

Tech arbitrage

French and Swiss fund managers and selectors diverge in their preferences among US and Chinese tech giants. **Adrien Paredes-Vanheule** finds out more

Discussing the US equity market and ways to consistently outperform the S&P 500 index, Pictet Wealth Management's global head of Fund and Manager Selection Mussie Kidane says that over the last five years, one would have been to create a portfolio made up 90% of an ETF that tracks this index and 10% in the so-called FAANG stocks (2% each) and to rebalance that portfolio every year.

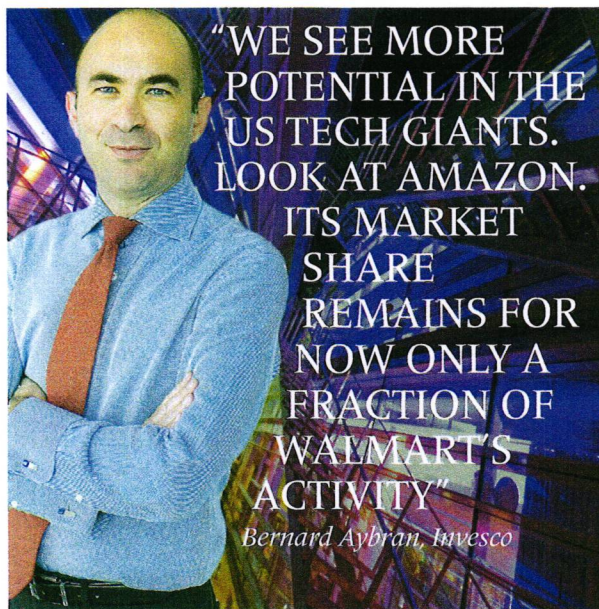
The challenge for active managers, as he puts it, has been the ultra-concentration of the market leadership on a few mega cap stocks including the ubiquitous Facebook, Amazon, Apple, Netflix and Google (FAANGs).

But the acronyms do not end there, for it is not only FAANGs finding room in investors' portfolios, but also their Chinese counterparts Baidu, Alibaba, Tencent and Xiaomi (BATXs), thus leading to a situation of tech arbitrage.

"Big US tech names and their Chinese equivalents are must-haves in equity portfolios. On average, we cannot term FAANGs' valuations as extravagant even though these of Netflix and Tesla are harder to explain. There are important components of many active fund managers which are overweight tech. As per European tech names, the issue lingers in the poor offering. Managers get two or three same names like Gemalto and Wirecard," observes Bernard Aybran, deputy CEO and CIO multimanagement at Invesco.

Aybran says Invesco positions on both US and Chinese tech giants' equities as the firm is invested in an active Asian manager holding the BATXs.

"That said, we see more potential on the US tech giants. Look at Amazon. On the commercial side, its market



share remains for now only a fraction of Walmart's activity if we compare both stocks," he argues.

Furthermore, Aybran notes the rebalancing of indices will propel interesting moves within nomenclatures as telecoms are due to rebrand as communications services.

"In the US, this sector's weight in the S&P 500 will pass from 3% to 10%. Alphabet – Google's parent company – is due to be removed from the discretionary sector to be transferred in the new communications services bucket. Some other IT and discretionary names will follow. That will have an impact on MSCI indices' composition that we will have to monitor," he outlines.

ADDRESSABLE MARKETS

At Dauphine Asset Management, FAANGs represent 3% of the Dau-

phine Megatrends fund of funds, which had some 38% of its net assets invested in the technologic disruption trend as of June 2018.

"FAANGs' volatility will likely stretch in a significant manner and we want to be positioned on other players enjoying a very strong growth," Dauphine AM's CIO Guillaume Di Pizio explains.

China's Alibaba, Tencent and Baidu are preferred as they trade at lower valuations than the FAANGs and half of the Chinese population has yet to gain internet access.

"The market that can be addressed in China is colossal. Moreover, Facebook and Google cannot enter this market, which is not reciprocal like we have seen with Alibaba that can impose its payment methodology Alipay in the United States, Dauphine AM's CIO highlights.

Though he considers FAANGs a performance driver no investor would like to be cut off from, Di Pizio assesses the market offers a premium to quality management skills of visionary CEOs who manage to reposition their companies by adapting them to a larger addressable audience and capacities to monetise their products.

A similar view is provided by Athymis Gestion's CEO Stéphane Toullieux who sees the company capacity to renew and address changing consumption habits of Millennials as a key differentiator.

"FAANGs are core to Millennials trends and we have been invested in four of those stocks since Athymis' Millennial fund inception two years ago, with an overweight Amazon and underweight Facebook. We are delighted with these choices at the moment.

\$53bn Apple's profits in 2017

FRANCE/SWITZERLAND

"The Millennial theme and the revolution of usages resulting from it leads us to stocks linked to social networks like Twitter, cloud such as Salesforce and PayPal. But Asia should not be forgotten with Samsung and Alibaba," he says.

Toullieux feels BATXs carry a more spectacular growth potential than that of the FAANGs as they grow as multi-activity businesses.

A position he reduced was Facebook as scandals start to multiply.

"We do not hold it in the Athymis Better Life fund as Facebook does not make the world any better in our view."

A "daily regret" is on Netflix, which Athymis Gestion sold a few months ago. Since then, the manager has been trying to find entry points to get back in.

If Toullieux praises the FAANGs growth and cash generation - he likes their "pluri-optionality" too, meaning the capacity to launch initiatives that can bring further growth - in contrast Ostrum AM's equity CIO Jean-Louis Scandella points to future prospects making stockpicking harder.

"If companies were books, most would be Ulysses stories today. At the beginning, Amazon was doing e-commerce, Google was a search engine and Facebook a social network. But It doesn't stop there. They are in TV, sport broadcasting, finance, research like Google with transhumanism. It is very complicated to analyse what they are and have become," says Scandella.

He notes that understanding newcomers has become difficult since they raise funds for products whose use is impossible to understand without the help of a specialist or an engineer and which do not even exist yet.

Scandella adds he favours Tencent and Alibaba to Facebook and Amazon respectively.

"Alibaba is a builder of a new world in China with its shopping malls. Before Alibaba, the shopping experience in China was pretty sad. Also, the cost of delivery is cheaper because of the way cities are built in China.

"It is easier to deliver 20 to 30 par-

cels in a same building than in 20 or 30 different houses. Life is built around new technologies in China."

NOT OVERCROWDED

At Geneva-based private bank Reyl & Cie, senior portfolio manager Jonathan Cohen acknowledges FAANGs have been a trigger of performance similarly to Asian IT peers having led the rise of emerging markets and Chinese equities over the past year.

However, FAANGs do not form a particular conviction in Reyl's US equity fund selection.

Cédric Özazman, head of Investments and Portfolio Management, does not see a consensus around FAANGs among US equity fund managers.

"We have a US deep value fund that has none of the FAANGs in the portfolio. The current focus of the market on FAANGs rather comes from the arise of the passive strategies. These stocks gain market valuation hence they gain weight in indices that are being replicated," argues Reyl's investment chief.

"Diversification is key. We therefore combine innovation and US technology even though the theme is a bit overcrowded.

"FAANGs still deliver fantastic earnings and valuations are not that

expensive. So, we are happy to keep them in our direct line investment recommendations. Combining this with European staples which have no more premia compared to the market currently can help the balance of a portfolio if a macroeconomic event such as recession were to occur," he adds.

Diversification is also sought by Léonard Dorsaz, head of External Fund Selection at Banque Pigeat Galland & Cie, which invests directly in Facebook and Amazon. Dorsaz looks for US equity funds with a different profile, not necessarily including "appealing" FAANGs.

Are FAANGs becoming overcrowded? Stephan Germann, CIO of Plurigestion (to be rebranded Pleion as of September 2018), estimates that "as long as we say FAANGs are overcrowded, that means they are not".

"You can consider some of the FAANGs are weaker than others. We could have thought that Apple would have struggled to renew itself but in the end, even though new Apple devices may not carry any technological revolution, the firm's performance and earnings are similar to these of the other FAANGs.

He says the market environment is such that any new big tech listing would see an investor rush and bad events cannot affect FAANGs' public reputation.

Germann expresses a preference for Google because of a cheaper valuation and YouTube's potential can be better exploited.

"You need to have them all and to reallocate from time to time to that FAANG that is cheaper than the others. It is dangerous not to have FAANGs in portfolios," assesses Germann.

Plurigestion's CIO also buys Chinese names like Tencent, arguing Chinese techs follow the path drawn by its US counterparts because there will be dominant companies and no competition since foreign players won't be allowed to enter the Chinese market.

"It will soon become difficult for new entrants in the Chinese tech sector to get room among Chinese FAANGs," Germann predicts. ■

