ANALYST WEEKLY

The opportunities within 'tech'

14.FEBRUARY.2022

Summary

Focus: looking for opportunities in 'tech'

'Tech' is now bigger and much more diverse than it seems. We look for correction opportunities as Fed risks are now better priced, and tech' secular growth is still compelling. The cheapest 'tech' industries are telecoms (like VZ) and biotech (like ABBV), and the cheapest tech growth in internet retail (AMZN) and machinery (DE). Priciest tech includes defence/aerospace (RTX) and healthcare equipment (MDT). We favour all-weather 'big tech' versus 'disruptive tech' as enter a tougher macro-economic investment world. See Page 4

Fed fears stalled the markets rebound

Volatility returned to markets. 7.5% US inflation and geopolitical tensions halted a building rebound. Investors boosted bets for a 0.5% start to Fed interest rate hiking cycle on March 16, 10-yr bond yields soared to over 2%, and oil spiked to $95/bbl. See our latest presentation, video updates, and twitter @laidler_ben. See Page 2

Worst performers of 2021 leading this year

Many of 2021 worst performers now leading this year, like Brazil (EWZ), UK (ISF.L), China (MCHI). Similar to US 'dogs of the Dow', with the cheapest and most out-of-favour rebounding. See Page 2

Interest rates rising everywhere

US not raised interest rates yet, but the global trend has changed with 100 hikes last year and this year likely twice that. History shows markets often react with relief to a first hike. See Page 2

Junk bond alarms sounding

US junk bonds (JNK, HYG) have been selling off, and is often an alarming equities lead-indicator. But we think this is a false alarm. See Page 2

Some Valentine's Day relief

Our 'Valentine's' price index has sat out the huge commodity rally. This is good news for romantic Feb. 14 consumers. See related stocks from Hershey (HSY) to Richemont (CFR.ZU). See Page 2

Crypto assets hold over key levels

Bitcoin (BTC) and Ethereum (ETH) rallied above key $40,000 and $3,000 levels. XRP (XRP) led gains after rulings in Ripple's long-running SEC lawsuit. Blackrock (BLK), the world's largest fund manager, to launch crypto services in latest sign of institutional investor adoption. See Page 3

Commodity rally alive and well

Brent crude oil prices hit a high $95/bbl. as US inventories fell to their lowest since 2018 and Russia-Ukraine geopolitical tensions spiked. This offset US-Iran nuclear talks progress. Russia and Iran are both top-10 oil producers. We see commodities in a rare 'sweet spot'. See Page 3

The week ahead: Fed, earnings, geopolitics

1) See wind down of positive US Q4 earnings with NVDA, CSCO, WMT, DE, CAR, MAR. 2) Fed minutes (Wed) and latest retail sales to focus on hawkish tightening cycle and US consumer resilience. 3) China likely to continue as only global central bank to be cutting interest rates. See Page 3

Our key views: Earnings to offset valuations

We see a positive 2022, but with lower returns and higher volatility than last year. Economic growth is strong and earnings forecasts too low. Valuations are the risk as interest rates rise from still very low levels. We focus on cheaper and cyclical assets that have strong growth and offer defence to valuation risks: like Value and overseas equities, and commodities. See Page 5

Top Index Performance

	1 Week	1 Month	YTD
DJ30	-1.00%	-3.27%	-4.40%
SPX500	-1.82%	-5.24%	-7.29%
NASDAQ	-2.18%	-7.40%	-11.85%
UK100	1.92%	4.26%	3.74%
GER30	2.16%	-2.88%	-2.89%
JPN225	1.67%	-2.78%	-3.81%
HKG50	1.36%	2.15%	6.45%

*Data accurate as of 14/02/2022

Market Views

Fed and Russia fears stall the markets rebound

- Volatility returned to global markets. Higher 7.5% US inflation and Russia-Ukraine tensions halted a building rebound. Investors boosted bets for a 0.5% start to the Fed interest rate hiking cycle on March 16, and 10-year bond yields soared over 2%. The USD strengthened and oil hit $95/bbl. DIS and KO continued the strong Q4 earnings season. US profits are now up 30% and Europe's over 50%. This week the focus is the Fed minutes, China rate cuts, and remaining Q4 earnings. See **Page 6** for our Resources guide of reports, webinars, presentations, videos, and twitter**.**

Worst performers of 2021 leading this year

- Many of the worst performing markets of 2021 are now leading this year, like Brazil (EWZ), UK (ISF.L), China (MCHI). This is similar to the US 'dogs of the Dow' phenomena of cheapest and often worst-performing and most out-of-favour assets of the prior year rebounding the next.

- We are bullish many of these cheaper and often more-cyclical overseas markets. China is cheap, focused on stability, and uniquely cutting interest rates. The UK also cheap, seeing 200% earnings growth this quarter, and with a market focused on financials and commodities.

Interest rates rising near everywhere

- The US has not raised interest rates yet, but the global trend has decisively changed. There were 100 hikes last year and this year is annualizing at twice that. This is driven by economic growth and inflation, which boosts company profits.

- But higher interest rates and rising economic slowdown risks also hurts valuations. This is a new global investment regime of lower, but still positive, returns and more volatility, and drives focus on cheap sectors and overseas markets. The global history shows markets often react with relief to the first hike, as well priced in.

Junk bond alarms are sounding

- US junk bonds (JNK, HYG) have been selling off and ignoring the recent equity rebound. This is unusual as they normally move together. And concerning as junk bonds are often a lead 'canary-in-the-coalmine' indicator. It is key to consider what fixed income markets tell us, from recession probabilities to equity risks.

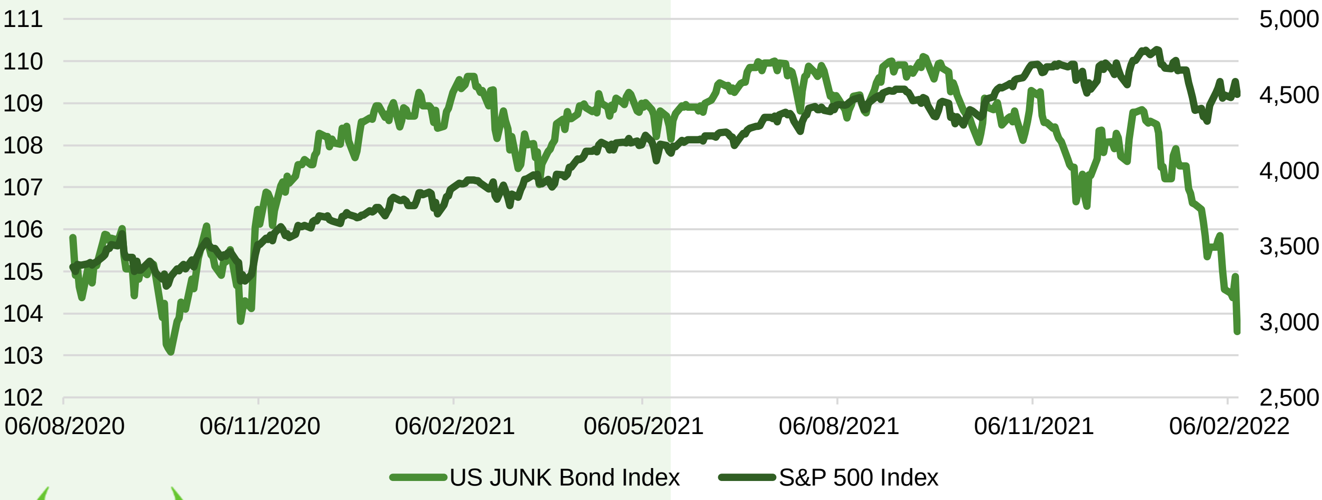
- We think this is a false alarm, with earnings still strong, GDP to firm as omicron eases, and the Fed interest rate outlook already hawkish.

Valentines Day relief

- Commodities are off to one of their best starts ever. But not all have soared. Our 'Valentine's' commodity price index has bucked the inflation surge and is flat versus the 30% commodity surge in the last year. This is a relative bright spot for squeezed romantic consumers.

- US Valentine Day spend is seen at $24 billion this year, or a romantic 10% more than last year, to $175. Most popular are candy (56%), flowers (37%), and jewellery (22%). Bullishly, 're-opening' activities like an 'evening out' (24%) and 'experiences' (41%) – concert or sports events – rebounded. 8% want crypto! Related stocks range from Hershey (HSY) to 1-800-Flowers (FLWS) and Richemont (CFR.ZU).

US Junk bond (LHS) performance vs S&P 500 (RHS) - 18 months



Source: Refinitiv, Proxied by HYG high yield bond ETF

Market Views

Crypto assets rebound

- Bitcoin (BTC) and Ethereum (ETH) rallies have accelerated above their key $40,000 and $3,000 respective price levels, as broad risk aversion eased, and after assets median -50% correction.
- XRP (XRP) led gains, rising near 50% last week, helped by perceived favourable legal rulings in Ripple's long-running lawsuit with the SEC. Meme coin Shiba Inu (SHIBxM) also soared.
- Blackrock (BLK), the world's largest fund manager is reportedly to launch crypto trading services to its clients in a further sign of broader institutional investor adoption.

Commodity rally alive and well

- The commodity price rally continued, with the broad-based Bloomberg Commodity Index up 11% this year. Brent crude prices hit $95/bbl. as US inventories fell to lowest since 2018 and Russia-Ukraine geopolitical tensions spiked. This offset US-Iran nuclear talks progress. Russia and Iran are top-10 producers.
- Copper rose on signs no.1 importer China's infrastructure demand was rising, as new bank lending surged. Whilst no.2 producer Peru saw further supply disruptions. 'Dr Copper' is a key barometer for the health of world economy.
- We think commodities remain in a 'sweet spot' of robust demand, tight supply, and increased investor demand for inflation-hedge assets.

The week ahead: Fed, earnings, and geopolitics

1. A diverse week of Q4 **earnings**, led by metals giant BHP, tech titans NVDA and CSCO, largest retailer WMT, agricultural equipment leader DE, and 'reopener' stocks CAR and MAR.
2. See latest **Fed** minutes (Wed), and Governors speaking. Investors expect at least five rate hikes and shrinking massive $9 trillion balance sheet this year. **Retail** sales also expected to rebound from December's omicron weakness.
3. The **Chinese** authorities likely continue being the only global central bank to cut interest rates, with inflation (Wed) a still-low est. 1.7%.
4. Russia-Ukraine **geopolitical** tension spiked, adding to market nervousness and boosting oil prices, with US seeing imminent hostilities.

Our key views: Earnings to offset valuations

- We see a positive 2022, but with lower returns and higher volatility than last year. Earnings forecasts are too low, with GDP growth strong. Valuations should stay supported by still low bond yields and record company profitability.
- US Fed has turned hawkish, with markets now expecting 5+ rate hikes this year to combat 7% inflation. This has been largely priced-in. Q4 earnings reports have been beating forecasts. The January sell-off improved valuations.
- Focus on cheap and cyclical assets that benefit from good growth and stubborn inflation: Value, commodities, crypto. Cautious on bonds.

US Equity Sectors, Themes, Crypto assets

	1 Week	1 Month	YTD
IT	-2.85%	-8.90%	-12.12%
Healthcare	-1.05%	-5.37%	-8.74%
C Cyclicals	-1.33%	-8.65%	-10.71%
Small Caps	1.39%	-7.47%	-9.58%
Value	-0.86%	-4.25%	-3.25%
Bitcoin	4.32%	-1.02%	-10.51%
Ethereum	-0.70%	-9.23%	-21.36%

Source: Refinitiv

Fixed Income, Commodities, Currencies

	1 Week	1 Month	YTD
Commod*	0.30%	6.14%	10.82%
Brent Oil	2.79%	9.98%	22.02%
Gold Spot	2.86%	2.38%	1.64%
DXY USD	0.57%	0.91%	0.07%
EUR/USD	-0.86%	-0.58%	-0.20%
US 10Yr Yld	3.01%	15.10%	42.96%
VIX Vol.	17.83%	42.57%	58.89%

Source: Refinitiv. * Broad based Bloomberg commodity index

Focus of Week: Opportunities within 'tech'

'Tech' bigger and more diverse than seems. FAANGM correction opportunities as Fed better priced

'Tech' is by far the largest global sector and has spread well beyond traditional information technology into industrials, healthcare, retail and communications. It ranges from unprofitable, long duration 'disruptive tech' (like ARKK), to cheaper, shorter duration, highly profitable 'FAANGMs'. Lumping them all together is increasingly wrong, especially when the macro winds are turning more challenging. We see attractive 'correction' opportunities in the strongest and cheapest, especially now bond yield risks are better priced.

Cheapest 'tech' is telecoms and biotech. Cheapest 'growth' in internet retail and machinery

We plotted price/earnings valuations and earnings growth for 15 of the most tech-driven US industries, from software (led by MSFT, V, MA, ADBE) to semis (NVDA, AVGO, QCOM) but also biotech (ABBV, AMGN) and autos (TSLA, F). The lowest valuations are in telecoms (VZ) and biotech, reflecting competition and bond yield headwinds, respectively. Whilst the 'cheapest' (most growth for lowest P/E) is internet retail (AMZN), followed by machinery (DE) and electrical equipment (EMR). At the other extreme, the highest valuations are in aerospace and defence (RTX, BA), and the most 'expensive' (lowest growth for highest P/E) includes health care equipment (MDT, ISRG). Broad exposure is also available through Smart Portfolios.

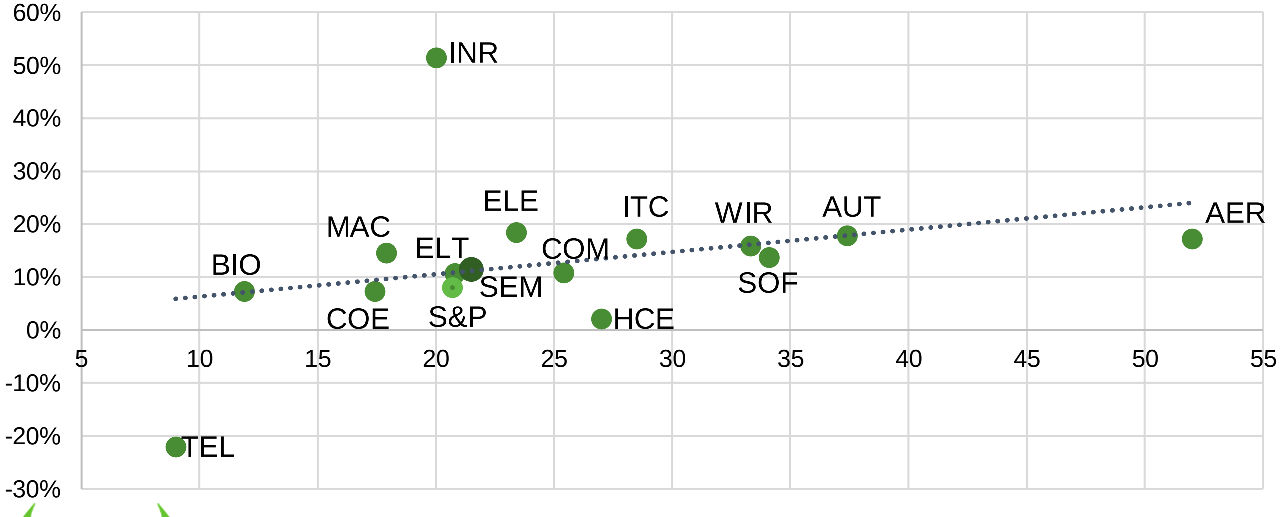
Favour 'big tech' versus 'disruptive tech' as enter a tougher macro-economic world

There are two extremes within tech. The most 'disruptive' tech stocks, proxied by the ARK Innovation ETF (ARRK), have halved since a year ago and still trade around a 11x price/sales valuation. This is three times the S&P 500, and twice that of the big-tech FAANGM's average. They are exposed to the headwinds of rising interest rates, slower economic growth, and structurally higher equity market volatility. By contrast, FAANGM's are over 20% of the S&P 500, and their P/E valuations fallen to 28x. This is attractive given their 33% EBITDA margins versus S&P 500 20%, and revenues growing 14% this year, near twice the index rate.

Favour cheaper cyclical sectors, but looking for tech opportunities with yield surge better priced

We are more focused today on cheaper and faster growing sectors, like energy (XLE) and financials (XLF), and overseas markets, like UK (ISF.L) and Europe (EZU), that have more cyclical sectors. But we are looking for opportunities in tech. We are using more tech every day. Its disruption is spreading across more sectors. The growth drivers are secular. This is complemented by the high profitability and fortress balance sheets of many. Tactically, we also see that the major headwind of higher bond yields, that reduces the present value of future cash flows, is easing. US 10-year bond yields have seen one of the sharpest rises ever in the past month, and tech has underperformed sharply. Much has already been priced in. Whilst structural constraints, from high debt to poor demographics, will restrain huge further bond yield rises.

US 'Tech': 2022e Price/Earnings Valuation (x, Horizontal axis) vs Earnings Growth (%, Vertical axis)



Source: MSCI. AER=Aerospace & Defence. AUT=Autos. BIO=Biotechnology. CEO=Communications Equipment. COM=Computers. ELT=Electronic Equipment. HCE=Healthcare Equipment. INR=Internet Retail. ITC=IT Consulting. MAC=Machinery. SEM=Semiconductors. SOF=Software. TEL=Diversified Telecoms. WIR=Wireless Telecoms

Key Views

The eToro Market Strategy View

Global Overview	Forecast a very rare fourth consecutive positive year in 2022, with naturally lower returns and more volatility than last year. Main drivers of 1) GDP growth to remain well-above average, and supported by further vaccine-driven re-opening. 2) Monetary policy tightening is increasingly well-priced in by markets, and inflation pressures to ease during the year - but to remain elevated versus history. Focus on reflation and cyclical assets: equities, commodities, crypto, small cap, value. Relative caution on fixed income, USD, and defensive equities.

Traffic lights*	Equity Market Outlook
United States	World's largest equity market (55% of total) seeing GDP growth 2x average , and driving earnings upside 'surprise', and a rare fourth consecutive year of 10%+ equity market returns. Valuations at 20x P/E are 25% above historic levels but supported by still low bond yields and strong earnings growth outlook. See further cyclicals and value catch-up, after a decade of underperformance, whilst 'big-tech' supported by its structural growth outlook.
Europe & UK	Equity markets helped by 1) a greater weight of cyclical sectors, and lack of tech, 2) 25% cheaper valuations vs US, 3) decade of under performance made under-owned by global investors. Helped by a dovish ECB to hold rates 'low-for-longer', and multi-year €750bn 'Next Generation' fiscal support. A weaker EUR helps many companies, with 50%+ company revenues from overseas. '4th wave' virus resurgence may provide additional buying opportunities.
Emerging Markets (EM)	China, Korea, Taiwan dominate EM, with 60% weight, and is more tech-centric than US. China outlook improving as cuts interest rates (opposite of rest of world) reducing slowdown and property sector risks, focuses on stability ahead of 20th Party Congress, and with valuations now 40% cheaper than US and market heavily out of favour. Will support EM, but is exposed to Fed tightening. China recovery also helps global sectors from luxury to materials.
Other International (JP, AUS, CN)	Canada and Australia benefit from strong equity market weight in commodities and financials, as global growth rebounds and bond yields set to rise. Japanese equities among cheapest of any major market and vaccination rates accelerating, but structural headwinds of low GDP growth, an ageing population, and world's highest debt.

Traffic lights*	Equity Sector & Themes Outlook
Tech	'Tech' sectors of IT, communications, parts of consumer discretionary (Amazon, Tesla), dominate US and China. Expect more subdued performance as bond yields rise. But are structural stories with good growth, high margins, fortress balance sheets that justify high valuations. 'Big-tech' the new defensives. 'Disruptive' tech more vulnerable.
Defensives	Consumer staples, utilities, real estate offer more defensive cash flows, less exposed to economic growth. Makes them more sensitive to rising bond yields. Expect them to underperform in a more cyclicals focused environment with earnings strong and yields rising. Healthcare is more attractive, with cheaper valuations and more growth.
Cyclicals	We expect cyclicals - consumer discretionary (autos, apparel, restaurants), industrials, energy, materials, to lead performance. They are most sensitive to the sharp economic recovery, reopening and higher bond yields, with more sensitive businesses, depressed earnings, cheaper valuations, and have been out-of-favour for many years.
Financials	Financials will benefit from the GDP growth recovery, with higher loan demand and lower defaults. Similarly, they benefit from higher bond yields outlook, charging more for loans than they pay for deposits. Sector has 2nd cheapest P/E valuation, and regulators recently giving flexibility to pay large 8-10% dividend and buyback yields.
Themes	We favour small cap vs large, on more GDP growth exposure, earnings upside, and domestic focus. Similarly, value over growth on GDP recovery, lower valuations, under-ownership after decade under-performance. Dividends and buybacks recovering with cash flows. Power of dividends under-estimated, at up to 1/2 of total long term return.

Traffic lights*	Other Assets
Currencies	USD well-supported for now by rising Fed interest rate outlook and 'safer-haven' bid on virus fourth wave virus. This is likely more modest than prior USD rallies as rest of world growth recovers and virus fears ease. A strong USD traditionally hurts EM, commodities, US foreign earners, such as tech, but helps EU and Japan exporters.
Fixed Income	US 10-year bond yields to rise modestly as inflation above 2% average Fed target, 'real' inflation-adjusted yields negative, Fed to gradually tighten policy. Will be modest as inflation expectations already high, wide spread to other market bond yields, and structural headwinds of all-time high debt, poor demographics, and low productivity.
Commodities	Cross-currents of rising global growth concern on virus fourth wave, and stronger USD. But remain in 'sweet spot' of above-average GDP growth, 'green' industry demand, years of supply under-investment. Industrial metals and battery materials well positioned. Oil helped by slow return of OPEC+ supply. Gold hurt by likely rising bond yields.
Crypto	Institutionalization of bitcoin market barely begun, as asset class benefits from very strong risk-adjusted returns and low correlations with other assets. Altcoins have outperformed as see broader interest and use cases. Clear supply rules a benefit as inflation rises. Volatility remains very high, with the 16th big pullback of the last decade.

Source: eToro

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