Tech Weakness; Buy the Dip?

The Nasdaq Index has been particularly weak in the last few weeks, with many parts of the Tech sector seeing a near term peak in late February. Should investors buy the dip or is this the time to exercise caution and perhaps look elsewhere?

First of all, we should try and ascertain why the sell off has happened and find out what, if anything, has changed. The narrative surrounding Tech remains the same and that narrative is a very bullish one; we can all see how technology is transforming our lives and our businesses and how the promise of AI and machine learning will continue to do this at an accelerating rate. The current global chip shortage has also put a focus on the world's insatiable demand for such products, which now go into practically everything we use from cars to fridges to washing machines. Global inventories are very low and in need of a major restocking and this tends to be viewed as early cycle and bullish for the industry. However, chip stocks have not responded well to this situation and the Vaneck Semiconductor ETF has fallen 12% from its recent high in February. Other areas of Tech mirror this underperformance, with Software down 14% over the same time period. Furthermore, Q1 earnings have been very positive across the board but stock reactions have been muted at best and, in some cases, stocks have sold off on great numbers. When stocks go down on blow out quarterly earnings, we think it's time to review and consider what's priced in.

One of the interesting facets of today's market is that there is a 'whale' in the Tech investing space. Cathie Wood's Ark ETFs are famous for their performance and asset gathering, the Innovation ETF having raced to $35bn in assets in February, although this has now reduced to $22bn today due to these tougher markets. The potential issue is that if the Tech sell-off continues, there is a well-known big fund that is holding many of the higher beta Tech stocks and investors could start to trade against the Ark Fund by shorting the stocks that it holds. Ark is very transparent and publishes what it buys and sells each day, so the information is freely available. Ms Wood has already sold down some of her mega cap names, selling 30% of her position in Apple on 11 May, but is keeping faith with smaller, higher beta stocks. There is a risk that further weakness snowballs into more selling by this prominent and closely watched fund manager. While big redemptions have not yet been seen, anyone who invested into the Innovation Fund from November onwards is already underwater, and this could be a factor as any rally in the underlying stocks could be met with selling, as those investors who got in late seek to limit losses.

Our view is that Tech has had a great run, is well owned and is certainly due a breather. It may be that the February peak marks a top for the sector, at least in the short term, and we have taken profits in many of our Tech positions. We prefer other areas of the market, like the Industrials sector, which we believe will be a big beneficiary of the Biden Infrastructure plan, which is looking increasingly likely to be passed. There are some exciting opportunities for these somewhat less glamourous companies to go through their own transformational period.

Felix Wintle, Fund Manager, VT Tyndall North American Fund, 14th May 2021

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