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Elston Insights

4th November 2022

Big tech derates – is this a good time to buy?

- Big tech has dominated US equity indices in recent years
- Shares have deflated as economic outlook has deteriorated
- How investors could allocate if they see a buying opportunity

When it comes to the technology sector, it has seemed for many years as if the only way was up. And prior to corporate rebrands, the largest names even had their own acronym - "FAANGs" – standing for Facebook, Apple, Amazon, Netflix and Google.

The tech era

Technological innovation remains a central driver for growth in today's world. However, much has been written about the dislocation of some big tech companies' share price valuations from their financial fundamentals and profitability. The pandemic exacerbated this issue, acting as a sugar-rush for the likes of Amazon and Netflix as digital adoption expanded. Unlike dirty "big oil" of yesteryear, "big tech" has been perceived as low carbon and "clean". Towards the end of 2021, valuations began to look frothy, and tech exerted a notable dominance over the US equity market, which in turn dominates world equity indices. For some passive investors, as well as also active investors shy of benchmark risk, tech's valuation and concentration created its own set of risks.

As noted by us here in an article last year and here in a piece from 2020, index investors can choose to mitigate this concentration risk by investing in the equal-weight version of an index rather than one that uses the more common cap-weighted methodology. As in investor, it just depends on what is prioritised: the stock performance chicken or the index performance egg?

Old world economics

In any case, it was perhaps inevitable that in 2022, a world away from the easy-money environment of the preceding decade, the relentless upward grind of interest rates and inflation

would trigger a de-rating and a heavier discounting of future growth. This was old world economics in action as the easy money era came to an end.

Since the start of the year, FAANG share prices have fallen by anything up to almost three quarters (in Meta's case) and disappointing earnings announcements last week prompted a further mini-rout. So is this now a buying opportunity? For those minded to think so, there are a number of ways to get exposure:

What are the options?

- For US tech, the iShares S&P 500 Information Technology Sector (LSE:IITU) is the largest ETF to provide access to the sector and consists of 76 US tech companies weighted by market cap. Its largest holding is Apple at 26% and the fund's structure is "physical" ie, it owns the underlying assets.
- The Invesco US Technology Sector UCITS ETF (LSE: XLKQ) is a slightly cheaper alternative and caps any one constituent at 19% thereby reducing single-stock risk. The fund's structure is "synthetic" (swap-based) rather than physical – meaning there is counterparty risk.
- For those wanting a broader view, the Xtrackers MSCI World Information Technology UCITS ETF (LSE:XDWT) covers large and mid-sized listed technology holdings across the world expanding the universe to 195 names, but as a cap-weighted, index invested in physical holdings, it is still dominated by the US which makes up 86% of the index.

While investing in individual names can be interesting, tech-focused ETFs enable a more diversified approach. And for those concerned about concentration risks, a close look at the index rules and resulting holdings is informative.

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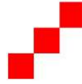

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