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Why Tech-Sector Volatility Doesn't Worry Us

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While a few companies in the US technology space have been in the hot seat lately, Jonathan Curtis, vice president and research analyst with Franklin Equity Group, is largely unfazed. He said temporary “blips” affecting certain stocks are par for the course as consumers get used to new technologies—and how they impact our lives. He sees the overall long-term fundamental backdrop for the sector as sound.



We’ve seen a recent selloff in the US technology sector as some companies in the space have faced near-term challenges and negative press. But as long-term investors, we are not deterred. The tech sector overall has been performing well over the past year, so it certainly doesn’t surprise us to see the market give back a bit of those gains.

In the first quarter of this year, concerns about consumer data privacy and potentially tighter regulatory controls exacerbated existing investor nervousness tied to speculation the US Federal Reserve would quicken the pace of interest-rate hikes in response to higher wage growth. Investor sentiment was further rattled by the possibility of an escalating trade skirmish, primarily with China.

Data Privacy Concerns: The Elephant in the (Digital) Room

While safety issues have bubbled up in the autonomous vehicle space recently, online platforms have faced increasing scrutiny over data privacy. Facebook was caught in the crosshairs amid revelations that a data analytics firm improperly kept a small portion of Facebook's user data for years, igniting a major debate over user and data privacy.

While we can't predict what will ultimately happen with Facebook or any other individual company, we think tech companies in general will be able to regain consumer confidence and keep engagement high. We view the sector's recent setback as likely a short-term blip and not a structural change in the trajectory of the industry or the business models of these companies.

That said, it's clear consumers are just starting to understand how these types of digital businesses operate. We believe digital social networks in one form or another will survive, because people have a strong desire to connect with each other and the businesses and causes that matter to them. And, while advertisers on these platforms recognize the value proposition in targeting consumers, they likely will need to do so in a less-opaque manner. We feel confident these issues can be worked through.

Taking a Long-Term View of Tech Transformation

Investors are starting to understand that technology is playing an increasingly important role in the global economy, and we think the sector's long-term fundamentals are positive. We have seen a big-picture trend of digital transformation—which encompasses areas including artificial intelligence (AI), cloud computing, software-as-a-service and robotics—growing across the economy.

The digital transformation appears to be gaining momentum, even as certain companies experience growing pains. Advancements over the past few years in AI and machine learning have created opportunities for technology vendors in the data-processing supply chain and for enterprises with unique and compounding datasets.

We believe that through the course of 2018 and 2019 investors will come to appreciate how technology companies with large and compounding datasets will be able to combine their data with machine learning algorithms to create new sources of revenue, reduce costs, build predictive models and create compounding competitive advantages. We expect the entire data chain (data storage, processing and analysis) to benefit from this seismic shift, especially for companies that have relatively unique datasets.

Market volatility aside, we believe 2018 is shaping up to be a good year for information technology (IT) sector fundamentals (including growing revenue, growing earnings per share and increased dividends), based on the digital transformation theme, lower taxes and the need for increased productivity in a tightening labor market. We believe some stock market-related setbacks are inevitable and may occasionally weigh on what we consider to be a solid IT-driven growth outlook, with significant technology-related changes set to take place in the next few years.

Corporate tax reform is helping to bring capital back to the United States, which is being applied to share repurchase activity and increased dividends for shareholders. We are also hearing that a number of companies outside the technology sector will be increasing their investment in technology as a result of tax reform, which lowered the corporate tax rate across the board for US companies.

Technology is helping companies across industries develop more service-oriented, data-centric relationships with their customers. Tech-platform businesses have done well in the advertising space, and they are taking the close business relationships they have with consumers—and the data they've collected—into expanded areas like financial services and transportation.

We feel companies that are not tech-centric at their core are likely going to be compelled to respond to the advancements that these big tech-platform companies are having in categories that are new to them. As a result, these non-tech-centric businesses will need to invest in innovation. So, we should see this double benefit of leadership from core tech-platform companies as well as efforts by legacy businesses or companies outside the technology space to leverage technology to play more defense.

Finding Value Amid Volatility

As some investors have been selling shares of tech-sector companies of late, we, as active managers, have been looking for stocks that appear to have the best long-term growth prospects and highest quality business models and teams amidst the inevitable reappearance of volatility that we have seen in early 2018.

Today's progressively sophisticated technology and software also allow companies to provide products and services that seemed impossible even 10 years ago. In particular, we believe the transition to technology-on-demand will be integrated into day-to-day life in the years ahead. This transition is being enabled by a large base of always-connected consumers, high-speed internet access and an expanding global cloud infrastructure. As it grows, industries far afield from IT are feeling the impact of the emerging platform disruptors across a wide array of industries.

We continue to rely on our disciplined, bottom-up research to identify companies leveraging long-term trends that provide growth opportunities over time, regardless of shifting markets and any short-term "blips."

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