



"In the short run, the market is a voting machine but in the long run, it is a weighing machine" – Ben Graham

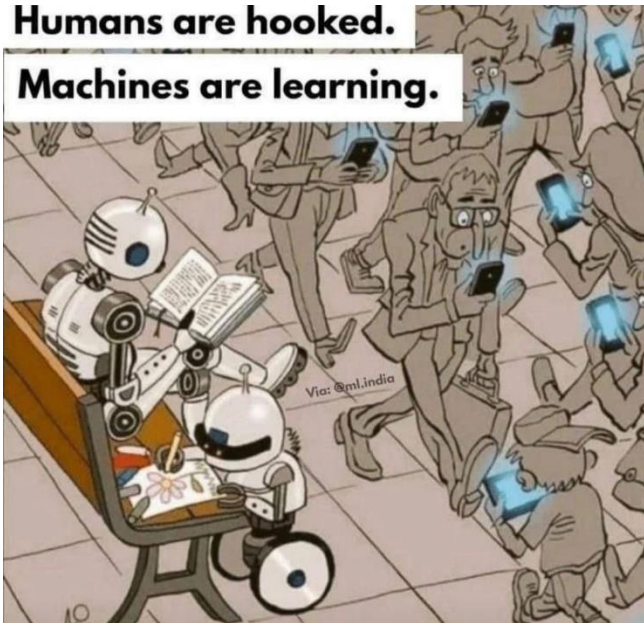
As the narrative of human subservience to artificial intelligence has gained traction, speculation is ripe that Tech sector will be the main beneficiary and earn abnormal profits.

However enough has been written already about the YTD market frenzy and its narrow breadth in the backdrop of FED pause and AI revolution, so in our latest monthly market insights, we will share our two cents by simply framing the facts against the narrative.

After all, a picture (s) speaks a thousand (s) words!

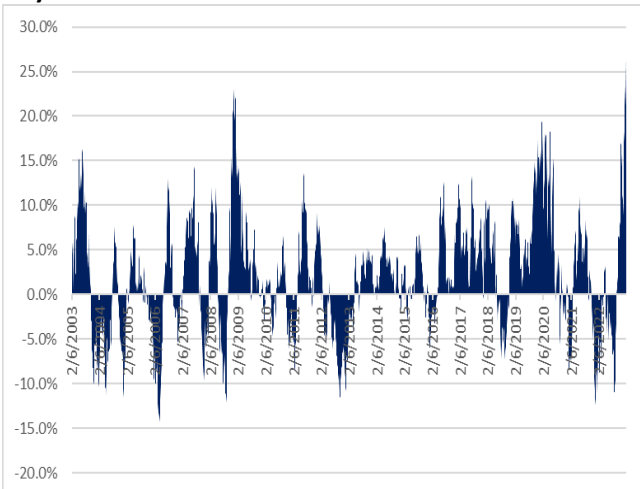
Humans are hooked.

Machines are learning.



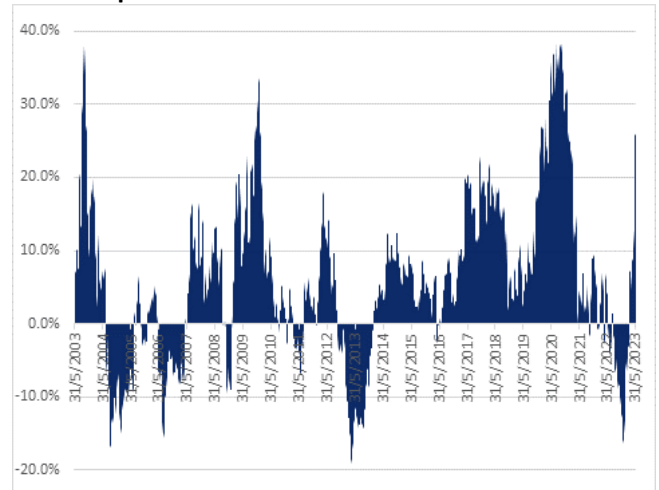
Source: Twitter.

Best 90D outperformance of Tech vs S&P 500 in the last 20 years.



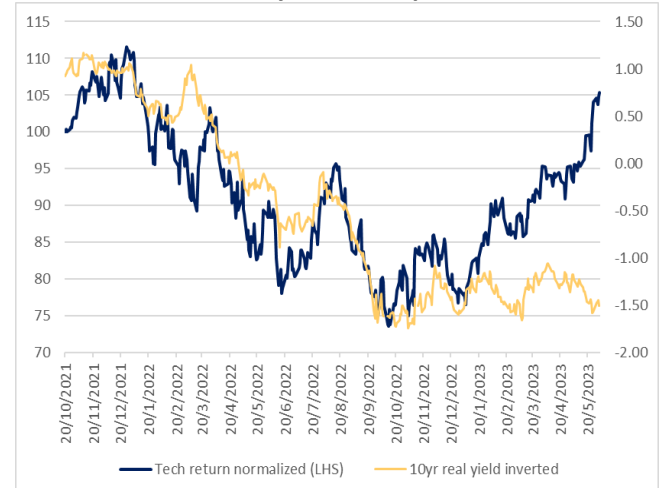
Source: Bloomberg.

252D outperformance of Tech vs S&P 500.



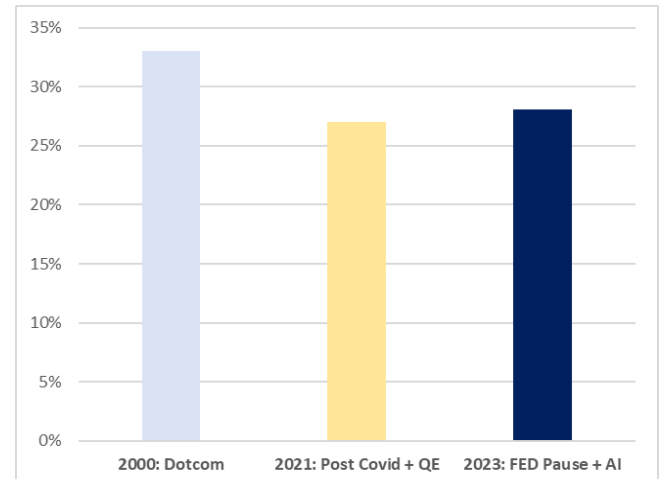
Source: Bloomberg.

Correlation between Tech sector and 10yr bond yield breaks. Tech sector only 4% below peak.



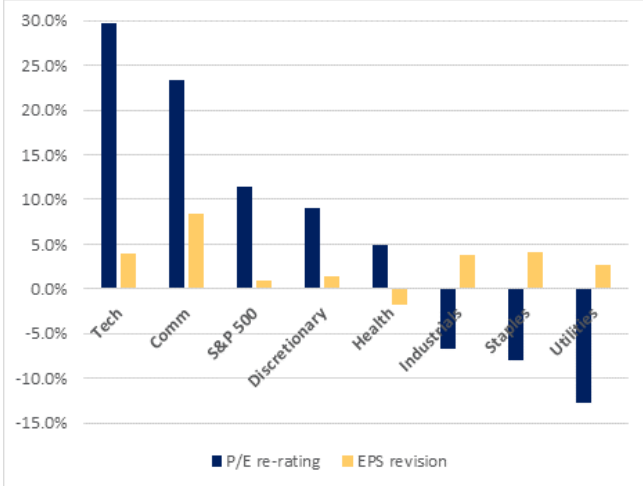
Source: Bloomberg. SPDR ETF price return.

Tech sector weight in S&P 500 reaches 23yr high, only below dotcom era.



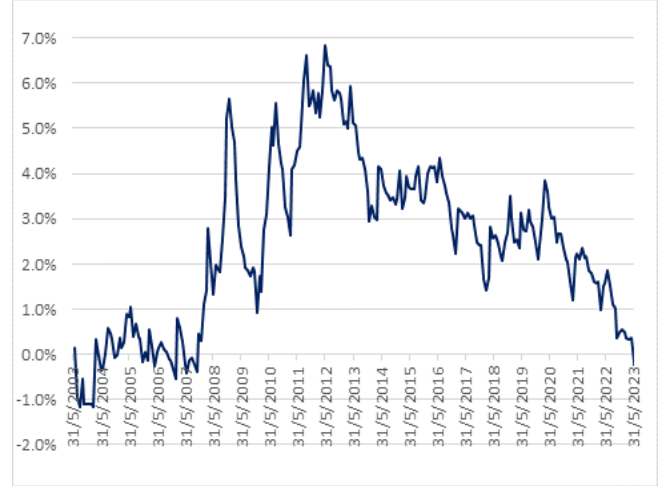
Source: S&P Capital IQ. 2023 percentage as of 31st May 2023.

P/E multiple of Tech sector expands ~30% YTD to reach 29x whereas its forward EPS revised up ~4%.



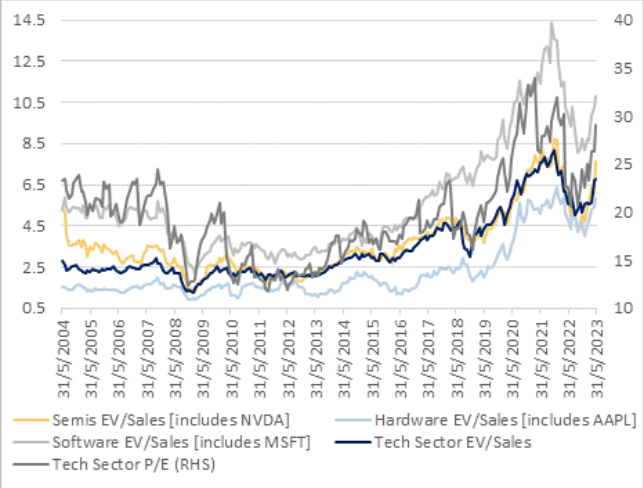
Source: Bloomberg estimated P/E ratio and Bloomberg blended 12m forwards EPS change.

The spread between Tech sector earning yield and US bond yield turns negative, last seen before 2009 GFC.



Source: Bloomberg. S&P 500 Tech E/P minus 10-year US bond yield i.e. risk premium on S&P Tech turns negative unless compensated by growth.

Tech sub-sectors' valuations reaching 2021 levels driven by mega-caps.



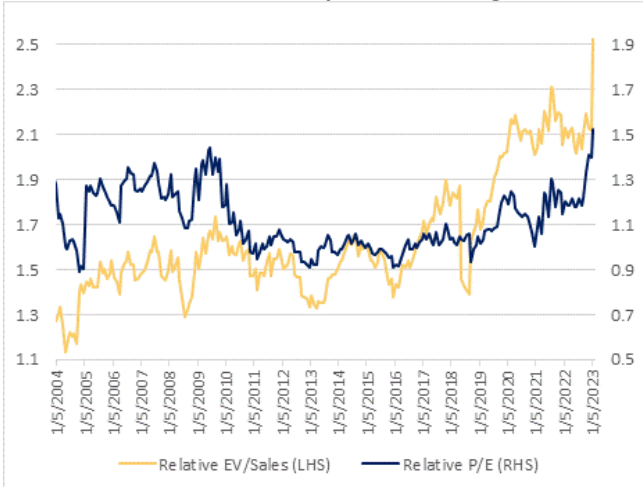
Source: Bloomberg: EV/12-mth trailing sales, P/E = Bloomberg estimated P/E.

Russell 1000 Growth Index valuation to Russell 1000 Value Index reaching 2021 peak.



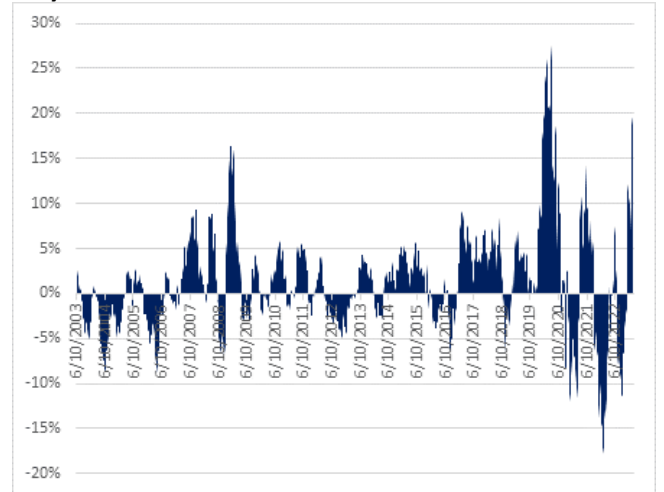
Source: Bloomberg. Russell Growth vs Russell Value P/E.

Valuation premium of Tech sector versus S&P 500 ex-Financials reaches historical peak, excluding dotcom era.



Source: Bloomberg. S&P 500 Tech multiple relative to S&P 500 ex-financials multiple.

90day outperformance of Growth vs Value shy of covid only.



Source: Bloomberg. Russell 1000 growth vs Russell 1000 value index.

Conclusion

So, what do we make of these pictures?

On the one hand, Tech sector valuations now look extremely rich relative to S&P 500 and Bonds. On the other hand, expectation of strong fundamentals of Big-Tech, AI opportunity and slowing economic growth is a tailwind; add to it the support from policy given the consensus on FED pause.

That said, there are no easy answers but as history has it (unless investors are craving another dotcom) when one sector has achieved escape velocity and driven the overall market higher, subsequently it has felt the pressure of

gravity, else other sectors have caught up; from a macro standpoint, a still high nominal GDP growth rate, a secularly tight labor market and a FED pause could be the catalyst for value factor.

On balance, positioning for such an inflection or otherwise, we turn tactically underweight Tech sector relative to Healthcare and Staples sectors whereas tactically Short Growth (Russell 1000)/Long Value (Russell 1000) via optionality.

For further details on our active fund management capabilities and strategies, you can reach out to us at IR@farrocapital.com

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