Technology Sector in the "Work from Home" Economy

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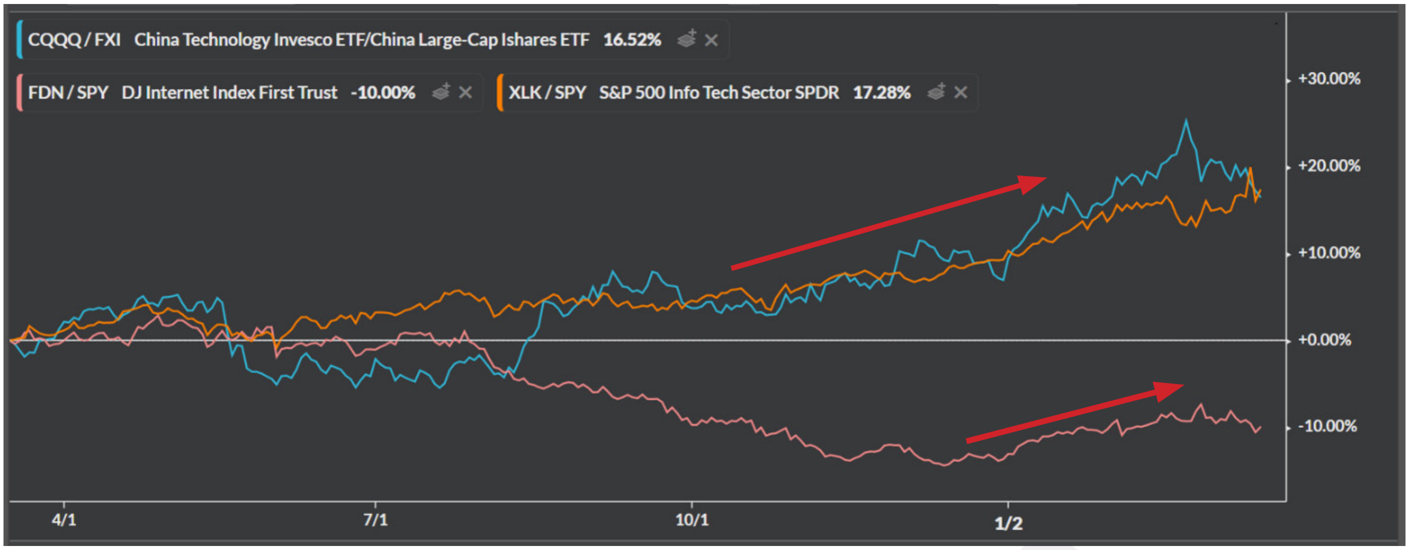
Although none of our investment systems directly incorporate fundamental data, we enjoy contemplating the fundamental narratives reflected in the price trends our systems ultimately find attractive. Our systems are currently quite leery of equity or other risk assets, as we now sit firmly in a bear market induced by the widespread economic halt caused by the coronavirus Covid-19. However, our Decathlon system continues to favor technology-sector equities more than its other investment opportunities. In addition, our Weekly Sector Rotation strategies have held on to the technology sector, due to its slightly better momentum, despite selling nearly all other sectors and raising substantial cash.

As the chart below shows, if what has happened in China offers a prediction for how the "work from home economy" will play out from here, technology stocks may remain relatively attractive. This seems counterintuitive to how many may have expected the bull market to end. Past bull markets have often been characterized by excess investment in the sectors that led the market on the way up, leading to outsized losses on the way down. The most recent bull market was certainly driven in part by outsized gains from technology companies and the "Internet 2.0" mega-caps, but so far, these same companies are faring better than other equities in the bear market that ended the eleven-year bull run.



Source: Koyfin. Data for the period 3/15/2019 through 3/17/2020.

This bear market, likely already a recession, is unique in that the economy seems to lack the "financial excess" that typically brings about the end of an economic cycle. In this exceptional environment there are two obvious reasons why tech companies could remain attractive investments:

1. **Excellent Balance Sheets**
The "FANG" (excluding Netflix which is far smaller) + Microsoft and Apple have cash balances between $55 and $207 billion. "Cash is king," especially when no one else has any. Companies with weaker balance sheets are likely to be stressed in the current economic environment, while the aforementioned companies should be able to make tough decisions or explore opportunities not available to other businesses.

2. **Countermeasures to Coronavirus Accelerate the Shift from Offline to Online**
Consumption is unlikely to stop entirely during social distancing measures, and the long-term secular trend of consuming more online is likely to accelerate, as is the use of software that enables more flexible and efficient working capabilities. While the advertisers–from which some of these giant technology companies draw large portions of their revenues--will surely pull back spending significantly, it is unlikely the usage by their user bases will falter. In fact, the "forced" introduction of work-from-home arrangements may actually take hold at some companies, which would more permanently increase cloud and/or online activity.

Although there is minimal financial guidance coming from companies in the midst of this crisis, some anecdotes seem to support the idea that the "winners" of our economic expansion may continue to "win" on a relative basis in this bear market.

- **JD.com,** the largest online and largest overall retailer in China, expected double digit sales growth for the first quarter as recently as a month ago, despite China recently releasing -4% retail sales growth for February.

- **Walmart's CEO** seemed to corroborate that as well:
  "I mean customer behavior can change in a period of time like this. I think we saw that some in China as people bought more online and we were able to satisfy some of that demand there."[1]
  - Walmart (WMT) CFO Brett Biggs

- Management at **Adobe** and **Zoom** have offered similar sentiment on the shift to digital in the wake of the new "work from home" economy.
  "This if anything will accentuate the need to engage digitally not just internal to the corporation to keep the corporation going, but externally, in order to engage with customers."[2]
  - Adobe (ADBE) CEO Shantanu Narayen

  "Given this coronavirus, I think the over the night [sic] almost everybody read and understand [sic], they needed a tool like this. This will dramatically change the landscape."[3]
  - Zoom (ZM) CEO Eric

It is easy to instinctually want to "sell everything" during such levels of unprecedented market volatility. We feel most at ease **following the guidance of our quantitative models rather than our own emotions,** and the most successful investors during this period will keep a level head and invest with reason. This may be one example of an area where things are not necessarily as dark as they are in other corners of the economy. Of course, no one knows what the future will bring, and **we stand ready to heed our models' guidance should it change as the economic situation unfolds.**

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Disclosures:

[1,2,3] The Transcript, "The Transcript 03.09.20", 03/09/2020. https://theweeklytranscript.com/2020/03/09/the-transcript-03-09-20/

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