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2020 Fund Perspective

# FF – Global Technology Fund

March 2020

## Coronavirus: what is the impact on the portfolio strategy and the sector?


**Summary**

- COVID-19 has disrupted China's technology supply chain to various degrees, but we expect manufacturing to revert to more normal levels by the end of March
- Hardware and semiconductor segments, and areas related to consumer discretionary spending, business travel and conferences will be impacted
- Video-gaming and digital media will be net beneficiaries
- We continue to seek opportunities in the current environment – and have added high-quality semiconductor and US names to the portfolio
- While there will be a short-term impact to fundamentals, the long-term portfolio themes remain intact


### What is the impact on the technology supply chain?

The shutdown of manufacturing activity in China due to the coronavirus, known as COVID-19, has disrupted the country's technology supply chain to various degrees.

For those areas that are fully automated, such as semiconductor fabrication, there has been little impact with 100 per cent utilization since the outbreak. However, manufacturing processes that require a level of labour involvement, have inevitably been disrupted and that is now slowly coming back − we expect utilization rates to gradually increase from roughly 50 per cent today, to full capacity by the end of March.

### Which technology segments are more likely to be impacted by the disruption?

Globally, areas that are more susceptible include:

- **Hardware and semiconductor segments** – more integrated in the global supply chain than other areas.
- **Consumer discretionary spending related segments** – weaker offline shopping demand with consumers staying at home, and weaker consumer confidence in times of uncertainty.
- **Business travel and conference related segments** – imposed restrictions and cancelations will also dampen demand for tech in these areas.

### Which technology areas will be cushioned in the current environment?

Areas of technology that will not be negatively impacted by the epidemic include:

- **Video gaming** – with more people staying at home and playing games, this is an area we see as being a net beneficiary of this health event. The revenue impact on such gaming companies will be positive.
- **Digital media** – consumption will increase as people stay at home. Providers such as Netflix will see subscriptions increase and would also be a net beneficiary.

### What is the impact on the portfolio?

Given the demand driver for technology is structural and not cyclical, our long-term themes of cloud computing, artificial intelligence, machine learning, 5G rollout, electric vehicles and digital media consumption, remain intact. Long-term, the health event could be positive for technology demand, as people look to increase sensors and analyse more data as a result.

We continue to seek attractive opportunities, particularly in the current volatile environment, and have added high-quality semiconductor names to the portfolio.

US technology stocks have fallen further than the rest of the world − with more forced sellers and index-driven strategies in that market − so we have also added high-quality US names to the portfolio in recent weeks.

**While we believe there will be a short-term impact to fundamentals, the long-term themes of FF-Global Technology Fund remain unchanged:**

| Impact on portfolio themes |
|---|
| ▪ Cloud computing will continue to provide more services, particularly if technology demand increases post-epidemic. |
| ▪ Artificial intelligence and machine learning will increase due to greater demand for analytics. |
| ▪ 5G buildout will continue to be a strategic initiative for telecom operators, we don't see this being pushed out because of the health event. |
| ▪ Digital media consumption will increase, particularly as more consumers remain at home in the current environment. |
| ▪ Video-gaming will also increase, as consumers remain at home, play games and purchase more items. |
| ▪ Electric vehicles – such as the electrification of power trains – will also continue. |

## Key questions and answers

**Will there be longer-term implications when it comes to companies choosing where to set up production facilities, to reduce concentration risk?**

Companies have already been diversifying their manufacturing locations. And though tech manufacturing has been highly concentrated to China, diversification efforts have been underway – and regardless of COVID-19, we believe these efforts will continue.

**Has COVID-19 exacerbated deglobalisation and the splitting of the two technology ecosystems between China and the rest of the world?**

We believe the US-China trade tensions and the impact of the coronavirus are separate issues.

Regardless of this grey swan event, China will continue its efforts to become increasingly independent of the West, in terms of building its technology ecosystem.

**How will supply chain disruption impact earnings for the likes of Apple and Microsoft?**

Both Apple and Microsoft have indicated they won't meet earnings guidance, and this stems from both demand and supply dynamics.

From a demand perspective, consumers are staying at home and not engaging in offline shopping, and this is coupled with weaker confidence during uncertain times. This impacts demand for both Apple and Microsoft products. Additionally, for Microsoft in particular, weaker demand from the corporate PC market due to the shutdown of offices will inevitably impact their enterprise PC business too.

On the supply side, there is the obvious impact of disruption to manufacturing processes. For example, Hon Hai Precision Industry, which supplies Apple with electronic manufacturing services, is seeing their manufacturing capability slowly return, and has said their facilities will be 100 per cent utilized by the end of the month.

**What are your views on increased scrutiny and new regulation in the technology space?**

We believe regulatory scrutiny will continue, but it may not necessarily be a negative for large technology companies. Given there are no guidelines at the moment, clear and healthy guidelines could be seen as positive for these companies' fundamentals, in our view.

**What are your views on the technology sector now, given it has been 20 years since the 'dot-com' bubble?**

We are positive on the sector's fundamentals and valuations – and there are significant differences between markets today and in 2000.

Fundamentals today are very solid and based on real demand (cloud computing, digital advertising, e-commerce) – companies are generating revenue and profit. Back in 2000, tech demand was driven by the hope for future demand, companies didn't have solid business models to monetise web traffic, and there was overbuilt capacity.

And valuation sentiment today is much more rational – trading around roughly 20x price-to-earnings; compared to headline valuations of 50-60x in 2000.