Technology demand putting heat in tech stocks rally

Digitalisation and automation likely to drive tech boom for the next five years

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ONE of the main theme investors, industry players and analysts are telling themselves is that stay-at-home orders because of the pandemic have accelerated the usage of technology.

A question that is hogging the investment world these days is whether the lofty valuations of tech stocks are justified. The concern is whether the share prices of tech stocks are in for a major correction. Is this going to be a repeat of the year 2000 dot.com bubble burst?

And with the Covid-19 pandemic continuing to hurt economies around the world, it is unusual for technology stocks to surge to all-time highs.

The Nasdaq technology index, for instance, is up by 86% since March last year.

Back home, the Bursa Technology Index has almost tripled and hit an all-time high of 90.86 points from 26.33 points a year earlier, outperforming the benchmark FBM KLCI.

No wonder then that these concerns have led the technology-heavy Nasdaq index to enter into a correction territory over the last two weeks, sliding by over 10.5% from its peak on Feb 12.

Similarly, Bursa Malaysia's Technology Index has fallen by almost 11.8% since its record-high level on Feb 25.

However, since the correction, both Nasdaq and Bursa Tech Index have recovered a bit.

This then brings back the question – are these tech stocks in a bubble and can their super-high valuations be justified, considering that a number of them are trading at price-earnings multiples of more than 100 times?

Adding to the froth are the spikes in share prices of recent listings of technology-focused special-purpose acquisition companies (SPACs). The amount of money raised by SPACs in the past 12 months has topped US$120bil, going by *Bloomberg* data. Post-listing, many of these SPACs have seen their share prices rise further even though these cash shells have yet to make their acquisitions yet.

However, some point out that historically, technology stocks have tended to trade at higher valuations than other sectors as it is seen as a "high growth" sector.

One analyst also believes that in comparison to the 2000 dot-com heyday, today's listed technology firms are mostly backed by "clear" earnings growth forecasts.

"The valuations of the technology sector are justified through their earnings growth and cash flow. There are fundamental values in the sector, unlike during the dot-com bubble of 2000," the analyst says.

In 2000, many valuations in technology stocks were even more stretched and investors were bidding for unprofitable Internet companies that had no tangible assets and were only a few years old.

Today, most technology companies are supporting structural change in both lifestyle and businesses.

An analyst with a government-linked investment company dismissed that there is bubble building in the technology sector and that the recent selldown in technology stocks is "a short-term correction".

"When looking into the technology sector, there are the software companies which are usually trading at higher valuations in the US. Then there are the hardware companies such as semiconductor manufacturers that are usually trading at 'more reasonable" prices," he tells *StarBizWeek*.

He reckoned that at the moment most technology stocks are trading at "slightly elevated" valuations but he does not consider those valuations lofty.

"Technology companies today are generating profits and we expect their growth will continue this year, backed by the structural change in how people are doing business and in their lifestyle for the next three to five years.

"Their growing sales would support their current valuations," the analyst says.

New technology drives

Pentamaster Corp Bhd chairman C B Chuah tells *StarBizWeek* that the local semiconductor manufacturers are supported by demand created by new technological advancements such as 5G, electrical cars and autonomous vehicles.

In addition, he says, the work-from-home trend due to the Covid-19 pandemic has given an extra boost to the demand for handphones and other gadgets such as computers and advanced home appliances.

"These technologies are driving the demand for handphones and wearable devices. In addition to Internet of Things, cloud computing and automation are drivers of growth as they require higher usage of semiconductors items.

"We expect demand to remain elevated in the next two to three year," he says.

Chua adds that Pentamaster's factories are running at full capacity and that the company has already started to expand its manufacturing plant by almost 50% to cope with demand.

Pentamaster manufactures automated and semi-automated machines and equipment, designs and manufactures precision machinery components, as well as assembles and installs computerised automation systems and equipment.

Chuah says that the recent shortage of chips was due to the sudden surge in demand in the second half of 2020 because of the movement control order (MCO) that saw many factories scale down their production. This was coupled with a spike in electronic devices, with people working and studying from home.

"People can't travel or go anywhere, many want to upgrade their devices. In the past, you could buy computers anytime but now there is a waiting period," he explains.

"As long as there is new technology, the demand for semiconductors will continue to grow," he adds.

Meanwhile, Astramina Advisory managing director Wong Muh Rong argues that while valuations of the technology companies are high, the sector should not be viewed through the lens of 2000 dot-com bubbles.

She says that the world has shifted from being capital intensive to digitalisation and automation that would drive the technology sector's earnings.

She adds: "I expect companies in the software technology industry are going to pick up, especially in the digital banking, payment and cloud computing industries. At the moment, the market is giving too much attention to the hardware companies."

However, she says that for the sector to pick up, Malaysia should focus on upgrading its Internet infrastructure.

The MyDigital blueprint, which was unveiled on Feb 19, not only focuses on the rolling out of 5G Internet connectivity but also aims to enhance the usage of cloud services and the full adoption of digital signature by the public sector and to undertake the full implementation of the National Digital Identity, among others.

Rally is not yet over

Rakuten Trade head of equity sales Vincent Lau says that the rotational shift of investors from technology stocks to other recovery sectors could be one of the reasons for the recent selldown.

However, he believes that the rally in technology stocks is far from over due to the rapid digitalisation and automation globally, as well as increasing demand for technology products that can support the innovations.

"Some of the technology stocks are not cheap but they are backed by orders, and many of the semiconductor players are expanding their manufacturing plants," he says.

Lau says the Malaysian technology stocks could rebound once the selldown of Nasdaq is over.

"It is a healthy correction for the technology sector as they have gone up a lot since last year," he adds.

The World Semiconductor Trade Statistics projected that the global semiconductor market will grow by 6.2% year-on-year to US$452bil in 2021 while the global industry association SEMI estimates that global semiconductor manufacturing equipment sales will grow by 11% year-on-year to US$70bil this year.

Aside from the overall digitalisation effort, JF Technology Bhd CEO Dillon Atma Singh says the work-from-home trend, as a result of the MCO to reduce the infection rate of Covid-19 pandemic, has given the extra boost to the demand for smart devices, which in turn drives the semiconductor sector.

He reckons that the boom in the technology sector could last for five years and that many semiconductor players are ramping up their production line due to "robust demand" in the coming years.

"The work-from-home trend in many countries is causing the shortage of computer chips globally that has hit the automotive sector.

"I don't see the supply issues to be resolved until 2022, as many factories are operating almost at full capacity and that the demand remains elevated," he says.

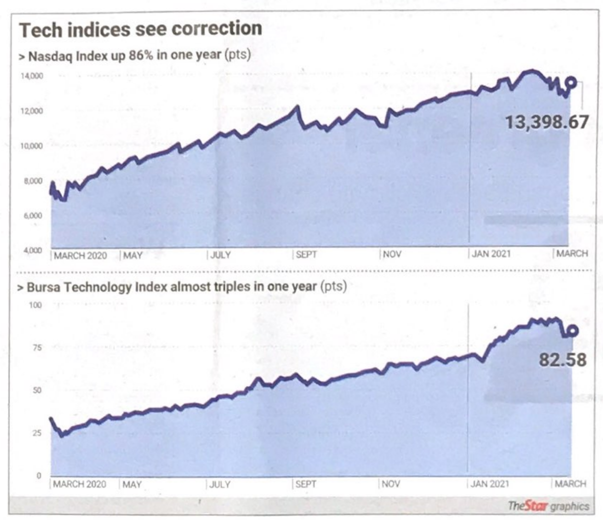
He points out that although many companies are increasing their capacity, the deployment of 5G connectivity, IoT and artificial intelligence would be the next driver of demand for chips.

"Once the 5G connectivity infrastructure is up and running, more people would want to upgrade their devices. That is why we see the demand will remain robust in the next five year," he says.

JF Technology is expanding its plant capacity by more than double that will be ready by mid next year while its new factory in China will be ready by August this year.

"We have been running at full capacity since the beginning of 2020," Dillon says.

Growth driver: A visitor tries out a gaming facility with 5G technology at a store in Kuala Lumpur. Although many companies are increasing their capacity, the deployment of 5G connectivity, IoT and artificial intelligence will be the next driver of demand for chips.



JF Technology provides test contacting solutions for integrated circuit (IC) testing for the automotive, 5G, Internet of Things and home appliance segments.

On the flip side, in December last year, the world's largest asset management firm BlackRock's chairman and CEO Larry Fink warned that stock offerings are soaring to "unsustainable" levels. "The question is: Is the market pricing too large of a forward growth rate for these companies?" he said. "There are going to be many accidents."

Morgan Stanley's chief US equity strategist Mike Wilson reckons that the sell-off in technology stocks is likely not over as investors are rotating out of high growth tech stocks and into value and cyclical stocks as many economies open up.

Last November, asset manager Amundi chief investment officer Pascal Blanque said that the boom in the shares of US technology giants is a bubble that will burst once interest rates increase or "over-exuberance" in the tech story fades.

"It's a perfect bubble waiting to burst. It's not if, but when," he said at the Reuters Global Investment Outlook Summit, adding that "you cannot justify the current valuations" and investors should adjust their stock portfolios accordingly.