Don't bail on the global leader yet

Facebook's blunder shouldn't turn investors away from its many benefits

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"Don't make excuses — make good." — Elbert Hubbard

In June of 2016, I recommended to readers of this column to buy Facebook stock. Since that time, Facebook (symbol: FB) is up a very strong 41 percent, versus 28 percent for the S&P 500 Index.

However, Facebook announced on March 16 that Cambridge Analytics, a data analysis and consulting firm that worked with the Trump campaign in 2016, had improperly obtained information on over 50 million Facebook users. While numerous accusations abound on who is actually responsible for this mishap, the bottom line is that many Facebook users feel their privacy has been violated and that trust in this brand has clearly suffered.

Numerous readers of this column have asked me what they should do with their Facebook shares. So, I will outline three different scenarios — the bull case, the base case and the bear case for Facebook stock — with my own current recommendation at the conclusion.

THE BULL CASE

The bull case for Facebook relies on an effective PR campaign that eases users' concerns over their privacy and outlines clear, concrete steps to prevent future data breaches. Advertisers, the main source of revenue for Facebook, continue to pay up, and the scandal blows over relatively quickly with no significant regulatory punishment. More importantly, user fallout from the scandal is minimal. As such, the stock remains resilient and quickly resumes its impressive growth.

THE BASE CASE

This is more complex, and the impact will obviously be larger. Here the Facebook story stays in the news for an extended period of time, damaging the brand. Advertisers steer some of their marketing budgets away from Facebook to wait for the dust to settle, requiring the company to exert considerable effort retaining and attracting new advertisers. Accordingly, the stock will likely continue to lag and underperform in the short-to-intermediate term but can ultimately recover.

THE BEAR CASE

It is hard to imagine that Mark Zuckerberg and Facebook could do worse in its public relations efforts than it has done

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thus far, but the bear case assumes they continue to appear nonplussed. Regulators move more aggressively and faster than expected, forcing changes to the Facebook platform. As such, user engagement and advertising revenue will decline, as will Facebook shares. The brand will have, in effect, peaked.

So what is my recommendation?

This issue for Facebook reminds me a lot of the Wells Fargo consumer abuse scandal. Since that news broke in September 2016, Wells Fargo stock has lagged both the broad stock market and its banking peers by a wide margin.

I believe Facebook is in for a similar fate over the next 12 to 18 months, as the base-case scenario I described is the most likely outcome.

However, as a long-term investor, the truth is that Facebook is the dominant social media company on the planet, and I truly doubt many Facebook users will really stop using the app because of this controversy.

In fact, with Facebook 23 percent off its all-time highs, I think it presents an attractive entry point for the serious long-term investor to buy a great growth company. In my career of investing, when a superb company hits a speed bump, and the shares are revalued lower on the news, stepping in and buying the stock has paid off handsomely. With Facebook, this is one of those times.

If I owned it, I'd hold it, and if I didn't, I'd buy some.

I "like" Facebook.

Finally, 2017 was an incredibly smooth, positive year for stocks, as the S&P 500 Index experienced 1 percent moves up or down only eight times for the full year. However, in the first quarter of 2018 alone, we have had 21 such moves and two 10 percent corrections! A few readers believe this is a bad omen for stocks in 2018. However, I would like to point out that higher volatility does not at all mean the markets will be weak. In fact, according to data from FactSet, going back to the 1950s, stock markets actually average a positive 8.5 percent return in the year following abnormally low market volatility.

Stay Bullish!

Jim Burns, a chartered financial analyst, is president of J.W. Burns & Co. The opinions expressed here are his and do not necessarily reflect those of The Post-Standard. Readers should do research before deciding on an investment.