CORE DATA research

US Tech Stocks: Bubble or Bonanza?

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Contents

FIVE KEY TAKEAWAYS

1

Almost all advisors (94%) say their clients have exposure to US tech stocks. While 60% of advisor clients gain exposure through individual tech stocks themselves, the most popular investment vehicles used to access the sector are actively managed US large cap/growth funds (68%) and thematic/sector ETFs (63%). More than half (52%) also invest via index funds tracking the broader US stock market such as the S&P 500. This demonstrates that a large number of investors have indirect exposure to tech stocks – putting their portfolios at risk of losses in the event of a correction in the sector. Advisors therefore need to ensure that clients with index funds tracking the US market are aware of the high concentration of tech stocks and the potential risk this carries.

2

The majority of advisors are bullish on the future performance of tech stocks. More than half (53%) say they will outperform in the next year while 28% say they will perform in line with the broader market. Only 16% think US tech stocks will underperform. This optimistic view has led advisors to downplay the existence of a bubble. Only one third (34%) think there is a US tech stock bubble brewing. And an even smaller proportion (18%) think the growth in tech stocks will follow the same trajectory as the dot-com bubble. Advisors are likely overlooking the similarities with the dot-com bubble of the late 1990s because they see the recent rise of tech as an entirely new phenomenon driven by different market forces.

3

The majority of advisors (52%) agree the pandemic has helped push FAANG stocks to valuations disconnected from their fundamentals. But at the same time, advisors do not think tech stocks will fall back down to earth upon removal of the COVID boost. Less than one in five (17%) say an end to the pandemic/effective vaccine will cause a crash in tech stocks. And just 6% think an economic recovery will cause a crash in US tech stocks. This suggests that rather than seeing the tech sector as a pure COVID play, advisors think these companies will continue to benefit from long-term structural and secular trends.

4

Despite their bullishness, advisors think stretched valuations and regulations impacting the tech sector are the most likely causes of a potential crash in tech stocks. Such concerns are translating into action for some advisors — a quarter (26%) have recommended that clients sell tech stocks to protect them from market falls. It is prudent for advisors to recommend clients with heavy exposure to tech to trim their positions on diversification grounds. But they could face some awkward questions if these offloaded stocks go on to generate large returns. When trimming positions, investors could consider a targeted approach by distinguishing between the new breed of recently listed tech companies and the more reliable FAANG stocks.

5

It is interesting to note that while 34% of advisors think there is a US tech stock bubble, only 26% have advised clients to sell tech stocks. This suggests some advisors are adopting a tactical stance towards the sector by recommending clients continue to capture returns in the rally before taking profits when they see signs of the bubble bursting.

Methodology: CoreData Research surveyed 400 US financial advisors in December 2020. Respondents worked for national broker/dealer wirehouses, regional broker/dealers, independent broker/dealers, bank broker/dealers and registered investment advisory firms.

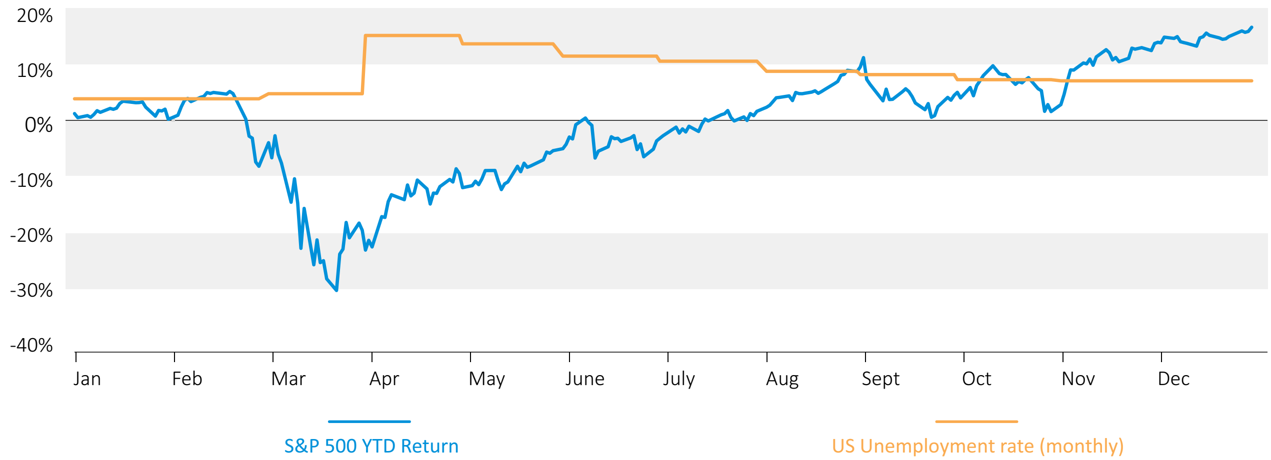
INTRODUCTION

The COVID-19 pandemic has had devastating effects on the US economy. As of writing this paper, COVID-19 has caused more than 510,000 deaths and more than 28 million cases, with counts continuing to rise. The prolonged effects of government-manded lockdowns forced businesses to close and unemployment to skyrocket. A report from the US Congressional Budget Office estimates the pandemic will cost $16 trillion in GDP over the next decade.[1] The fallout from COVID-19 for the US economy will be felt for years to come.

But there has been a significant disconnect between the performance of the US stock market and the wider economy. A massive selloff at the onset of the pandemic led to the S&P 500 being down 30.75% YTD as of March 23, 2020. After this dip, the stock market earned back what it lost and continued to soar past its previous records. The Nasdaq and S&P 500 would end the year up 43.64% and 16.26% respectively, with the latter setting 33 record highs in 2020.

This rally, led mostly by the performance of large-cap US tech stocks, is somewhat perplexing given the state of the rest of the economy. The disconnect has led some to draw parallels to the dot-com bubble of the late 1990s, where the Nasdaq gained more than 400% between 1995 and 2000.

The tech rally has some similar characteristics to the previous dot-com bubble. There has been a prolonged period of low interest rates, exploding valuations and a significant rise in speculative investments on the part of retail investors.



Source: U.S. Federal Reserve Bank, Yahoo Finance

[1] https://www.nytimes.com/2020/06/01/us/politics/coronavirus-economy.html?campaign_id=4&emc=edit_dk_20200602&instance_id=19014&nl=dealbook&regi_id=86292630&segment_id=29856&te=1&user_id=65d7a20413099e4ffd3c5062cb2e9fa3

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With a primary focus on financial services CoreData Research provides clients with both bespoke and syndicated research services through a variety of data collection strategies and methodologies, along with consulting and research database hosting and outsourcing services.

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CoreData Research has developed a number of syndicated benchmark proprietary indexes across a broad range of business areas within the financial services industry.

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- Deep understanding of industry issues and business trends
- In-house proprietary industry benchmark data
- Industry leading research methodologies
- Rolling benchmarks

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Whitepaper compiled by CoreData

To discuss your research needs, contact:

SYDNEY
CoreData Pty Limited
Suite 7, Level 9, 66 Hunter St
Sydney, NSW, 2000
T: +61 2 9376 9600
E: sydney@coredataresearch.com

PERTH
CoreData WA
Level 2 East The Wentworth
Building, 300 Murray St
Perth WA 6000
T: +61 8 6500 3216
E: perth@coredataresearch.com

US
CoreData Research LLC
15 Court Square, #450
Boston, MA 02108
T: +1 857 239 8398
E: boston@coredataresearch.com

UK
CoreData Research Ltd
Office One, 1 Coldbath Square,
Farringdon, London, EC1R 5HL
T: +44 796 910 1179 /
+44 779 336 7190
E: london@coredataresearch.com

PHILIPPINES
CoreData Research Services Inc.
Unit E-1608 Philippine Stock
Exchange Centre, Exchange Rd,
Ortigas, Pasig City, 1605
T: +63 998 581 9950 /
+63 917 562 5667
E: manila@coredataresearch.com