

## TECH: Combining Growth with Value and Quality

### *Product in Focus:*

#### *TECH: ETFS Morningstar Global Technology ETF*

- The tech sector has provided significant opportunities for growth investing in recent years
- Prudent technology investors should examine value and quality stocks
- TECH actively selects technology leaders that have a competitive advantage over other companies
- The portfolio contains 25 to 50 stocks from a global universe



### Technology Is On A Roll

The Information Technology (IT) sector has contributed nearly 30%<sup>1</sup> of total global equity returns over the past 5 years. This is more than double the performance of the next best sector – consumer discretionary, which itself can attribute much of its performance to ‘tech style’ stocks such as Amazon. Although there have been speed bumps along this growth trajectory there is a consensus that the incorporation of technology into our daily lives and the subsequent growth of the companies behind this will continue for some time.

The big-name FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) have sky-rocketed, with Apple and Amazon becoming the first two companies to top the US\$1 trillion mark in 2018 and Microsoft recently achieving the same milestone.

The Nasdaq 100 hit new all-time highs in April and to date has only posted a single negative week in 2019. As such, losses in the correction of the last quarter of 2018 have largely been recouped, but the volatility has not been forgotten by many. Questions, rightly, are being raised as to whether valuations are overblown, whether we are building towards a second tech bubble or, alternatively, whether the technology revolution is only just beginning.

<sup>1</sup> Bloomberg data as at 30 April 2019. The Information Technology sector contributed 13.2% of the 5-year total return of 46.4% of the iShares MSCI World ETF as a proxy for the global equity market

## How Do you Navigate Stretched Valuations and Volatility?

Exciting times lie ahead for technology companies, but it's unlikely to be completely smooth sailing, with bouts of volatility always a possibility. Prudent technology investors should consider:

<b>GARP</b>	Seek growth at a reasonable price
<b>Value</b>	Seek attractively priced companies with strong fundamentals and hold until the market returns to 'fair value'
<b>Quality</b>	Seek quality companies with well-established business models
<b>Diversification</b>	Seek safety in global diversification

## Introducing ETFS Morningstar Global Technology ETF (ASX: TECH)

ETFS Morningstar Global Technology ETF (**TECH**), which tracks the Morningstar Developed Markets Technology Moat Focus Index, was designed with this approach in mind. Here's how its stock selection works to provide exposure to technology sector growth, while focusing on value, quality and diversification.

### ➤ Growth

As a technology sector fund, **TECH** is by default highly exposed to growth as an investment factor. It is worth, however, clarifying exactly what constitutes a technology stock in this context.

Relative to the well-known Nasdaq 100, this fund is less broad from a sector viewpoint, but broader on a regional basis. The Nasdaq 100, while highly technology exposed, is currently only about 45% invested in pure technology companies. **TECH** is therefore a more pure-play in terms of exposure to technology growth.

Of the FAANG stocks **TECH** currently holds Apple, Google and Facebook.

### ➤ Value

**TECH** benefits from research and analysis conducted by Morningstar's extensive team of global equity analysts in assessing the fair value of eligible index constituents.

Eligible companies are ranked according to their ratio of price/fair value and only the most undervalued companies are included in the Index.

**TECH** currently holds positions in 31 companies, of which 20 are showing fair value above current market price (Chart 1). The weighted-average discount to fair value across the portfolio is 6.6% as at the end of April. This compares with a 5.5% weighted average premium to fair value across the Nasdaq 100<sup>2</sup>.

Further, companies that fall into the bottom 20% based on price momentum are screened out to ensure that the Index is not mistaking negative sentiment for value.

<sup>2</sup> Morningstar Direct as at 30 April 2019. Based on Morningstar analyst fair value ratings, which are available for 97.3% of the market capitalisation of the Nasdaq 100 index.

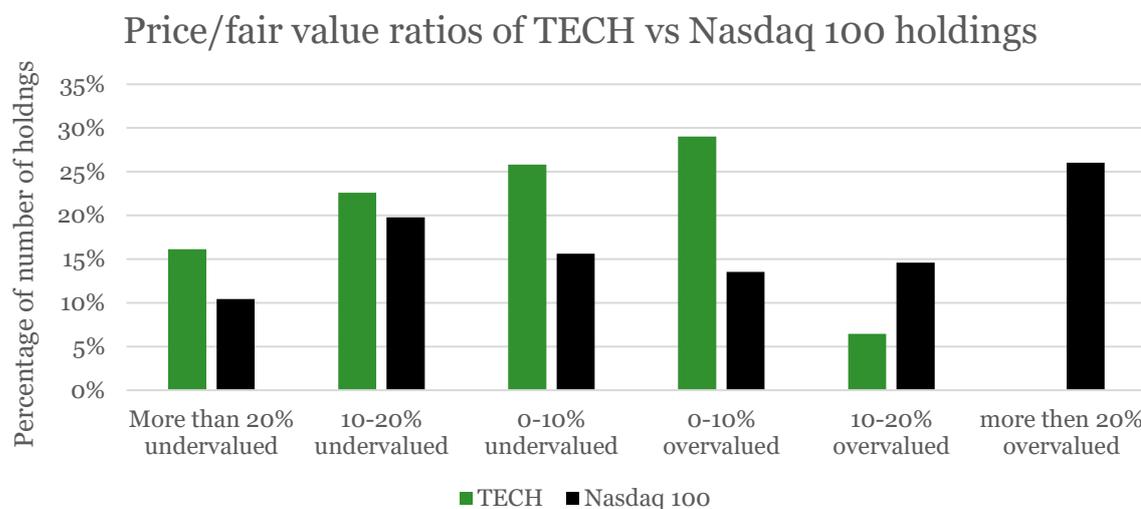


Chart 1: Morningstar Direct as at 30 April 2019. Chart shows the percentage of total holdings of TECH and constituents of Nasdaq 100 Index that are under/overvalued by the specified amounts based on price / fair value ratios calculated by Morningstar.

### ➤ Quality

**TECH** invests only in quality companies and does this by screening firms according to their Morningstar Economic Moat Rating. An economic moat, as the name suggests, is something inherent in a company's business model that defends its market position and cannot be easily replicated by competitors. It is the source of their competitive advantage and only well-established, high quality businesses achieve moat ratings.

*Wide Moat* companies are the highest rated and are deemed able to maintain above average returns for the next 20 years.

*Narrow Moat* companies are the next highest rated and should maintain excess returns for at least 10 years.

**TECH** currently holds 12 *Wide Moat* companies including Adobe and Salesforce and 19 *Narrow Moat* companies including Computershare and LINE.

### ➤ Global Diversification

The Index selects between 25 and 50 stocks from across global developed markets and equally weights them on a quarterly basis.

Diversification benefits arise from the number of stocks chosen and the fact they are drawn from an international universe. **TECH** currently holds stocks from the U.S., Japan and Australia.

The equal weighting scheme is designed to both limit excessive exposure to the mega-cap names and to provide a greater opportunity for smaller companies to meaningfully contribute to performance.

## How has TECH performed?

Chart 2 and Table 1, below, show the performance of **TECH** relative to a selection of prominent ETFs that offer technology-related exposures. These funds include Nasdaq 100 trackers listed in Australia and the U.S. (NDQ and QQQ respectively), a fund tracking the broad, market cap weighted S&P Global IT Sector Index (IXN) and the largest U.S. technology sector ETF (XLK). Returns are in Australian dollars and are net of fees.

Since its inception on 7<sup>th</sup> April 2017, **TECH** has returned 30.1% p.a., which is 3.5% p.a. ahead of XLK and 6% p.a. ahead of the two Nasdaq 100 ETFs.

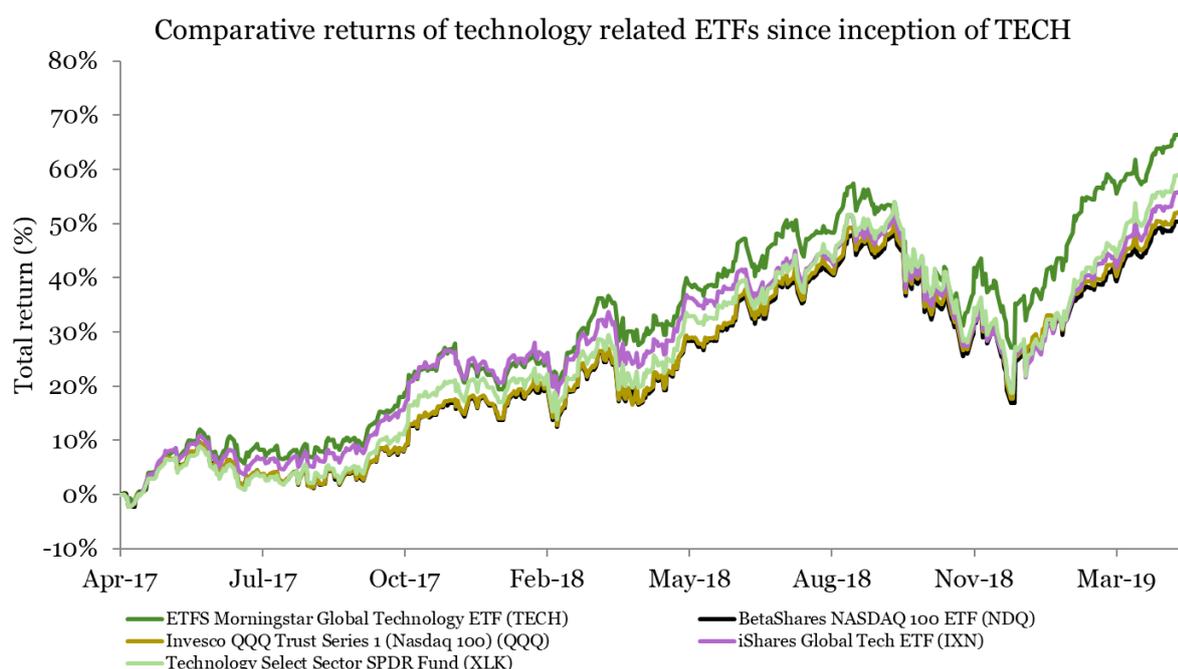


Chart 2: Bloomberg, as at 30 April 2019

Period Total Return	1M	3M	6M	1Y	2Y	from 7-Apr-17
ETFS Morningstar Global Technology ETF (TECH)	<b>8.3%</b>	20.3%	<b>22.1%</b>	<b>31.2%</b>	<b>28.7%</b>	<b>30.1%</b>
BetaShares NASDAQ 100 ETF (NDQ)	6.4%	16.8%	12.7%	26.9%	22.2%	23.5%
Invesco QQQ Trust Series 1 (Nasdaq 100) (QQQ)	6.2%	16.4%	12.6%	27.3%	22.7%	23.9%
iShares Global Tech ETF (IXN)	6.8%	20.7%	14.0%	24.1%	23.9%	25.3%
Technology Select Sector SPDR Fund (XLK)	7.1%	<b>22.9%</b>	14.8%	30.7%	25.8%	26.6%

Table 1: Bloomberg, as at 30 April 2019

## Performance Without Taking More Risk

Not only has it performed strongly, it has achieved its performance without taking undue levels of risk – its volatility since inception ranks fourth-lowest amongst the five funds shown. IXN, which holds close to 120 stocks compared to TECH's 31 at present, has been about 1% p.a. less volatile.

## Performance During the Recent Market Correction

Chart 3 shows the performance of the same five ETFs since the end of Q3 2018, which encompasses both the period of market volatility seen in the last quarter of the year and the subsequent recovery in 2019 to the end of April. Over that period **TECH** returned a total of 12.2%, which is more than double the return of the Nasdaq 100 funds and over 4% ahead of the next best performer, XLK.

**TECH**'s maximum drawdown over the period from the end of September 2018 was 17.4%. This was almost 4% ahead of the next best fund, IXN, which dropped 21.4% over the period. In the recovery since Christmas, **TECH** returned 35.8%, which ranks second amongst the funds, behind only XLK, which rose 38.1% to the end of April.

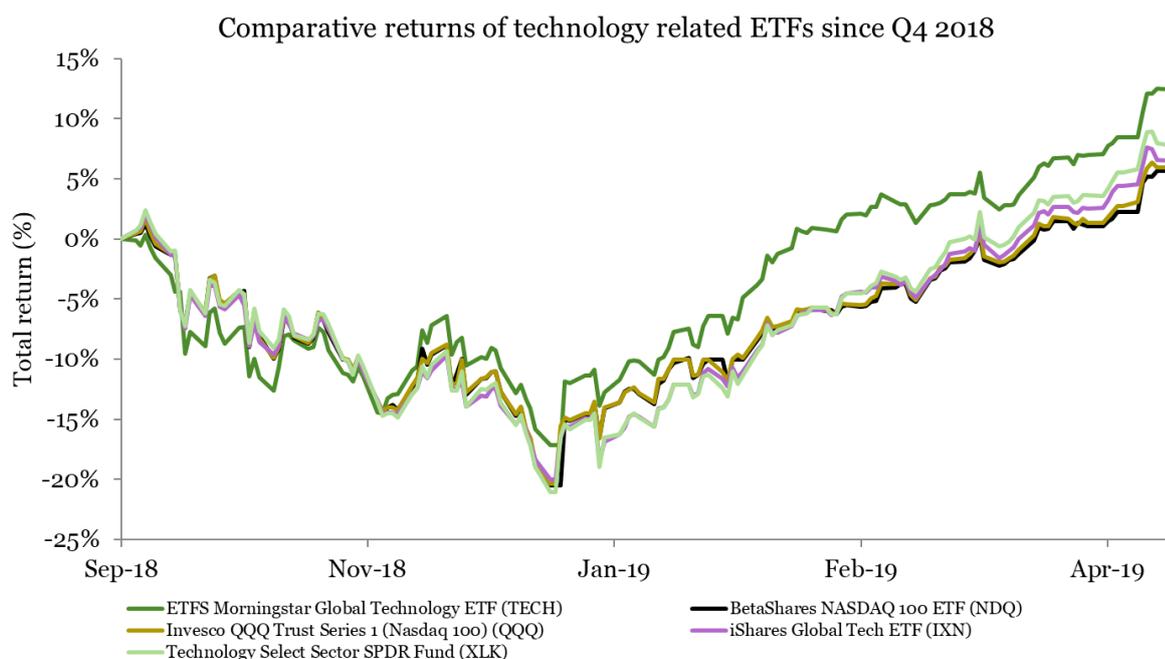


Chart 3: Bloomberg, as at 30 April 2019

## Summary

The ETFS Morningstar Global Technology ETF affords investors a simple solution to allocate assets to the technology sector in an intelligent way. This fund has been designed to provide pure exposure to the sector with stock selections seeking to choose a diversified portfolio of companies that have a competitive advantage over others operating in the field.

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