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FUND COMMENTARY – Q2 2023

Threadneedle (Lux) Global Technology

Paul Wick
Fund Manager
Since: 14/03/2014

Fund Information

You are investing in a fund that is actively managed in reference to the benchmark below. Please refer to the Prospectus and KIID for the Fund objective.

Fund Benchmark: MSCI World Information Technology Index

Inception Date: 31/05/1997

Fund Currency: USD

Fund Domicile: Luxembourg

Summary

- Global stocks rose, and technology significantly outperformed.
- Gross of fees, the fund posted a return of 12.5% in US dollars, lagging its benchmark.
- The underperformance was due to unfavourable selection effects.
- We added to some holdings, including Tenable, Splunk and T-Mobile. We sold Ericsson, GlobalFoundries, National Instruments and Qualcomm.

Market Background

World equities posted positive returns in the second quarter (Q2). Technology stocks continued to outperform defensive sectors, boosted by the prospect of lower interest rates and rising optimism about the potential for artificial intelligence. The MSCI World Technology index returned 14.8% in dollars, compared to a return of 5.6% for the MSCI All-Country World index.

Early in the quarter, better-than-feared bank earnings for Q1 were supportive of equities. In March, headline US consumer price inflation (CPI), slowed for the tenth consecutive month. Meanwhile, U.S. non-farm payrolls eased again, suggesting that the strong labour market may finally be showing signs of cooling. Estimated U.S. gross domestic product growth initially came in below consensus. However, this was later revised up to 2.0%, slightly above original estimates, and the housing market remained robust. The mixed economic picture and lack of consensus around the US Federal Reserve's future rate path continued to fuel the debate about whether there would be a soft or hard economic landing.

Although U.S. indices stalled overall in May, tech-focused companies continued to climb. At the May Federal Open Market Committee (FOMC) meeting, the Fed increased rates by 0.25%, as expected. However, investors were left wary after minutes from the meeting suggested uncertainty around the future direction of policy. Throughout May, negotiations to suspend the US national debt ceiling grinded on and eventually resulted in an agreement to suspend the debt ceiling until January 2025. The CPI eased further in April, falling to an annual rate of 4.9%, although the Fed's preferred inflation gauge – the index of core personal consumption expenditures excluding food and energy – moved slightly higher to 4.7% year over year. June brought welcome stability in the banking sector, along with relief that the government treasury default had been avoided. Equities were also supported by a cooler-than-expected May CPI report, which showed that annual inflation had slipped to 4.0%, its lowest level since March 2021. The Fed then announced that it would pause interest rate increases to assess the impact of prior hikes, however, the central bank's comments remained hawkish and suggested a longer wait for rate cuts.

Within the benchmark MSCI World Information Technology index, the semiconductor segment posted robust gains of over 20%. The hardware and software sectors also fared well, with gains in the high teens. IT services posted an absolute return but lagged the technology benchmark, while electronic equipment also showed modest gains. Communications equipment was the only sector to fall during the quarter, dipping slightly into negative territory.

Performance

12M Rolling Period Return in (USD) - as at 30 June 2023

	06/22-06/23	06/21-06/22	06/20-06/21	06/19-06/20	06/18-06/19	06/17-06/18	06/16-06/17	06/15-06/16	06/14-06/15	06/13-06/14
Fund (Gross) %	27.97	-18.75	69.39	29.96	10.15	20.88	40.15	0.07	19.75	31.83
Index (Gross) %	37.16	-19.10	43.09	33.26	13.13	28.96	33.84	2.11	10.22	30.90

Source: Columbia Threadneedle Investments as at 30/06/2023. Gross of fee fund returns are time-weighted rates of return net of commissions transactions costs and non-reclaimable taxes on dividends interest and capital gains using pricing of investments which is either the last traded price or a bid basis. Cash flows are factored as of the end of the day and exclude entry and exit charges. Index returns include capital gains and assume reinvestment of any income. The index does not include fees or charges and you cannot invest directly in it. The return of your investment may change as a result of currency fluctuations if your investment is made in a currency other than that used in the past performance calculation.
Past performance does not predict future returns and future returns are not guaranteed.

For detailed information on Fund Changes please see Significant Events - Threadneedle (Lux) Funds PDF available on www.columbiathreadneedle.com/en/changes

Gross of fees, the fund returned 12.5% in dollar terms and lagged the benchmark MSCI World Information Technology index.

Among the benchmark positions, sector allocation was positive for returns. The above-benchmark stance in semiconductors made the greatest contribution, followed by gains in electronic equipment. IT services made a more modest contribution, while communications equipment and software dragged slightly. Hardware was the month's only significant laggard. Turning to stock selections, picks in semiconductors were most detrimental with smaller losses in IT services and software. Hardware and communications equipment recorded slight relative gains. Our stock picks in electronic equipment provided the greatest boost to returns. Meanwhile, the off-benchmark holdings detracted from relative performance overall.

Nvidia's blowout earnings report was the standout event for tech stocks, further igniting investors' interest in AI and causing shares in several semiconductor companies to soar. The fund's underweight position in Nvidia was the biggest drag on returns after its management raised its quarter-on-quarter sales guidance by 50%, and said that earnings would be twice analysts' consensus estimates. The company said that data centres were behind the surge in demand, as customers transition from CPU hardware to AI accelerators. The overweight in Synaptics was another notable laggard after the company lowered its guidance due to reports of excess inventory among its IoT (Internet of Things) customers. Analog Devices also underperformed after it reported weaker orders from auto and industrial customers in China. Teradyne was weaker than the technology benchmark after reporting lower sales across the business, particularly in its PC and handset divisions. More positively, Broadcom, Renesas, Lam Research and Marvel were among the top chip stocks. Broadcom led the pack and remains a high conviction holding due to its strong market positions in data centres, networking and recurring software. The company is highly profitable and operates in end-markets benefitting from powerful long-term secular tailwinds. The firm is well positioned to benefit from AI, thanks to its Jericho3-AI fabric, which helps network operators manage the growing demands from surging AI workloads. We also like Broadcom for its approach to capital allocation, with management committing to return excess cash to shareholders. Renesas posted gains after reporting that margins had risen to the mid 50% range, while revenue has proven surprisingly stable considering the fluctuating recent demand in its consumer markets. Shares in Lam Research overcame reports of weak trading in June and suggested that sales will pick up in the second half of this year and continue to improve in 2024. The company said it should benefit from rising tool exports to Chinese foundries after the US clarified its recent trade restrictions. Shares in Marvel gained as the company reported higher chip sales to facilitate its customers' increasingly ambitious plans. The firm said it has multiple new chip designs entering production, partly to meet the rapidly growing demand for AI.

The fund's returns in hardware were hindered by the underweight in Apple, as the shares made further gains. Apple, which comprises a 16% weight in the benchmark index, is increasingly viewed by investors as a resilient consumer goods firm winning a rising share of global electronics spend. Our holding in Apple represents approximately 6% of the fund's assets, which we view as appropriate from a portfolio construction and risk management perspective. The Apple losses were partly offset by our gains in Dell. The company said was optimistic about the potential productivity gains from AI, and that customers' demand for AI technology was reflected in longer lead times for its AI Servers.

In software, Dropbox and Palo Alto Networks were among the top contributors. Dropbox posted results that were better than forecast due to strong sales from the recently acquired Formswift, a cloud-based platform that helps businesses build, edit and share personalised documents. Palo Alto also topped expectations, with strong cashflow and sales due to progress in their software firewall and next generation portfolio. The company remains well positioned in their core firewalls business and is enjoying rapid growth in SD-WAN, next generation VPN and cloud workload security. The fund's underweight in Microsoft (a 13% weighting in the benchmark) was the segment's main detractor as the shares benefitted from enthusiasm towards AI. Microsoft's investment in ChatGPT creator Open AI has earned it a perceived leadership position in generative AI, and Microsoft continues to implement the technology across its product range. Elsewhere, not owning Adobe was detrimental to relative returns as the firm reported record revenue driven by strong demand for its cloud software solutions. The holding in TeamViewer was unhelpful as the shares drifted lower despite posting positive Q1 results. Investor enthusiasm for its strong margins and double-digit revenue growth was tempered by the prospect of rising financing costs, though management said the company was on track to meet its full year guidance.

In IT services, the holding in GoDaddy had the most notable impact, weighing on relative returns after posting a small absolute loss in a rising market. However, management said the company made good progress towards its target of returning to double-digit revenue growth, while the applications and commerce segment topped forecasts. The loss from GoDaddy was partly offset by the favourable impact of not owning several stocks that lagged the benchmark, including IBM, Accenture and EPAM. The electronic equipment segment also benefitted from not owning index laggards, including Keyence and Murata Manufacturing. Communications equipment made a negligible contribution to relative returns in aggregate. Gains from not owning Cisco were offset by the underperformance of F5 and Arista Networks. F5 reported pleasing Q2 revenue growth but cut its forecast for the remainder of this year, citing persistent macroeconomic uncertainty. Arista also reported sales progress and said that improving supply chains should lead to further improvements later this year.

Bloom Energy was the most significant detractor among the fund's off-benchmark holdings. The company said that its core earnings are more predictable, while its unit costs continue to fall by double digits despite inflation. However, Bloom's shares came under pressure after the firm unveiled plans to offer a $550m convertible bond to shore-up its balance sheet and provide a cushion to help with costs associated with its next phase of growth. The company's management adequately addressed investors' concerns about its debt at a well-received investor day later in the quarter, and our investment thesis remains intact. eBay also weighed on relative performance, as the shares were largely flat for the period. The company's Q1 results were ahead of expectations and management said the firm was making progress towards its long-term objectives. Shares in Activision Blizzard continued to tread water in the absence of significant developments regarding Microsoft's planned acquisition of the firm. Turning to financial services, not owning Mastercard, PayPal and Block boosted relative returns, as sentiment towards payment firms continued to be dogged by concerns about lower consumer spending and fears that Apple Pay is gaining a bigger share of the payments market.

Activity

We added to several positions including Tenable, Splunk, T-Mobile, Cerence, Bloom Energy and Match Group. We also increased the holdings in HireRight, Dell, Fidelity National Information Services, Dropbox, GoDaddy and Microchip Technology.

We sold Ericsson, GlobalFoundries, National Instruments and Qualcomm.

Outlook

By the midpoint of 2023, the technology market has posted strong returns. This has mostly been due to enthusiasm surrounding artificial intelligence and its potential to transform the global economy. We too are excited about the productivity gains promised and believe we are in the early stages of a secular trend. However, we remain watchful that the early winners may not be the companies that are the greatest beneficiaries of AI over the long term. We also note that this year's market gains are attributable to a small number of large companies, and that the impact of the Fed's tightening campaign may not have been fully realized. We remain true to the valuation aware investment discipline that has served our investors well over the years. With that in mind, we will continue to position the portfolio to take advantage of opportunities that offer the best balance between risk and reward.

Key Risks

The value of investments can fall as well as rise and investors might not get back the sum originally invested.

The investment policy of the fund allows it to invest in derivatives for the purposes of reducing risk or minimising the cost of transactions.

Where investments are in assets that are denominated in multiple currencies, or currencies other than your own, changes in exchange rates may affect the value of the investments.

The fund has a concentrated portfolio (holds a limited number of investments and/or has a restricted investment universe) and if one or more of these investments declines or is otherwise affected, it may have a pronounced effect on the fund’s value.

The fund typically carries a risk of high volatility due to its portfolio composition or the portfolio management techniques used. This means that the fund’s value is likely to fall and rise more frequently, and this could be more pronounced than with other funds.

All the risks currently identified as being applicable to the fund are set out in the “Risk Factors” section of the Prospectus. Please read the Key Investor Information Document and the Fund Prospectus if considering investing.

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