iShares by BLACKROCK®

Why the tech sector glass is half full

Sentiment toward technology stocks is oscillating between optimism and scepticism. We dig into tech sector opportunities–and obstacles.

Technology has been one of the best-performing sectors globally this year, accounting for roughly half of U.S. and emerging market (EM) Asia equity returns so far. Yet investors are torn between optimism on this fast-growing, high-earning sector and scepticism given its meteoric rise and memories of the dot-com bust. Our bias is to the former. We see opportunity in firms that are able to monetise their technology amid structural shifts.

Investors have tended to overestimate the near-term effects of technology and underestimate the long-term potential. But we see disruption and transformation across the technology universe creating attractive long-term investment opportunities for both growth and income seekers.

Technological disruption has only just begun: Digital has yet to permeate many industries; e-commerce represents under 10% of all retail sales; traditional devices are becoming connected via the Internet of Things (IoT); and artificial intelligence (AI) is starting to transform processes.

The many intricacies of tech may be outshone by high-flying headline makers: the U.S. FAANG stocks (Facebook, Apple, Amazon, Netflix and Google's parent Alphabet) and their powerhouse equivalents in China – BAT (Baidu, Alibaba and Tencent). Both groups have propelled their regional stock markets higher year-to-date. FAANG returned 35% compared to 10% for the remainder of the S&P 500, while BAT returned 81% versus 26% for the remainder of the MSCI China Index.*

* Sources: BlackRock Investment Institute, with data from Bloomberg, September 2017.

But healthy corporate earnings and upbeat forecasts have been the drivers of technology performance, in our view, not "irrational exuberance." The increase in global tech valuations has surpassed the broad market, but we see the move as largely warranted. Our base case: Technology broadly, including players outside the sector label, appear to have legs—even after a strong run.

Many companies beyond the popular acronyms hold appeal for diversified portfolios. Equities have become a critical income source in traditional 60% shares 40% fixed income portfolios, our analysis shows. Tech can play a lead role: The sector is home to many high-quality mega-cap stocks that offer healthy and growing dividends. Many more companies outside the tech sector label are leveraging data and analytics to evolve their business models. We believe the winners of the race to embrace new technology will be those companies that are least complacent today.

Semiconductors in particular are a story worth a read, we believe. We view them as both the backbone and the future of the tech industry. The once highly cyclical group is benefiting from a more diverse demand base, reduced supply after years of consolidation, and new applications in a data-driven world. But the industry may face real competition from China, which has named semis as a strategic priority.

We do see two would-be obstacles for technology stocks in general. We are worried about profit-taking in the short term, as nervous investors look to lock in gains and redeploy their capital in other opportunities. In the longer run, potential regulation is a concern, as the sector's size and influence draw the attention of policymakers. Yet strong fundamentals make this sector a long-term buy, in our view.

Want to know more?

blackrock.com/au/ishares iShares.Australia@blackrock.com 1300 474 273

IMPORTANT INFORMATION

iSH–5842–26.10.17

BLACKROCK®

MKTG1017A-280628-864987