POLAR CAPITAL

Polar Capital Global Technology Fund

Fundamentals are cause for tech bullishness

Q: Gary Corcoran (GC): We've seen some softness in tech and AI trades in recent weeks. What does this mean for the underlying fundamentals of the companies?

A: Nick Evans (NE): We had a very strong start to the year for AI on the back of an extremely robust Q4 earnings season, with a lot of new data points. That got people very excited as the data points on AI were universally strong and people started extrapolating them. So, I think we always knew that wasn't sustainable. In that context, this has been a healthy reset.

We haven't picked up a single weak AI data point; maybe something like ASML orders were a bit softer but that's because they're trying to agree a deal with TSMC and we know it's coming, so it's not a negative data point. It's not fundamentally driven in our view. Expectations are a bit too high. Supply is constrained still and that will ease as we get into the back half of the year.

Regarding the macro backdrop, and by that, I mean interest rates; it's unhelpful to see rate expectations change that much and it's not good for growth stocks. If you look at the performance of the Goldman Sachs Unprofitable Growth Index, it's pretty dire because of that. So that was an additional headwind, but it's certainly not fundamentally driven. If you look at all the big hyperscalers or the big cloud AI players, they've all increased their capex materially. In aggregate we're now looking at 44% growth year-on-year. A quarter ago, not even that, we were expecting 26% and before that it was 18%. Since the start of the year, expectations have shifted from 18% to 44%. What's embedded in expectations for other AI stocks is still the old numbers. The expectations are very reasonable against very big capex numbers that are going to start to flow through, which is where you'll start to see strong earnings revisions if we're correct.

Q: GC: With inflation being stickier than expected and the Fed pushing its interest rate cuts out even further, how much of a headwind is that for you?

A: NE: It's unhelpful and expectations have changed a lot. We came into the year with the consensus for six interest rate cuts, and now we're dealing with the prospect of one or two. The fear was rates might get hiked on stagflation concerns. That just doesn't look likely and Fed Chairman Powell took that off the table himself. So, while we're dealing with 'higher for longer', I think the risk of a rate rise is extremely low. The macro data we're seeing suggests that inflation will start to ease. The labour markets are in better shape. The tailwind of excess savings is fading. You can even see it in some of the data; Amazon talked about consumers being more sensitive; Disney have reduced their outlook and Starbucks talked about it as well. There's a trading down and a squeeze on the consumer, and a healthier jobs market. That means rates are going to come down at some stage and that will be a fairly powerful tailwind.

You've got the productivity impact of AI to layer on top of that too. Productivity is improving, and that's not even because of AI yet, but once that starts to kick in, you could have even stronger disinflationary growth. I think that's a pretty compelling backdrop to us. It feels more like we're in 1995, both from a macro and a tech perspective - very early in a new cycle with strong potential growth. The bull case would be if the productivity gains kick in it would be more like the roaring '20s again. That's not our base case, but the macro backdrop feels pretty healthy. Higher for longer rates aren't great if you are investing in low growth equities, but we're not, we're investing in companies we think have very powerful growth ahead at the margin. It's unhelpful for equity flows, but I don't think it derails the tech or AI story in any way.

Q: GC: If fundamentals are intact and macros aren't your primary cause for concern, what are your views on valuations?

A: NE: Valuations aren't our primary concern either. I think the pullback that we've seen over recent weeks has actually opened up pretty interesting opportunities. We've been adding to positions, and we've moved to a fully invested position in the Fund. I look at all of the big bellwether tech stocks and the valuations look reasonable relative to the growth prospects. At the higher end you've got the NVIDIAs and AMDs and Microsofts of this world; at the lower end you've got the semiconductor companies like Qualcomm and TSMC. Somewhere in between, mid 20 - 23 x earnings, you've got some of the bigger internet companies, like Meta and Alphabet. That's not the sort of multiples that you see in a bubble and most of those companies we see as winners. At its core, big companies are valued pretty attractively relative to their growth prospects.

Nick Evans, Partner, Polar Capital Global Technology Team

May 2024

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