CIO Perspectives

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Key points

- Recent spike in bond yields triggered sharp selloff in "long duration" equities in the Technology sector
- Despite the selldown, "Big Tech" displayed superior resilience relative to "Emerging Tech"
- US bond yields have historically displayed strong inverse relationship with the valuation of the Technology sector
- Prevailing level of 1.92% for the UST 10Y suggests that the bulk of the increase in bond yields (and by extension, correction in Technology) is behind us
- Strong earnings surprise for Technology in current reporting season underlines the resilience of the sector
- Prevailing weakness in Technology presents an opportunity for investors to build long-term positions in secular trends

Asset Allocation

Rising yield concerns on Technology – Priced in

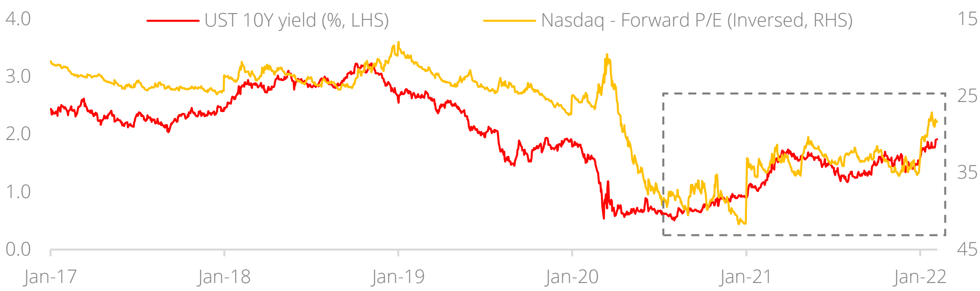
Yields concerns weigh on "long duration" equities; "Big Tech" displayed strong resilience relative to "Emerging Tech". The hawkish Federal Reserve pivot towards policy normalisation continue to dominate market narratives as investors remain fixated on incoming inflation and wage data to gauge the extent of monetary tightening this year. On a year-to-date basis, the S&P 500 has lost 5.9% while "long duration" equities like Technology bore the brunt of the selldown, with the Nasdaq losing 10.4%.

The selling pressure on Technology is based on the assumption that rising bond yields will translate to lower present value for high growth companies with low profitability on a discounted cash flow perspective. And indeed, this train of thought is evident in the stark outperformance of "Big Tech" over "Emerging Tech" in this selldown as investors exited Technology plays with low profitability.

Everything has a price – Technology selldown hitting a trough as rising yields concerns are priced in. As Figure 1 shows, the forward valuation for Nasdaq has historically displayed close inverse relationship with bond yields – With rising yields translating to valuation compression and falling yields leading to valuation expansion.

Since 2021, the forward price-to-earnings ratio (P/E) for Nasdaq has compressed 32% and this coincided with a 100bps increase in the US Treasury (UST) 10Y yield. Based on consensus forecast, the latter is expected to hit 2.15% by 4Q22 and the prevailing level of 1.92% suggests that the bulk of the increase in bond yields (and by extension, valuation contraction for Technology) has already taken place.

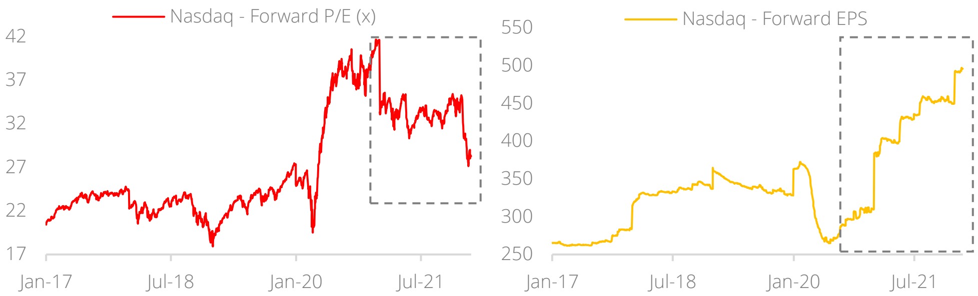
Figure 1: Tech valuation pricing in the impact of rising bond yields



Source: Bloomberg, DBS

Resilient Tech earnings offsetting contraction in valuations. The ongoing US earnings season saw the Technology space reporting earnings surprise of 90% and this is the highest on S&P 500. Notable Technology-related companies reporting earnings beat include Apple, Alphabet, and Microsoft. Since 2022, Technology sector earnings forecast has been revised up 10% and more upward revisions are expected as the global economic recovery gathers pace. The prevailing weakness in Technology presents an opportunity for investors to build long-term positions in secular trends.

Figure 2: Pullback in Tech valuation offset by robust earnings growth



Source: Bloomberg, DBS

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