Be Greedy When Others Are Fearful – Is it Time to Buy Tech?

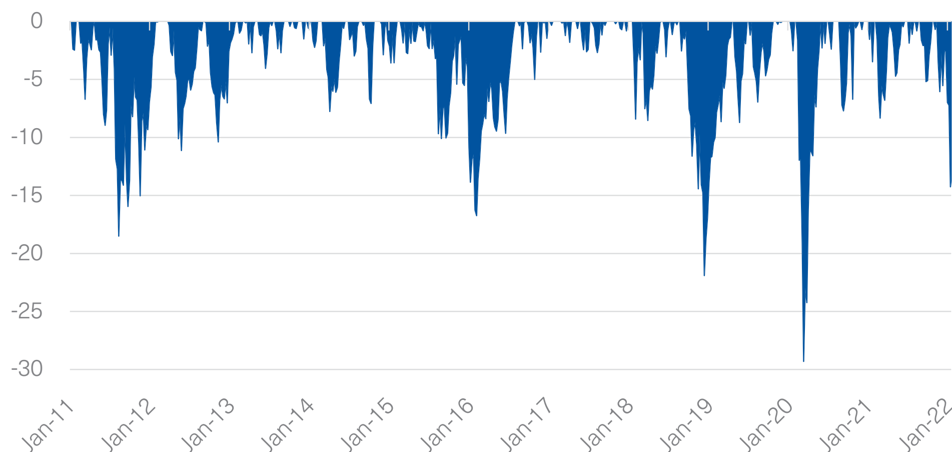
Funds in focus: Brompton Tech Leaders Income ETF (TLF, TLF.U), Brompton Global Dividend Growth ETF (BDIV)

The NASDAQ is currently experiencing its worst start in the past 30 years, down 14.7% year-to-date as of January 27th. On January 24, 2022, the NASDAQ closed higher reversing a 4%+ intraday drop, which has happened only 5 other times in the past 30+ years, and the subsequent median 12-month return was 26.8%. While we caution past performance is no guarantee for future outcomes, investors sometimes seek solace in the adage "history doesn't repeat itself, but it often rhymes".

Year	% change at intraday low	% change from low to close	Forward 12-month performance %
10/28/1997	-4.5	9.4	8.4
10/26/2000	-4.6	6.2	-46.6
7/15/2002	-4.2	5.1	26.8
10/10/2008	-6.2	6.9	29.7
11/13/2008	-4.7	11.8	35.8
1/24/2022	-4.9	5.8	?
Average			10.8
Median			26.8

Source: Bespoke Investment Group (January 24, 2022)

Since reaching all-time highs in November 2021, the NASDAQ is currently experiencing a drawdown of 15.6%, the fifth worst in the past 10 years. Given the current trajectory, it is difficult to call a bottom at these levels but as we discuss below, the risk-reward favours upside moves albeit in a volatile fashion.

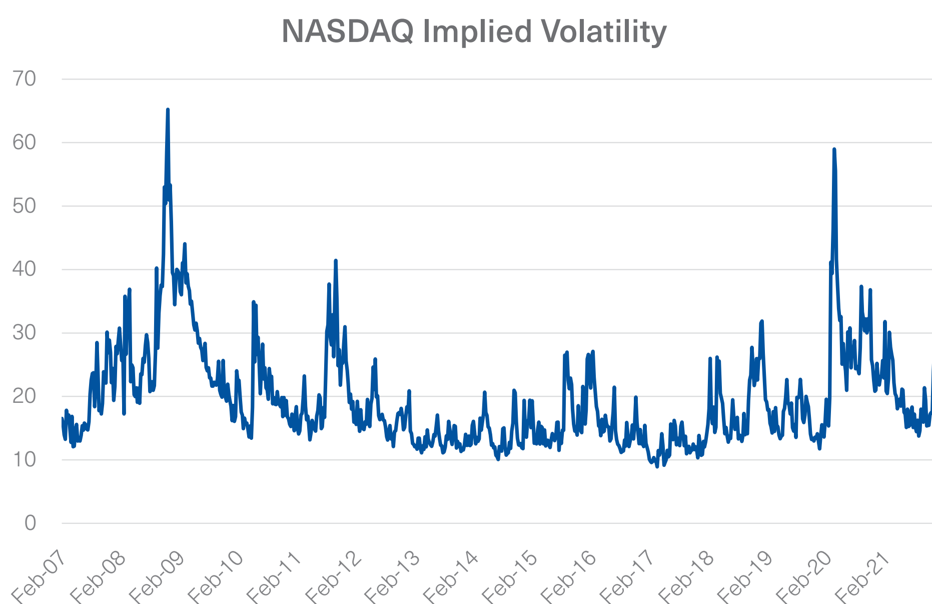


Source: Bloomberg (January 24, 2022)

One of the comments we have often heard from investors is that they feel as though they missed the run-up in tech since the COVID-19 rebound, thus they prefer to shy away from the sector rather than give into "FOMO". We believe the current pullback provides investors with an opportunity to invest in tech. The pushback is that rising rates will negatively impact long duration assets, which negatively affects tech. The reality is that tech has actually been the top performing sector in 3 of the last 4 Fed rate hiking cycles. We note that yields have been rising since the COVID-19 crash alongside strong performance in tech. In our view, it's not the upward direction of rates but the intensity of those increases which can cause dislocations in long duration assets. For example, the rotation from growth into value started in mid-November 2021. However, the large 2 standard deviation move in 10-year yields that occurred during the first week of January 2022 exacerbated the sell-off in growth assets, driving valuation for the NASDAQ back to near pre-COVID-19 levels (on a price-to-sales basis). In a volatile interest rate environment, we believe profitable

tech companies with strong economic moats and market leadership should perform well, especially those that return capital to shareholders in the form of share buybacks and dividends.

We believe fears in tech are overblown as the fundamentals supporting tech continue to be solid driven by long-tail secular trends such as digital transformation, which is underpinned by cloud, artificial intelligence, hyper connectivity, digital payments and e-commerce. Currently, the NASDAQ "Fear Index" (as measured by the 30-day implied volatility of at-the-money options on the NASDAQ index) is back to COVID-19 and the Great Financial Crisis levels. Volatility spikes are transient and as implied volatility compresses, liquidity in the index improves providing powerful upside flows for stock constituents. Arguably, the level of options activity (single stock and index) has intensified over the past 10 years compared to any other time in history. This structural dynamic has led to exacerbated up and down movements in the market, largely due to option counterparty hedging activity. As an example, during the COVID-19 crash in March 2020, the NASDAQ endured a 30% drawdown which lasted 23 days and took 53 days to recover, compared to a 23% drawdown in 2018 which lasted 80 days and took 81 days to recover and the 2011 selloff saw a drawdown of 18% which lasted 108 days and took 85 days to recover. In other words, the time to recover from a significant sell-off has been decreasing over the past 10 years. We believe the current drawdown in tech provides investors with an attractive entry point in light of strong fundamentals for the sector and the swift recoveries the tech market has been experiencing in recent history.



Source: Bloomberg (January 24, 2022)

Brompton's Approach

Our approach to investing in technology companies across our funds, particularly in our technology fund, Brompton Tech Leaders Income ETF (TLF, TLF.U) and in the technology holdings in Brompton Global Dividend Growth ETF (BDIV) is based on valuation grounded by both revenue growth and cash flow generation. We prefer to invest in companies that have market leading positions, expanding pipeline of opportunities and above average return on invested capital. In TLF, we actively manage our weights to software, semiconductor, IT services, fintech and hardware stocks. This balances the risk/reward profile of the portfolio across growth, defensive and cyclical themes. In addition, we use an active call writing overlay to enhance risk-adjusted returns.

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