now?�

The heady rally in technology and internet stocks is in some ways reminiscent of the dot-com bubble in the late 1990s, when the promise of the information superhighway translated into bullishness that ultimately imploded with excess.

In the dot-com boom, as now, there was pressure on fund managers to place large bets in the technology sector to keep up.

Fund managers say one difference between then and now is that firms like Amazon and Alphabet are more deeply entwined in the day-to-day lives of their customers, enjoy more of an edge over competitors and are expanding into more industries.

�The reality is there are relatively few winners in the U.S. economy now,� said Justin White, manager of the T. Rowe Price New America Growth Fund, which is up 21% this year, according to Morningstar. It has large holdings of Amazon and Facebook shares.

The boost from big technology companies is helping stock pickers achieve one of their best starts to a year since the end of the financial crisis. Nearly half of all actively managed U.S. stock funds, about 49%, beat their benchmark through May. That is the highest percentage of those funds outperforming in that period since 2009, when 56% did so.

The firms that try to beat the market have faced pressure in recent years from funds that aim to mimic the performance of broad market indexes, often at a much lower cost.

The best-performing large-cap growth stock fund this year tracked by Morningstar is the $4.7 million Zevenbergen Genea Fund, which was up 40% through Tuesday. Amazon by itself represented nearly 10% of the fund�s portfolio holdings as of the end of March. The fund, launched in 2015, is a new entrant from Zevenbergen Capital Investments, a $2.15 billion Seattle-based asset manager that has focused on growth stocks for three decades.

�The strong keep getting stronger. We don�t see that theme changing any time soon,� said Anthony Zackery, a portfolio manager at Zevenbergen. �Recent performance is a manifestation of the scale these companies have built out in recent years.�

Some fund managers say they are wary of how fast tech shares are accelerating. Mr. White of T. Rowe Price said he dialed back some of his bets on technology firms because their shares have risen so much this year. He said, however, that he is reluctant to hold less of the sector than his fund�s benchmark because there is still potential for further gains.

The growth of large technology stocks this year is �obviously unsustainable,� said Gavin Baker, manager of the $15.1 billion Fidelity OTC Portfolio. But he said the group was hit hard in late 2016, creating a low starting point.

Mr. Baker, whose fund is up 25% year to date, called Google, Amazon and Facebook artificial intelligence companies that he expects to expand over the next five to seven years.

By some comparisons, the shares have room to run. Tech stocks were an even bigger proportion of the S&P 500 back in 2000, representing 34.5% of the overall index compared with 23% today, according to S&P Dow Jones Indices. And valuations were higher then. The average stock price of S&P 500 tech shares trades at 19 times the earnings that analysts expect over the next year, according to FactSet. That is above the S&P 500 index�s price/earnings ratio of 17.7, but is far below the P/E of 53.4 that the tech sector traded at in March 2000.

Stock pickers say one of the biggest threats Google, Amazon and Facebook are likely to contend with is new regulations targeting online privacy and the way customer data is collected and used. Investors also say that, while antitrust concerns are a risk, especially in Europe, there is no way to predict their timing or impact.

There are also risks that as the companies expand they will compete with each other as their business models sprawl into new, overlapping industries.

But the flip side, some say, is the dominance itself. Says Mr. Lippert of the Baron fund: �We are going to have a winner-take-all or winner-take-most world.�