Flash Notes – Performance Update

October 2018

Threadneedle (Lux) Global Technology Fund

After a strong rally in the 3 first quarters of 2018, technology stocks have been under pressure since beginning of October 2018. We take the opportunity of a disappointing relative performance to follow-up on the **Threadneedle (Lux) Global Technology Fund**, to review the fund's performance, positioning and outlook. We hope this update will give you better insights about the strategy to support investment decisions within your client's portfolios.

Performance Review – YTD 2018

The fund underperformed both its benchmark and peer-group on a YTD basis. As of 30.09.2018, the fund returned +8.3% (ZU clean fee share class in USD - LU0957808578) versus +18.6% for the MSCI World / Information Technology GR index in USD. The fund is struggling since November 2017 and it has extended its underperformance until mid-October 2018. This is mainly explained by the fund's overweight and stock selection in the semiconductor industry, as well as an underweight and stock selection in both the hardware and software sub-sectors. All combined, it explains 90% of the underperformance, the remaining stock picking and sector positioning in electronic / communication equipment, IT services, internet software & services has had a negligible impact.

Underweight in Internet retail names has also been a drag, not owning positions in Amazon, nor Netflix, which have both posted stellar returns of more than 60% YTD, has been clearly detrimental to the relative performance.

Macro headwinds

The fund's positioning is facing two main macro headwinds. Semiconductor positioning is challenged by concerns derived from global trade tensions with China, and a potential cyclical peak in the sector's fundamentals. From a style investing standpoint, investors have also favored growth over value, meaning that they emphasised companies with increasing revenue growth, large total addressable markets, and rising subscriber growth, while companies with solid fundamentals and attractive valuations have not been rewarded.

Positioning

The strategy maintains a large relative overweight to the semiconductor industry, 35.6% of the portfolio compared to only 14.1% for the MSCI World / Information Technology index (as of 31.08.2018). However, this overweight has been trimmed down progressively over last months. The fund used to hold around 45% of its total assets in semiconductors 12 months ago.

The investment team retains a positive view on the sector and believes market fears of a cyclical peak are exaggerated for the following reasons:

- Industry consolidation over the last 5 years has resulted in fewer companies, more focused on profitability than gaining market. Currently, there are only 3 DRAM companies left: Samsung, SK Hynix and Micron.
- Increased growth in semiconductor contents across a wider range of end markets. The demand drivers are much more diverse than in the past. In addition to PCs and cell phones, huge amounts of DRAM is required for servers in cloud data centers, surveillance cameras, game consoles, automobile, artificial intelligence applications, or digital TVs

- Slowing of Moore's law has resulted in increased capital intensity to meet market demand, which is a positive for wafer fabrication equipment companies, or semi cap equipment holdings, such as Lam Research or Applied Materials.

Outlook

Paul Wick, lead Portfolio Manager, and his team remain positive on the outlook for the technology sector. Most segments of the technology industry delivered impressive fundamental performance over the last 9 months.

Enterprise IT spending has remained robust throughout 2018, spanning the areas of software, cloud computing, IT services, payment processing, storage, servers, and data networking.

In a similar vein, cloud data center spending has been impressive, with the combined budgets of Facebook, Google, Microsoft, and Amazon up over 40% year-to-date.

PCs are growing modestly in unit terms, and smart phone volumes are flat, although benefiting from higher average selling prices.

E-commerce and digital advertising are still growing at healthy rates, but social media engagement and penetration appear to be hitting a wall.

Cable TV subscribers are still fading, but the pace has declined back to a slow bleed. On the other hand, satellite TV is still beset by high churn.

While streaming music shows no signs of slowing, streaming video is decelerating.

Lastly, the trend of higher electronic content in automobiles shows no signs of abating.

WS Partners view

While we are disappointed by the relative performance of the fund, we still maintain our conviction on the strategy. We like the unconstrained and conviction-led approach implemented in the strategy resulting in a portfolio positioning which is very different from the benchmark and best peers.

In addition, the team has gone though many IT cycles since the 90's and they are very disciplined on valuations which over time tends to create value and avoid overpaying momentum stocks in the sector.

Even so we remain comfortable over the medium term, we will monitor closely the performance of the fund and keep you informed of any change in our opinion.