Brompton Insights

Big Tech Boom Or Gloom In 2024?

BROMPTON FUNDS

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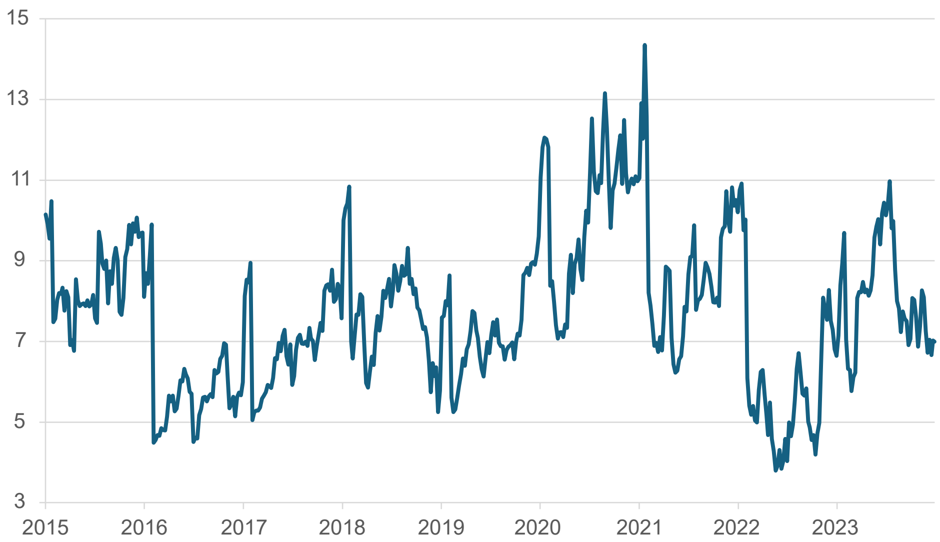
Funds in focus: [Brompton Tech Leaders Income ETF (TLF, TLF.U)](), [Brompton Global Dividend Growth ETF (BDIV)]()

The Magnificent Seven or Big Tech (Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, Tesla) accounted for two-thirds of the 26.3% S&P 500 returns in 2023.[1] The majority of this outperformance occurred during the first half of 2023, with the Magnificent Seven rally cooling in the back half of the year. Investors are wondering if this big tech boom will continue in 2024 or is the rally running out of steam? There are two likely scenarios that could play out.

Under the first scenario, we consider the popular narrative that the market is pricing in a soft economic landing given the Fed's pivot from rate hikes to cuts. This is bullish for risk assets, in that a rising tide lifts all boats. While Big Tech will benefit from this, we believe other tech firms (non-Magnificent Seven) could receive a disproportionate benefit and would likely outperform in the near-term. Equity volatility (as measured by the VIX) saw significant compression throughout the year, from the highs of 26.5 to a low of 12 (back to pre-Covid levels)[2] and as a result the equity index becomes pinned (narrow range of movement) while market liquidity improves. When the index is pinned, as one group of stocks outperforms, another group underperforms given idiosyncratic risk in the index constituents (all else equal). To put this in perspective, in the month of December the S&P 500 experienced a daily narrow range of movement for the most part given low volatility. During that time, Big Tech returned 4% and a basket of unprofitable tech stocks generated a 12% return.[3]

Consider another scenario where we enter into an economic recession as a result of prior rate hikes or an exogenous shock. Consensus calls for a 50% chance of a recession (likely to decline as rate cuts materialize), as measured by the New York Fed 12-month forward yield-curve implied recession probability.[4] Under this scenario Big Tech will likely outperform as this group can act as a safe haven trade similar to the first half of 2023. Big Tech companies have high recurring revenue, significant operating leverage and solid free cash flow generation. Best in class tech companies have high rates of invested capital and many also have track records of returning capital to shareholders in the form of share buybacks and dividends. This offensive/defensive characteristic along with share buybacks can put a reasonable floor to valuations during market turbulence. Valuation for big tech remains attractive trading at a 7 point premium to the S&P 500 on a forward P/E basis (37th percentile), which is well below the prior peak of 14.4 and slightly below the median at 7.7.

Big Tech vs S&P 500 Forward P/E



Source: Bloomberg as of December 27, 2023. Big Tech is represented by the GSTMTMEG Index.

We believe an actively managed approach to investing in tech should provide attractive risk adjusted returns versus a passive strategy given we are at a crossroad in our path to economic recovery, which is manifesting through a low volatility goldilocks market heading into a US presidential election year. A soft landing or a recession scenario should have different outcomes for the tech sector and actively managing this transition will be important in 2024.

Brompton's Approach

In our technology fund, Brompton Tech Leaders Income ETF (TLF, TLF.U), we prefer to invest in companies that have market leading positions, a combination of revenue growth and free cash flow generation, and an expanding pipeline of opportunities. Investors can also get exposure to technology in Brompton Global Dividend Growth ETF (BDIV) which invests in large capitalization global dividend growth companies. Both funds use an active covered call writing strategy to generate income and lower portfolio volatility.

(1) Source: Bloomberg as of December 29, 2023.

(2) Source: Bloomberg as of December 29, 2023.

(3) Source: Goldman Sachs Trading Baskets on Bloomberg as of December 29, 2023.

(4) Source: Federal Reserve Bank of New York as of November 1, 2023.

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