What the Tech: A Recap of the Past Quarter and Our Outlook Ahead

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Market Sector Update

The abrupt sell off of global equities in February set multiple records for all the wrong reasons. The rapid global spread of the COVID-19 virus reached pandemic proportions and prompted an unprecedented shuttering of businesses, cities, and national borders. In what will go down as one of the most rapid destructions of wealth in modern history, the S&P 500 index tumbled 33.8% from its all-time high on February 19, 2020, to the recent market low on March 23, 2020 (total return with dividends reinvested). During the same period, equity risk measures spiked as the CBOE Volatility Index (VIX) exceeded 80, a level not reached since the 2008 Great Financial Crisis. The recent market volatility clearly reflects the difficulty investors are having as they attempt to grasp both the containment path of the virus and the global economic implications.

Not surprisingly, technology stocks fell with the broader equity markets. However, the downside was generally less severe given the technology sector's abundance of healthy balance sheets, generally high-quality operating metrics and ongoing tailwinds from strong secular growth trends. Although technology equities have been relatively buoyant, we did see an increase in the dispersion of individual stock returns with subsets of technology stocks, particularly those of high-growth companies, exhibiting sharply increased volatility. Our view is that this type of price dislocation often creates opportunities for disciplined investors with strong underlying research and a long-term investment perspective.

We believe many of the more attractive technology companies are integral players in some of the most exciting, fastest growing segments of our economy. These technology investments include those in mobile communications and remote work, automation and electrification, e-sports and computer-based gaming, data management and cloud infrastructure, e-commerce and online payments, and biotechnology drug discovery, to name a few. Many of these industries have companies which are, in fact, experiencing a revenue surge during this unique time as their products and services are proving critical in this new work environment. Other companies have business models based on secular trends that we expect will transcend near-term sales and supply chain disruptions.

Investment Outlook

Our outlook is one of great divergence between the short- and medium-term. We have been encouraged of late by COVID-19 case data, which appear to be showing signs of a plateau in many states and countries. We believe the combination of shelter in place orders, improving scientific understanding of the disease, and improved citizen prevention habits will all have a marked effect in reducing transmission. That said, we expect that, even if we begin to see the peak in case load, we are just beginning to see the tsunami of economic weakness—the scope of which may be unprecedented in modern history. The sudden stop in business activity and the broad ramifications on the world economy will become sharply apparent as lagging data are released over the coming weeks.

Countering this weakness is the level of global stimulus, both monetary and financial, which is simply staggering in scope. We are optimistic that, as the world marches forward in its battle against our invisible enemy, investors will begin to turn and look towards better days ahead, days in which we will see a strong fiscal backstop and highly accommodative monetary policy. We are certainly not Pollyannaish; this is without a doubt an economic crisis with the potential to have long-lasting effects. That said, we are also well aware that the stock market is the ultimate leading indicator, and we believe the recent market pullback has resulted in the rapid discounting of companies that are exceedingly well positioned to benefit from long-term secular trends. Near-term volatility feels inevitable, but we see a clear opportunity for longer term focused, thoughtful investors with an ability and a willingness to tolerate that risk.

From a market segment perspective, we are seeing opportunities in select semiconductors and, from a longer term perspective, artificial intelligence, automotive electrification, and 5G.We are incrementally more cautious on software, which was a strong performing sector through the sell off and may be undervaluing the risk of a pullback in IT spending. We are particularly cautious of projects that are non-essential, significant in scope, or complex in implementation, as we believe these are more likely to be pushed out in a tightening spending environment.