

**Technology outlook:
AI, macro and valuations**

Q: Vik Heerah (Head of Marketing): Ben, the Fed has started its rate-cutting cycle – some might say too late, but it has started. What is your view on where that takes us in terms of rates? Any concerns about the softer economy and what this means for the tech sector?

A: Ben Rogoff (Fund Manager, Polar Capital Technology Trust): Well, overall it is fair to say rate-cutting cycles are positive for risk assets such as equities. They provide a supportive framework for companies borrowing and give us more comfort as investors that policymakers are behind us, so we are pleased to see the beginning of the rate-cutting cycle. Whether or not the Fed is behind the curve really remains to be seen, but we are encouraged by the front-end loading of rate cuts. That should give relief to people. Recession risk has certainly been on people's radar – you have seen that in rate markets and in much choppier equity markets than we are used to. It should encourage investor sentiment generally and I think it increases the odds that we avert a hard landing in this rate-cutting cycle.

Q: VH: Sticking with the macro and geopolitics, November is going to be an important [US] election and it looks very close at the moment. How could the outcome affect the technology sector?

A: BR: I think we have seen over recent days and weeks that the market prefers less uncertainty – as Kamala Harris has moved ahead modestly in the polls, markets have responded positively. In terms of outcomes, in the end we are in the investment business. However, it is probably fair to say that the tech sector would prefer a Harris win and continuity of sorts: less geopolitical risk, primarily as it relates to Taiwan where most of the leading-edge wafers are made today and that manufacturing capability is core to the AI story. Donald Trump has some positives and negatives. A Harris win, likewise, but as tech investors, it is probably good to see Harris edging ahead in the polls.

Q: VH: Equities have had a good rally, but recently we have seen some volatility. There have been concerns around valuations, especially in the mega-cap space. What is your view on valuations as we stand today?

A: BR: The volatility reflects the slightly less certain macro backdrop and recession risk, as we have seen in rates markets. There is also geopolitics with various conflicts that we are having to deal with. We have seen that in energy markets, and lots of other asset classes have responded to that slightly less certain backdrop. Our overall take on valuations is that they are fair, perhaps at the higher end of traditional trading ranges, but with CPI inflation heading back towards 2%, a P/E forward multiple in the 20s on the S&P does not seem entirely out of kilter. As it relates to technology, there is lots of press about how expensive the Magnificent Seven stocks have become, but in reality these are incredible assets – non-fungible, very difficult to substitute in client portfolios – and they dominate industry profits.

Overall, the tech sector is trading again at the slightly higher end, but far from the bubble days where we traded at 2x the market multiple.

Today, tech stocks trade at something like 1.3x the broader market. Again, at the higher end of the post-global financial crisis range but again, in our view, fair relative to the above average growth prospects of the sector.

Q: VH: Do you retain your conviction in AI? Do you still think that it will be groundbreaking?

A: BR: To be honest, it is difficult to put into words quite how excited we are about the AI story, and it is fair to say that the underlying technology has continued to make incredible progress over the past 12 months. The market and stocks around the AI theme have become slightly choppier, and I think to some degree they are victims of their own success. Year-on-year growth comparisons get more difficult against the staggering growth that we have seen over the past 12 months. There is a natural volatility that has come into the stocks, but the underlying technology makes huge progress; models are improving, the scaling laws that we think really define the scope of where AI can get relative to human cognition continue to look incredibly encouraging – so we have not adjusted the portfolios. We pivoted hard towards the AI theme last year and have maintained that portfolio positioning. At the edges, with rates coming down, we have added a little bit more duration and a handful of small and mid-cap stories, but the principal driver of the portfolio remains AI that we think is the defining technology of this decade.

Q: VH: Taking all of that together – some macro uncertainty; high conviction in AI; valuations – what is your outlook for the sector?

A: BR: We should start by saying that the elevated volatility we have experienced both up and down may persist. There is lots of uncertainty in the broader market and we are early in a technology cycle – elevated volatility is pretty normal at this point. We certainly saw that early in the internet days. It was an incredibly strong period for markets, if you recall, but it was punctuated by some quite material setbacks along the way. That may be a template that we follow, but we should not let that get in the way of a much more constructive outlook. The AI story is early – it is just two years since the launch of ChatGPT – but at the edges we are already beginning to see AI substitute for human labour in places like call centres. We see model improvement; we see capex budgets moving up and we are encouraged by the fact that scaling laws that will determine the outlook for AI are holding. With that in mind, we have been trying to take advantage of some of the cyclical weakness that we have seen in some of our AI assets. We are trying to rotate portfolios to better capture the winners of not just this year but beyond. I think it is fair to say that our view on AI, our excitement around the technology set, really is unchanged. We are really excited about the outlook for the tech sector going forward.

Ben Rogoff

Fund Manager, Polar Capital Global Technology Team

25 September 2024

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