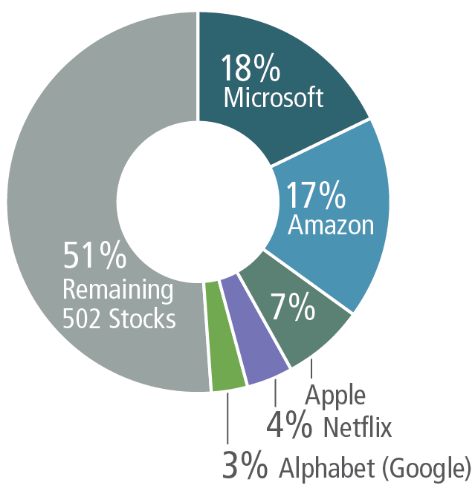
Market-Cap Equity's High Tech Trouble

December 2018

The Information Technology sector continues to drive returns for US equity markets despite the recent market correction, in which several of the major technology stocks, including Apple and Amazon, fell by more than 20%. The FAANGs –Apple, Amazon, Microsoft, Netflix and Alphabet (Google)—have contributed nearly 50% to total S&P 500 returns year to date, and 15% since the Global Financial Crisis lows in March 2009.

Consumer facing technology oriented names within the Communication Services and Information Technology sectors, currently make up 30% of the market, thus elevating concentration risk in US market-cap indices.

CONTRIBUTION TO S&P 500 INDEX TOTAL RETURN, YEAR TO DATE

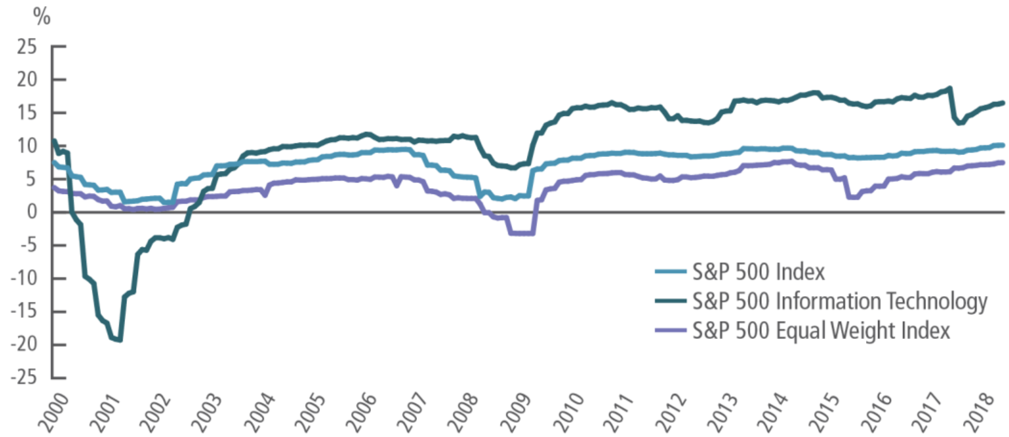


Source: Bloomberg, as of November 30, 2018.

As a result of the sustained positive trend in performance, consumer facing technology oriented names within the Communication Services and Information Technology sectors, currently make up 30% of the market, thus elevating concentration risk in US market-cap indices. Ample profit margins generated by these companies have pushed the S&P 500 Index 12-month trailing profit margin to a record 10.1% as of the third quarter of 2018, more than double since the 1990s. However, this may make profits and future growth expectations within traditional market-cap equity indices more susceptible to an economic downturn.

Technology stocks remain most vulnerable to increased global trade tensions and protectionist tariff measures, as the Information Technology sector derives over 50% of their revenue from outside of the United States.

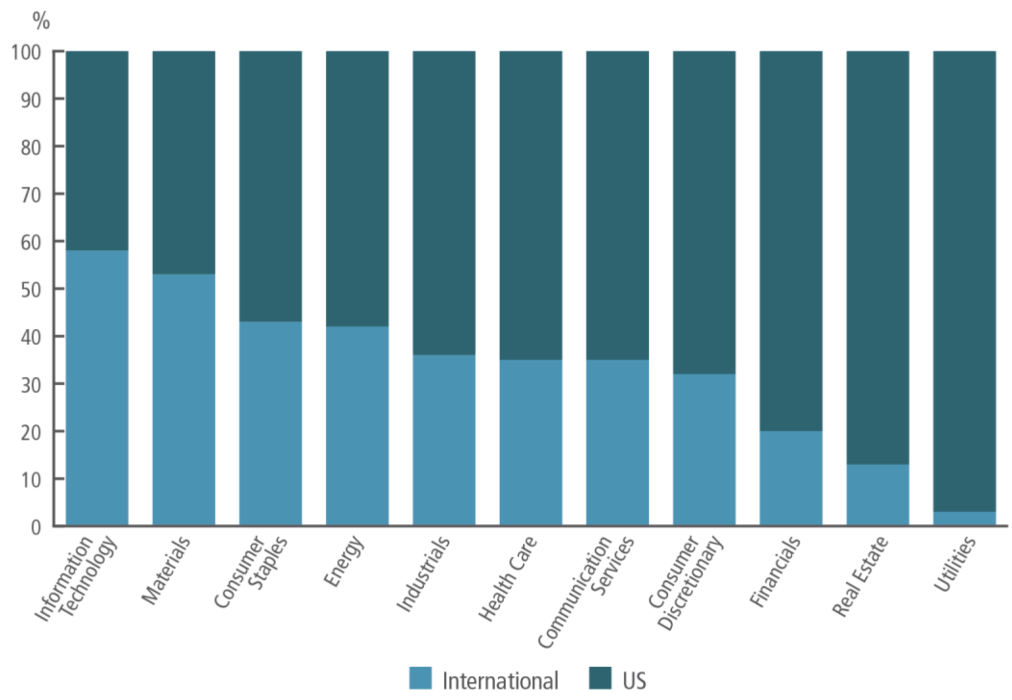
TECHNOLOGY COMPANY PROFIT MARGINS HAVE BOLSTERED S&P 500 INDEX



Source: Bloomberg. Data through November 30, 2018. Trailing 12-month profit margin.

Additionally, technology stocks remain most vulnerable to increased global trade tensions and protectionist tariff measures, as the Information Technology sector derives over 50% of their revenue from outside of the United States.

S&P 500 SECTOR GEOGRAPHIC REVENUE EXPOSURE (%)



Source: Factset. As of November 30, 2018.

Prudent investors may consider lightening exposure to market-cap equity index funds, rebalancing in favor of sustainable dividend, lower beta and value oriented holdings which can provide equity participation with less vulnerability to drawdowns amidst heightened volatility.

The US stock market's retreat during the fourth quarter has begun to spark further concern in investors that the high flying technology companies, will not be able to continue to boost sales at the same pace amidst fears of protectionism and rising interest rates. As we enter into 2019, and what appear to be the late stages of an extended economic cycle, we believe US and Global equities continue to be well positioned for future growth with a forward price to earnings ratio for global stocks reaching five-year lows as a result of the fourth quarter sell-off, dropping to 13.3x down from over 16.0x in early 2018. However, as volatility resurfaces, global growth slows down and trade tensions increase, the risks embedded within market-cap weighted equities may be amplified by a heightened concentration in growth stocks, particularly within the Information Technology and Communication Services sectors. Prudent investors may consider lightening exposure to market-cap equity index funds, rebalancing in favor of sustainable dividend, lower beta and value oriented holdings which can provide equity participation with less vulnerability to drawdowns amidst heightened volatility. Additionally, as increased risks are associated with every asset class, it is important to also maintain and/or add to alternative allocations such as Equity Market Neutral, maintaining exposure to an uncorrelated source of returns, distinct from traditional stocks and bonds.

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