Affin Hwang World Series
Next Generation Technology Fund

13 September 2022

Generational Opportunity in Technology

In Collaboration With BlackRock

The technology sector has endured a volatile period amidst rising interest rates and recessionary jitters. However, current valuation levels present a generational opportunity for long-term investors to build and add exposure to one of the fastest-growing and innovative sector historically.

First, A Look Back...

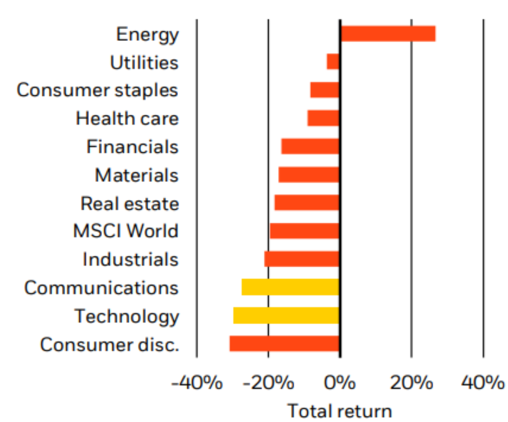
The first half of 2022 brought one of the most volatile periods of market behaviour in decades, with the MSCI ACWI declining -20.2% while experiencing large swings in price movement.

The majority of the volatility came about as a result of investor concerns regarding persistently high global inflation, uncertainty regarding Fed actions, and the Russian invasion of and continuing war in Ukraine.

While the broader equity markets experienced challenging performance during the period, the majority of the weakness has been concentrated in risk-on assets. This is primarily in companies deemed to be of higher growth (long-duration assets) and with higher multiples. Given the typical high-growth profile of technology companies, the sector has been one of the worst performers over the period.

Regionally, continued geopolitical conflicts, China's zero-COVID policy, and ongoing macroeconomic challenges in Latin America have dampened sentiment for emerging market equities across the board likewise.

Sector performance YTD



Source: Refinitiv Datastream, MSCI and BlackRock Investment Institute. July 1 2022 in USD

Fundamentally challenged or sentiment shift?

Many areas of the technology sector are currently trading at pre-pandemic multiples, erasing many of the gains that were experienced over the past two years due to exuberant multiple expansion following a pull forward of demand during 2020 shutdowns.

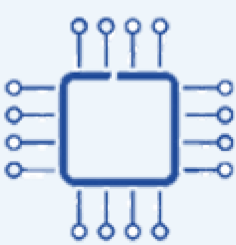
While the market selling for many of these industries was indiscriminate, it is important to understand whether these were driven by sentiment-led multiple compression, or fundamental shifts to the future potential growth of these businesses.

Software

The outsized drawdown of software companies, particularly in the small and mid-cap range of market capitalisation, appears to be a significant opportunity over the medium term.

That said, we recognize that market volatility is likely to persist in favour of risk-off assets, and as a result favour selectivity within software, concentrating around companies with strong growth trajectory but positive free cash flow.

Recurring revenue business models and economically-resilient businesses, such as cloud computing or cybersecurity, may outperform as companies look to replace potential personnel costs with more efficient tools and technology in a recessionary environment.



Semiconductor

As we look to the rest of the year, we note that many semiconductor companies that experienced a pull-forward in demand in anticipation of higher chip prices may face cyclical weakness over the next few quarters.

In addition, we maintain a neutral view on companies closely tied to consumer goods and economically-cyclical products, which may experience weakness in demand as inflation continues to impact consumer spending and the likelihood of a recession in 2023 increases.

Elsewhere, chip companies more closely tied to resilient business models and stable client bases (such as hyperscalers and data centres), appear attractive from a valuation perspective.

Longer-term, segments of the market (such as silicon carbide power semiconductors) that are benefiting from secular growth trends like electric vehicle adoption continue to be bright-spots in the industry.

Services

In 2020, the COVID-19 pandemic and subsequently social distancing restrictions led to an acceleration of adoption in many consumer technology businesses, particularly in the services industry (fintech, grocery delivery, telehealth, etc.).

The fintech market continues to display supportive tailwinds, such as continued room to run in penetration of many products and services. At the same time, the industry faces challenges, including more competition and commoditization in an increasingly crowded market.

We maintain exposure to high-conviction fintech companies, but remain divested from emerging markets fintech given currency and inflationary challenges in many of these regions. We see many IT services companies as continuing to provide a more value-led defensive tilt in the medium term and as such maintain a positive view on the industry.

Internet

The internet industry, primarily categorized by ad-based social media and e-commerce companies faces many headwinds from a returns perspective in 2022.

Some of the most well-known internet names (Snap, Netflix, Meta, Amazon, and Alphabet), have seen an average return of -51% year to date, with many of them now trading at decades-low multiples.

Given the nuances of company-specific fundamental challenges, we maintain a mixed view on the internet sector today, preferring companies with diversified revenue streams (such as Alphabet's various Google Services products or Amazon's highly profitable cloud computing business), and those with strong competitive moats in their respective markets.

That said, we continue to see challenges for many of these companies as recessionary fears impact advertising budgets over the next 6-12 months.

Risks & Opportunities

Selectivity will be key in the post-pandemic world. Fundamental challenges and macro trends like deglobalisation will create risks and opportunities across technology.

While some of the factors that have increased the shift to risk-off sentiment have proved to be short-term (such as pandemic-related supply chain shortages), many key elements have shown additional stickiness in economic impact. The persistently high levels of inflation remain a key metric to watch, as historical analysis shows that high inflation is closely correlated with weakness in high-growth stocks.

That said, to the extent that inflation can be marginally eased by improvements in the Russia-Ukraine war or China's COVID-19 policy requiring shutdowns of manufacturing regions, we may see a catalyst for improved market sentiment.

Ultimately, we anticipate that inflation will remain above pre-pandemic levels, leading to a type of market regime that may not as easily replicate the growth-favoured bull market of the past 10 years.

In addition, maturing businesses and increased competition in areas like internet and services may lead to increased dispersion going forward, requiring more in-depth understanding of company-specific drivers and risks than has been needed over the past decade.

Lastly, we remain selective on emerging market technology names in the near term, recognizing the incredibly attractive valuation profiles of many of these high-growth companies and adding to select high conviction opportunities.

In markets with higher inherent risk, we prefer exposure to foundational technology companies, primarily in the software and semiconductor industries, that are mission-critical to the domestic technological development of these nations.

Conclusion

1. Volatility Here to Stay

Key factors including China COVID policy, geopolitical conflict in Europe, recessionary risks will continue to add uncertainty to markets.

2. Generational Opportunity in Tech

The sell-down presents a unique opportunity for investors to add exposure to the most profitable, innovative and fast-growing companies in the tech sector.

3. Innovation Leaps in Technology

Multiple secular trends will continue to propel and drive growth in the technology sector over the long-term.

These include the digital transition to themes like the:-

- metaverse,
- Web 3.0,
- decentralized finance and blockchain,
- innovation within semiconductors and;
- Artificial Intelligence (AI)

Invest in the Next-Gen

In partnership with BlackRock, Affin Hwang AM launched the Affin Hwang World Series – Next Generation Technology ("the Fund") which provides access to opportunities in the next generation of technology companies globally.

By focusing on emerging hyper-growth companies leading the digital wave, the Fund provides investors an avenue to capture the next vanguards of innovation in a growing tech universe.

Book an appointment with us today to learn more.

Click the link below or scan the QR code beside

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