MONTHLY STRATEGY REPORT
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TECHNOLOGY, INDICES AND GROWING OLIGOPOLIES

BancaMarch

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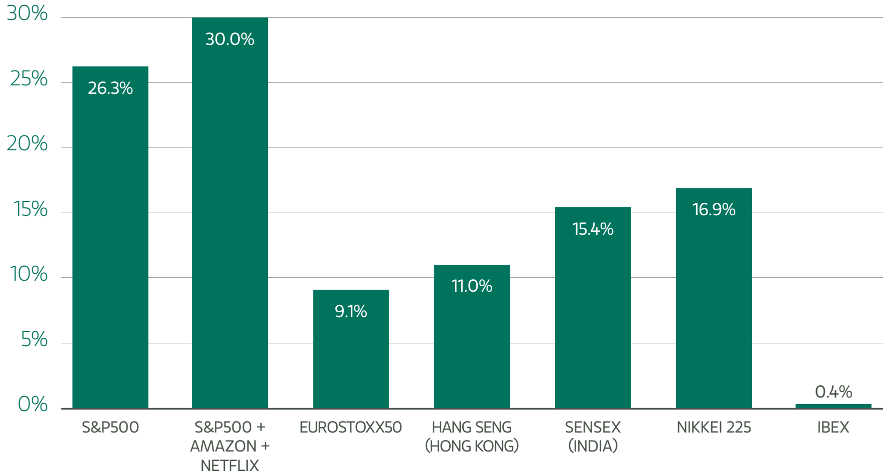
Undoubtedly underlying the strong growth of the economy and US corporate results is the contribution of the tech and 'new economy' companies. The consumer tech industry alone accounts for 10% of the country's GDP[1] and it has greater representation on US stock markets than on those of the core developed economies.

1. WEIGHTING OF THE TECH INDUSTRY ON THE MAIN MARKETS

Source: Bloomberg and Banca March



Nearly half of the S&P 500's gains since the beginning of the year (in an environment of feeble returns for the remaining geographical areas) are attributable to a heavier preponderance of tech. It is also interesting to note that the rise has been concentrated among very few securities. Only nine companies account for 78% of the index's gains, 58% of which (496 basis points) is attributable to the five companies known by the acronym FAANG (Facebook, Amazon, Apple, Netflix and Google).

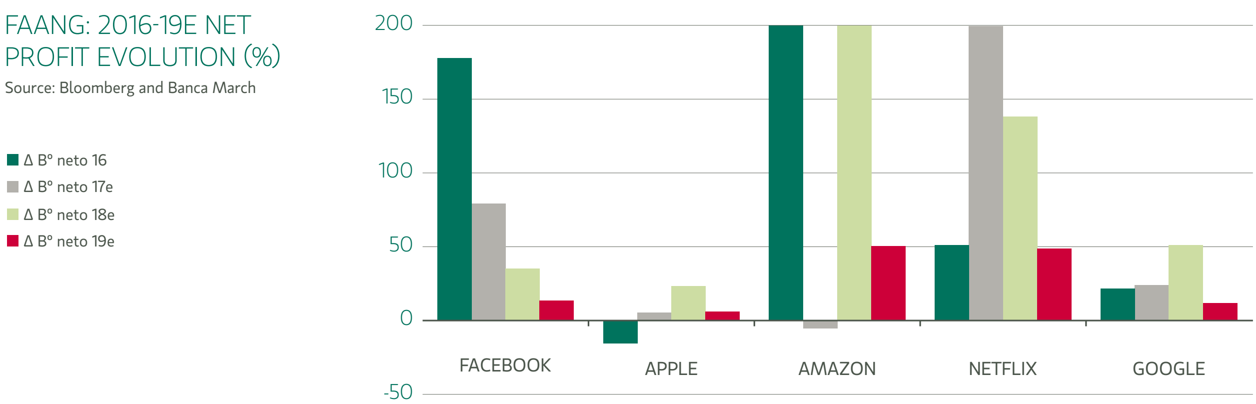
2. CONTRIBUTION OF FAANG TO S&P 500 GAINS

Source: Bloomberg and Banca March

NAME	PRICE($)	WEIGHT (%)	YTD (%)	PERO 12M	CONTRIBUTION (GDP)
S&P 500	2902	-	8,5	18,0	-
FACEBOOK	175,73	1,72	-0,4	20,1	-1
APPLE	227,63	4,39	34,5	18,1	151
AMAZON.COM	2012,71	3,16	72,1	105,0	228
NETFLIX	367,68	0,73	91,5	91,9	67
GOOGLE/ALPHABET	1231,8	3,03	16,9	22,3	51
TOTAL	-	-	-	-	496

3. FAANG: 2016-19E NET PROFIT EVOLUTION (%)

Source: Bloomberg and Banca March



1. US Consumer Technology Association - PWC. US Economic Contribution of the Consumer Technology Sector, 2016.

This group of major US companies has become one of the best representatives of the new economy and the global shift in consumer habits, toward a world much more inclined to obtain information, decide, and shop online. They are growing oligopolies that predominantly control the markets in which they operate; they have strong growth rates but, in many cases, high valuation premiums.

But, can it be said that technology only accounts for 26% of the S&P 500? What is technology? To what extent can companies be considered part of this industry? We all know that Intel and Microsoft are leaders in the semiconductor and software sectors, but which companies truly correspond to the Greek origin of the word, techne (art, skill, and craft), and logos (knowledge set)? Are Amazon, Google and Twitter tech companies?

These questions are difficult to answer. As proof of this, on 28 September, S&P Dow Jones and MSCI will change the way they determine the members and weightings of each sector on their indices. The Global Industry Classification Standard will be modified. These are the most significant changes in history, and with them the indices aim to better reflect the nature of each company's business within the industry. The two main modifications include:

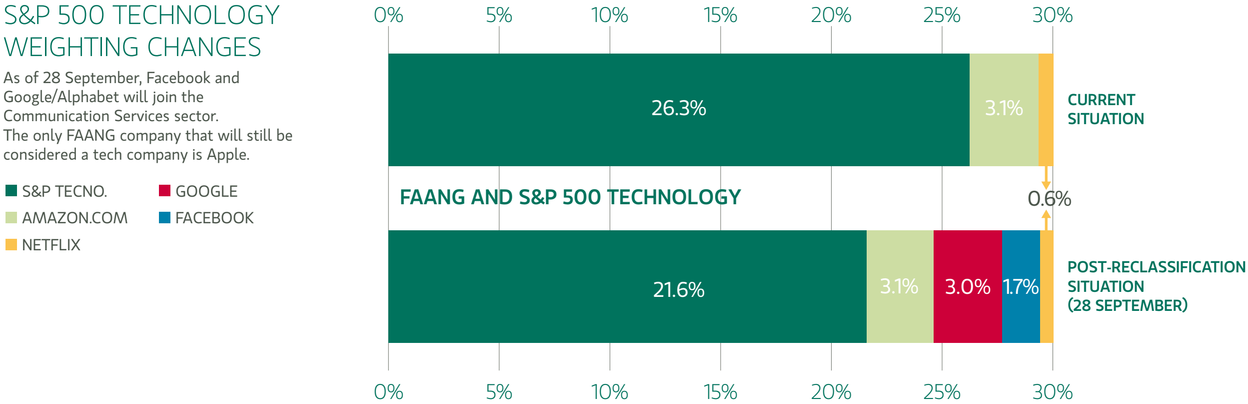
- The Telecommunications Services sector (currently weighted at 2%) will be renamed Communication Services with a weight of 10%. Companies like AT&T and Verizon will be joined by Netflix, Tripadvisor and Time Warner. Consequently, the profile of this sector, traditionally lacklustre, indebted, and with little growth, will change radically. A good reflection of this situation is the fact that the 12m P/E ratio of 11.8x will climb to 19.8x.

- The Internet Software and Services sub-industry will be eliminated and its components shifted to the Consumer Discretionary sector, Communication Services and Technology. As a result, the weight of S&P 500 Technology will shrink from its current 26% to 21%, by shedding companies like EBay, Alphabet/Google, Facebook and Twitter, which will move to the Consumer Discretionary sector.

- Apple is the only FAANG company that will remain in the S&P tech industry, with a weight of 4.4%.

4. S&P 500 TECHNOLOGY WEIGHTING CHANGES

As of 28 September, Facebook and Google/Alphabet will join the Communication Services sector.
The only FAANG company that will still be considered a tech company is Apple.



The new configuration of the indices is a confirmation that Darwin's theory of natural selection can also be applied to companies. What is initially a purely technological advantage slowly permeates the economy and if traditional business models fail to internalise and incorporate it swiftly, they will disappear. Adrian Slywotzky describes this phenomenon in his book, Value Migration[2], wherein he analyses how leading companies are able to transform business models to the extent that the rules of the game are changed, resulting in companies that have fewer competitive advantages (like technology). In the long term, they manage to absorb the value of their rivals. A good example of this was Apple's reinvention in the late 90s under Jobs, as opposed to companies like Eastman Kodak that failed to anticipate the looming technological wave.

2. Slywotzky Adrian J. Value Migration. Harvard Business School Press, 1996.

A near-term reading of the changes would aim to anticipate the behaviour of the USD 80 billion currently invested in ETFs and tech indices since the parameters for making comparisons are going to change dramatically. Already the increase in communication services versus technology is striking.

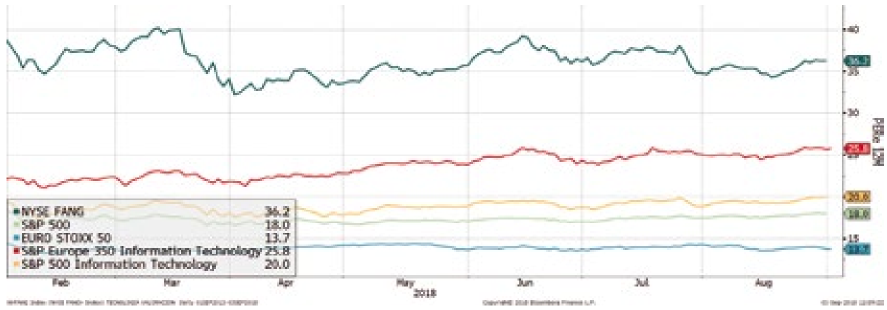
In any case, it is much more important to remember that technology is a treasure trove. Call it what you will, change the composition of the indices, say Apple is the only tech firm… the companies are the same. Having Silicon Valley as a driver of development and profit growth is a real advantage over other countries.

At Banca March, we continue to recommend overweighting in Technology (in addition to banks and industrials), but with important nuances:

- Be cautious with FAANG. These are companies with very different profiles united under a convenient acronym, whose business models, rates of profit growth, and valuations have little in common, as shown in graphs 3 and 4. Be especially prudent with companies like Netflix and Facebook, where the entry barriers are not as challenging as some may think and valuations are vulnerable.

5. VALUATIONS OF TECH INDICES

Source: Bloomberg and Banca March

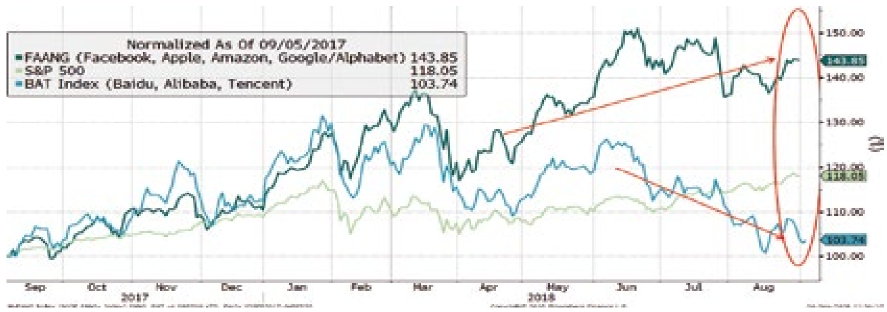


- It is preferable to channel investments toward indices or companies like those of the S&P 500 Information Technology, where, as graph 6 shows, not only is concentration risk lower but the valuation is 44% more attractive.

- We recommend refraining from buying tech at any price and being swept up in the "unstoppable growth" of FAANG companies. While it is true that establishing valuations for these new businesses is difficult, given that we have never before encountered a digital transformation, the markets always provide opportunities.

6. RETURNS: FAANG VS. BAT (BAIDU, ALIBABA AND TENCENT) AND S&P 500

Source: Bloomberg and Banca March



As graph 6 demonstrates, since the threat of a trade war began, the main Chinese competitors of certain FAANG companies, the BATs (Baidu, the Chinese Google; Alibaba, Amazon rival; and the giant, Tencent), have shown their vulnerability and in the last six months, presenting an opportunity to obtain a 30% appreciation. Technology yes, but not at any price.

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