FLASH

Covid-19's meteoric impact has accelerated a new tech age

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Covid-19 has accelerated the inevitable. Before the pandemic, the world had been moving on an inexorable path toward a new digital age, despite many businesses failing to invest in the requisite technologies. But as the Covid-19 meteor hit global markets, companies in sectors like retail that failed to recognise the encroaching new virtual age were brutally impacted in the market sell-off.

What is undeniably clear in the post Covid-19 age is that companies that do not leverage on new technologies might not remain competitive relative to new entrants. The sheer pervasive reach of tech across industries is challenging traditional valuation frameworks.

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Evolutionary steps

Tech has evolved strongly since the TMT bubble – and now the power of consumer-driven tech firms is underpinned by strong earnings and revenue growth, not wishful thinking and speculation.

Meanwhile, value and growth and other 'factor' models have failed to capture intangibles, such as the power of AI and access to data. The acid-test of quality in the depth of the crisis revealed that companies more attuned to the demand dynamics of a virtual world were the winners.

The term 'tech' is no longer fit for purpose. Tech is not a sector anymore; in many industries, company growth is now constrained by the degree to which tech exists in business models – across every sector. For example, even a cosmetics firm like L'Oréal has a strong tech component. Their e-commerce channel is growing very fast and as importantly, they have known how to attract younger generations with apps that use augmented reality for make-up.

For a long time prior to the crisis, we focused our equity stock selection on quality global players with high margins and rock-solid balance sheets harnessing strong tech attributes and consumer interfaces – for example, Amazon, Microsoft and Alphabet. Digitalisation of society is leaping forward, and these companies will benefit disproportionately.

Trends like flexible working arrangements, online meetings and home shopping delivery have been cemented by the crisis. Long after lockdown is lifted, we will see how deeply these behaviours have been engrained. We believe the virtual world we will see post crisis will look very different than anything we have experienced before.

Tales of two tech worlds

Not all tech companies are the same. We believe the companies focused on building strong consumer interfaces, business services and cloud technologies are particularly well poised to benefit from the crisis.

These firms have benefitted from the crisis, as business and societal practices have changed. On the other hand, businesses dependent on ad revenue, such as Facebook and Alphabet, have faced headwinds. Other businesses, like MasterCard, will also feel the impact of less travel and general discretionary spending.

We tend to avoid companies where risk is too hard to control. For example, miners around commodity price fluctuation risk and banks around interest rate risk. Another lens we apply is disruption risk – how tech can impact industry, for example, the implication for the hotel sector of Airbnb or the potential disintermediation of banks through fintech.

We have avoided typical 'value stocks' – and this bias has seen a larger geographical exposure to US over Europe. A lot of these stocks have been beaten up – and there will eventually be opportunities in sectors like travel and entertainment. However, it is crucially important to undertake forensic research to avoid value traps, as many firms are cheap for good reason. Above all, we are looking for companies which will emerge stronger from the crisis and equipped for the new digital age.