

Portfolio Manager View: Brad Slingerlend and Denny Fish

Brad Slingerlend and Denny Fish, Portfolio Managers within the U.S.-based Global Technology team, share their outlook for 2018, and discuss the positive trends they are seeing around their favored investment areas.

What lessons have you learned from 2017?

2017 reinforced our view that within technology, while an awareness of the macroeconomic environment is important, a focus on corporate fundamentals ultimately drives investment returns. We saw this as the technology sector recovered from weakness following the U.S. presidential election and delivered strong performance over much of the period. This was the result of investors recognizing the sector's solid earnings and growth prospects.

What are the key themes likely to shape the markets in which you invest in 2018 and how is this likely to impact portfolio positioning?

We seek to invest in companies tied to broad growth themes that stand to play out over years – not quarters. We see evidence that the transition to the cloud and the deployment of the Internet of Things (IoT) are accelerating. Looking into 2018, we believe even more technology customers will come to recognize the cost savings and security benefits associated with the cloud and Software as a Service (SaaS) when compared to legacy on-premises applications. We expect that the refinement and adoption of artificial intelligence (AI) will further entrench these themes as key shapers of the technology sector in the years to come. What further excites us is that these are now gaining traction in Europe and Asia.

We believe that there is an important difference in the sector between the late 1990s and today. At that time, stocks were priced off the “hope” of the Internet. Today's much more reasonable valuations are based on the reality of the Internet rewriting a new digital operating system for the entire global economy.

Another of our favored themes is the digitization of China's economy. We believe the rapid adoption of web-based services in China should allow the country to leapfrog the legacy economic models that presently weigh down many advanced economies.

Where do you currently see the most compelling opportunities and the risks within your asset class?

Semiconductors will be instrumental in the deployment of the cloud and IoT. Not only will IoT lead to a proliferation of “smart products,” it will also connect myriad other devices through sensors and radios that will gather data to be analyzed by cloud-computing platforms. Rather than viewing the recent strong performance of IoT-exposed companies as temporal, we believe it is the advent of a long-term trend that will reshape how technology is utilized across all industries.

With the connectivity provided by semiconductors at the nexus of this megatrend, we have reasonable expectations that chipmakers may take the reins of technology leadership alongside the Internet and software. As companies and households first embraced computers and then the Internet in the 1990s and early 2000s, semiconductor revenue growth exceeded



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that of GDP by two to three times. In recent years, the rate has downshifted, often only matching the pace of GDP. We expect IoT to act as a catalyst for semiconductors again achieving or exceeding those historical growth rates.

The semiconductor industry has also helped itself. A wave of mergers has led to more efficient supply and, in our view, markedly more well-run businesses. We expect that fewer companies should lead to more industry discipline and improved pricing power.

While we are enthused by these forces, we keep a constant eye on risks that may adversely affect the tech sector. At present, what most merits our attention is the possibility of regulatory encroachment. We have recently witnessed a wave of events that have the potential to snowball into a movement calling for greater privacy protection for customers. So far, governments have largely shown a light hand toward Internet regulation. A possible shift may come from Europe where authorities are planning to place regulations on the use of data.

Glossary:

Corporate fundamentals: information that contributes to the valuation of a stock, such as a company's earnings or the evaluation of its management team, as well as wider economic factors.

Internet of Things (IoT): the concept of connecting any device to the Internet (and/or to each other).

Software as a Service (SaaS): a software distribution model where a third-party provider hosts applications and makes them available to customers over the Internet.

Cloud computing: managing IT services remotely by buying computing and storing technology from specialized service providers over the Internet.

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Technology industries can be significantly affected by obsolescence of existing technology, short product cycles, falling prices and profits, competition from new market entrants, and general economic conditions. A concentrated investment in a single industry could be more volatile than the performance of less concentrated investments and the market as a whole.

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