Impact of large tech stocks on investor portfolios

Wynand Venter, Glacier International Business Development Manager, facilitated a discussion between Walter Jacobs, Chief Investment Officer and Portfolio Manager of BlueAlpha Investment Management and Malcolm Hoare, Sales and Distribution at Sarasin and Partners.

The decade of US technology stocks

According to Malcolm, the last decade has been the decade of US technology stocks, although the tide has turned this year. We see that in the last three years there have been a limited number of the so-called super cap stocks that have driven the market. The traditional market-cap weighted indices have outperformed the equal-weighted indices, driven by these stocks.

“So, yes, we’ve seen a rise of US superstar companies, but this is not a new phenomenon,” said Malcom. “In the 1800s, the railroad companies were the superstar companies in the US. John Deere was founded in 1837 and is still listed today. Over the last 40 or 50 years, agriculture equipment has kept pace with inflation, whereas John Deere has grown sales at a far greater rate than inflation and created a company that’s done exceptionally well in portfolios. They’ve kept on innovating,” he said.

Finding these winners is no easy task. At Sarasin, the team has a thematic process, and tries to find above-average companies by looking forward 10 or 15 years based on their mega themes, which include ageing, evolving consumption, climate change, digitalisation and automation.

Digitalisation

According to Malcom, many of the outstanding consumer technology companies start up in a disruptive growth phase. But it’s important to find the companies that deliver a good dividend and hold them in the portfolio for security. An important point to note is the fading winners – examples include Nokia, Blackberry, and 3M – history is littered with examples of these types of companies that do really well and then fade. One needs to be careful when looking at the current winners.

“The last decade was definitely a winning streak for consumer technology stocks, so we think perhaps going forward we may get some benefit out of industrial technology,” he said.

Is there opportunity in growth?

PwC releases a list of the 100 largest companies annually and the market capitalisation of these accounts for almost USD 32 trillion. The US dominates the list with around 60 US companies, followed by Europe and then China. This raises the question around whether there is still opportunity in growth in US?

Walter believes there will always be opportunities. “Looking at the MSCI World Index, we see the US percentage of the US MSCI to the MSCI World is 63%. If we look at GDP and adjust the numbers for purchasing power parity, then US GDP is only 15.48%. There’s a big disconnect between 60+ percent market capitalisation vs only 15% GDP,” he said. “The mega cap US businesses don’t just generate money from the US, but also from other parts of the world. Apple, for example, generates less than 40% of its revenue from the US and Johnson & Johnson only 50%. You can’t just look at size or market cap alone.”

Walter emphasises that they look at investments from a company level, not at a country level. There will always be opportunities at a company level. “In SA, growth has been very low but Edgars, for example, has had challenges and that in turn has provided opportunities for the likes of Mr Price or Foschini, and given them the opportunity to grow. Similar things happen in the US and that’s why there will always be opportunities,” he said.

Malcolm stated that Sarasin builds portfolios from the bottom up and that where the company is listed is less relevant. “67% of the earnings of the FTSE 100 come from outside of the UK. We’re slightly overweight UK but it’s not a true reflection of where you find the viable investment ideas,” he said.

There’s been double-digit growth over the last three years out of the US, but towards the back-end of last year the market started discounting rising interest rates, resulting in the rotation from growth to value and this has intensified this year.

“Value is re-emerging in the growth story, with many stocks down (e.g. Netflix, Tesla, Facebook) but these companies are going to have to maintain their growth because it’s the earnings that count,” said Malcolm.

Where to find the future superstars

As a thematic house, Sarasin looks forward 10 to 20 years and considers the trends that will unfold in the world, especially in the area of climate change, but also evolving consumption, age (the "grey dollar"), and urbanisation. "There are methodologies we can employ to try and find those companies," said Malcolm.

Is there still money to be made in technology stocks?

BlueAlpha firmly believes the answer is yes. They focus on a company's operating and economic profit and with companies such as Apple, that is still steadily growing. "Yes, Apple has competitors but comparing the return on capital, we see that Samsung's is half that of Apple. Nothing has changed on the operating front for Apple and that's what we watch. The same can be said for Microsoft and Amazon. We continue to hold fairly significant part of our portfolio in US technology stocks," said Walter.

Sarasin has not been a holder of Apple, although the company is happy to hold Amazon. "We look for businesses with a secure moat, and sustainable long-term earnings," said Malcolm.

Passive investing and the implications for clients

Sarasin is an active manager, but Malcolm acknowledges the benefits of blending both active and passive strategies. "What we do say is that investors need to be cognisant of which tracker or index they're in because if mega cap stocks are driving the index and they don't do well, then your investment won't do well," he said. "We've seen a massive dispersion of returns coming through and this tends to favour active managers."

Walter agreed that there is a place for both active and passive strategies.

Should investors buy into these companies or "wait-and-see"?

Walter stressed that BlueAlpha does not time the market. He urged investors to keep investing. He also urged investors to remember that when it comes to global investments, they probably don't have enough exposure. "If you're earning an income in SA, own a house here and your retirement fund is here, you need to ask whether 30 or 45% offshore exposure is enough," he said. "Any discretionary money should be invested offshore and don't try to time it – just invest consistently."

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