The Three Tailwinds Supporting Tech

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As Russ explains, history is not repeating itself with the recent sharp rise in tech stocks.

If you remember the late '90s you probably remember Pets.com. While the company lasted a scant two years, it rose to fame on the back of an expensive Super Bowl ad and a ubiquitous sock-puppet. What it was not known for was selling many pet supplies. According to Wikipedia, during its first fiscal year revenue totaled about $600,000. Based on my back-of-the envelope math, using 2020 estimates Amazon should generate a similar amount of revenue every 53 seconds.

For investors concerned about the relentless rise of technology stocks, it is important to ask whether the early '20s are becoming a repeat of the late '90s? As I've argued in the past, I think the answer is no. Tech outperformance is not based on hype or clever mascots but on three dynamics: earnings strength, accommodative monetary policy and accelerating secular trends.

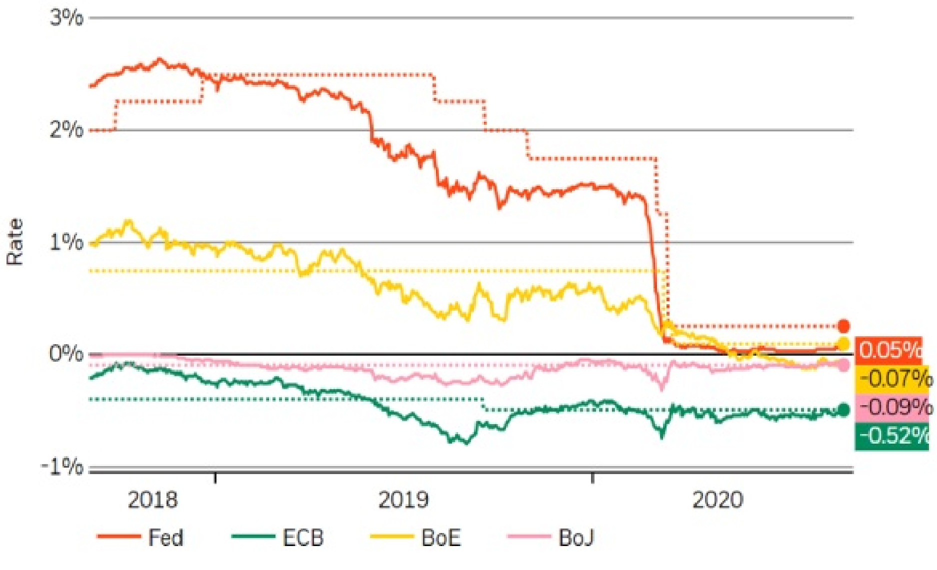
Earnings remain very real

The main reason tech companies continue to dominate: Earnings and margins remain remarkably resilient. This year's estimates for the S&P 500 Technology Sector suggest earnings growth of nearly 19%. One reason earnings have held up: Many of the industries in technology, notably software, continue to maintain sky-high margins, despite the disruptions caused by COVID.

Low-for-long interest rates supports growth and tech

As I have highlighted in previous blogs, technology stocks respond well to accommodative policy. While tech performs best in "risk-on" markets, even when volatility is rising tech tends to outperform if financial conditions are easing. Today, the necessities of the pandemic and a significant evolution in the Federal Reserve's thinking equate to unusually easy policy (see Chart 1), with real (inflation-adjusted) long-term rates at record lows. To the extent the Fed and other central banks are increasingly dedicated to and comfortable with a regime of negative real rates, this is supportive of long-dated assets, i.e. assets where your cash-flows tend to be further in the future, such as growth stocks.

Central bank policy rates and 1y1y forwards



Source: Refinitiv DataStream, chart by BlackRock Investment Institute. August 31, 2020.

Tailwinds are accelerating, not dissipating

Tech outperformance predated COVID and has been based on secular changes, both at the household and corporate level: internet retail, 5G, cloud-computing, gaming. As I have highlighted in the past, many of these trends are accelerating. One telling statistic: Despite the opening-up in most states, U.S. credit data continues to indicate that online retail sales are up 50% year-over-year. Another example of COVID accelerating well entrenched trends.

Trim and pivot

Given the above, I still believe that tech and tech related names will continue to outperform in the coming years. This does not mean that investors should not take the opportunity to trim some of their mega-cap winners. For investors looking to take profits on stellar year-to-date gains, I would consider rotating into other tech-related segments that still have room to run if the economy continues to improve. Examples of the latter could include payment companies and semiconductors. But stick with the sector. Techs gains are now built on a more solid foundation than the last time.

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