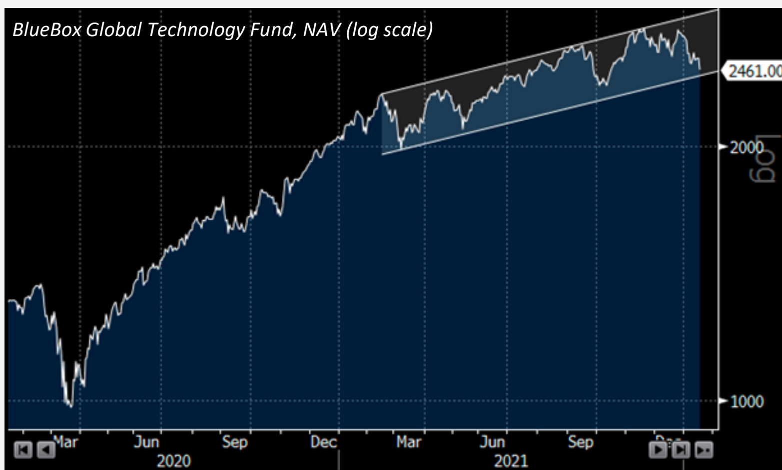
Global Technology Fund bluebox

Portfolio Manager Market Comment

Should we be worried by market weakness so far this year?

The start of 2022 has been pretty volatile, and much of the market commentary has focused on a rotation away from "Growth" to "Value", which is being taken as bad news for the Information Technology sector. Naturally, questions are starting to come in from some of our investors, so here is my attempt to answer them.

When will the current drawdown/capital loss within the portfolio finish?



It looks as though the BlueBox fund is still in the uptrend that started in February 2021. That's a 27% annual growth trend, so it's not sustainable (eventually in my view it reverts to mid/high-teens), but for now it is holding up, although we are currently near the bottom of it. So I think it's most likely that we bounce from somewhere around the current levels, as long as DecQ21 reporting season is good enough (it gets started properly on 27th Jan).

However, this may well be wrong: maybe (a) we are already moving into a new high-teens (slower) trend, or (b) the market is entering a digestion phase and needs to correct. The fund has only had ONE down month in the past 15 – that is NOT sustainable! At some point we will see a correction – I have no idea when, maybe it's now, but I don't believe it will be long or particularly deep, and it might be too quick to take advantage of.

How much further does it have to fall?

If we're sticking to the current trend, not very far at all. But that is a big IF! If the trend is flattening out to mid-teens growth, or if we are currently in a correction, then we could have significantly further to fall. However, we see nothing to reduce our confidence that the long-term trend of profitable tech is strongly upwards, so a sharp correction should present a buying opportunity.

There is always the chance that a surprise shock throws everything off course for a bit – currently a Russian invasion of Ukraine appears a possibility – at which point the internal dynamics of the technology industry take a back seat for a while. However, that is unlikely to change the long-term trajectory of the sector.

How will the forthcoming reporting season affect performance?

That depends upon whether it is better or worse than expectations, and there is plenty of evidence that can help us on this.

1. We believe that Direct Connection will keep the tech enablers on a mid/high-teens earnings growth trajectory for many, many more years, so the long-term trend is strongly positive. That's a great starting position.
2. There have been no negative pre-announcements of DecQ21 that I am aware of, so far. That indicates that almost no company has had a disaster and missed the management guidance given in Oct/Nov. That is a VERY good sign for the overall direction of the quarter: everyone is coming in "okay or better".
3. We have had two significant set of results in tech so far. First TSMC, which reports a couple of weeks earlier than almost everyone else, and its quarter was about as good as it gets, with a further, substantial, increase in its capex budget.

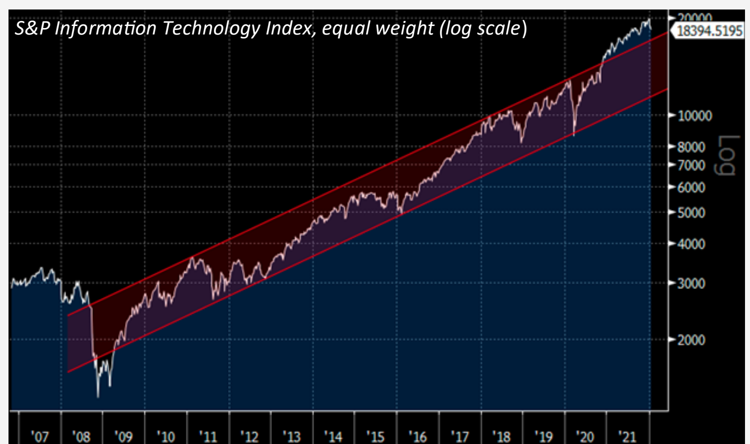
This shows extraordinary confidence in their order outlook for the next few years. TSMC is a huge portion of the logic semiconductor industry, and that industry is in turn the barometer of the IT sector as a whole. Tech is on fire (in a good way).

4. Secondly ASML, which just reported, and which is seeing such strong demand for its hugely expensive semiconductor manufacturing tools (they can cost more than $100 million each) that customers are asking for them to be shipped for immediate use, rather than tested by the customer first at ASML's facilities. Semiconductor order lead times continue to stretch out and chipmakers are desperate to increase their capacity to meet that demand. Again, tech is on fire (in a good way).

5. Meanwhile the market is confused about what "growth" means – so we see market commentaries stating that "growth" has been on a down-trend for a year, which is incorrect. What has actually been on a downtrend is "profitless growth", as shown in the chart of the ARK Innovation active ETF below (largely consisting of non-tech companies using technology to disrupt the health, consumer and industrial sectors, but losing lots of money buying tech to do that). For what companies with growing PROFITS have been doing, see the BlueBox chart above! That confusion is currently pushing the profitable growth companies towards the bottom of a strong upward trend, but my expectation is that by early February a strong results season will be pushing them back upwards.

Overall, BlueBox's "profitable growth" stocks tend to prove more resilient than either "profitless growth" or "growthless value" during periods of market weakness, and they then give us superior upside as sentiment improves.

Final point: we need to retain a sense of proportion. The chart to the right is the best long-term representation of what the tech sector is doing: it is a log chart of the equal-weighted S&P Technology index – this is the long-term performance of the AVERAGE large-cap US tech stock. You can see the current dip, but you may need a magnifying glass to make it out.



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