Tech stocks' short-term struggles may lead to long-term buying opportunities

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Technology stocks have been under pressure this year — thus far, the tech sector has been the second-worst-performing sector in the S&P 500 Index in 2021.[1] However, while I don't expect tech stocks to lead the market in performance very soon, I think there are some compelling reasons for investors with a long time horizon to treat any significant tech sell-offs as buying opportunities.

What has happened to tech this year?

Tech's underperformance started with the announcement last November that highly effective vaccines had been developed to protect against COVID-19. This was a "game changer" — a critical development that caused the stock market to anticipate a strong economic recovery, which meant cyclicals started to outperform more defensive areas of the stock market such as technology.

Then in the first quarter of this year, the 10-year US Treasury yield rose rapidly, most negatively impacting, higher valuation equities such as tech stocks.

In addition, there are also concerns that some tech companies will come under heavier governmental regulation.

Reasons for tech optimism

So why do I believe that any significant tech sell-offs would represent a buying opportunity for long-term investors?

Earnings and revenues are attractive for technology. First-quarter earnings season is almost over (as of May 21, 95% of the companies in the S&P 500 Index reported earnings for the first quarter) and the tech sector delivered a strong performance.[2] Tech was one of two sectors that had the highest percentage of companies that reported earnings above estimates — a whopping 94%.[2] And it's not just earnings — tech had the highest percentage of companies reporting revenue above estimates as well at 94% (followed by communication services, which includes a number of stocks formerly classified as part of the tech sector at 88%).[2] And tech is one of the sectors that reported the largest positive spread between actual revenues and estimated revenues.[2] And the tech sector is reporting the highest year-over-year revenue growth of all 11 sectors at 21.5%, with four of the six industries in tech having reported growth above 15%.[2] These results certainly help to justify current valuations, which are on the rich side but remain well below valuations during the tech bubble.

The future also looks attractive for tech. Estimates for calendar year 2022 indicate that the tech sector is expected to have the fourth-highest revenue growth of any sector.[2] Another important point to make is that the tech sector has the greatest non-US revenue exposure of any sector in the S&P 500 Index — 57% of tech companies' revenues are derived from outside the US.[2] Given that we expect economies outside the US to follow the US into a stronger recovery as economies re-open, the tech sector's strong revenue and earnings may have longer legs.

Post-pandemic themes have staying power. The pandemic resulted in people spending virtually all their time at home — working from home, exercising from home, being entertained from home, and shopping from home. While economies are re-opening and people are no longer at home full-time, some habits have developed that are likely to continue.

For example, e-commerce sales have dropped recently as COVID-19 infections have fallen and people have spent less time sequestered at home; however I expect they will remain a very substantial portion of overall retail sales — and that portion will soon resume its rise as a percentage of overall retail sales. Consumers recognize the convenience of shopping online, especially as Internet retailers continue to improve delivery times. While some people are likely to go back to the gym, a significant portion of consumers will continue to exercise from home at least part of the time given all the products that have been developed to enable workouts from home.

Fintech is another theme that gathered steam during the pandemic as more transactions became electronic. For example, while consumers are now spending more time dining and shopping in person, they are less likely to carry cash than they were prior to the pandemic. I expect greater reliance on electronic forms of payment to continue.

Finally, many employees are not planning to return to an office full time. Many expect to now be "hybrid" — working part of the time from home and part of the time in the office. Companies will need to continue to spend on technology in order to enable employees to work from home at least part-time. And that brings me to my next point ...

Corporate spending on technology is expected to accelerate. Companies in general have higher levels of cash that they can deploy on tech spending. They reduced their tech spending in 2020, and therefore need to spend more in 2021 in order to keep up. Global information technology spending is expected to rise 8.4% in 2021, and it's projected that the IT spending focus for 2021 will be on revenue growth.[3]

In addition, technology may offer solutions to the problems that many companies are facing today. The hacking of the Colonial Pipeline just a few weeks ago underscored the vulnerability of so many private entities that are charged with protecting themselves from cyberattacks. I would expect to see more spending on cybersecurity — and more innovation to meet these challenges. Similarly, some companies in certain industries are finding it difficult to source qualified employees, and are turning to technology for the solution. As I mentioned in a previous blog, the Cleveland Fed reported in the most recent Federal Reserve Beige Book, "In some cases, contacts indicated that they were planning to adopt more technology (in lieu of more employees) to keep up with demand."[4]

Personal spending on technology may also accelerate. There are elevated household savings levels in a number of countries, and there is the potential for it to be spent at least partially on personal technology — for example, the newest smartphone or tablet.

Conclusion

In short, despite the shorter-term headwinds, technology is a long-term force that offers solutions for today's problems and sparks creative disruption across industries. I believe it's an exciting time to be a global technology investor, with dips in valuations rendering attractive entry points.

Source

[1]Source: Bloomberg, L.P., as of May 21, 2021

[2]Source: FactSet Earnings Insight, as of May 21, 2021

[3]Source: Gartner Group, April 2021

[4]Source: Federal Reserve, Beige Book, April 14, 2021