From the Desk of the **Fundamental Equity Team**

Technology Sector Q&A as of November 9, 2023

Edited by Ana Bita

At a glance:

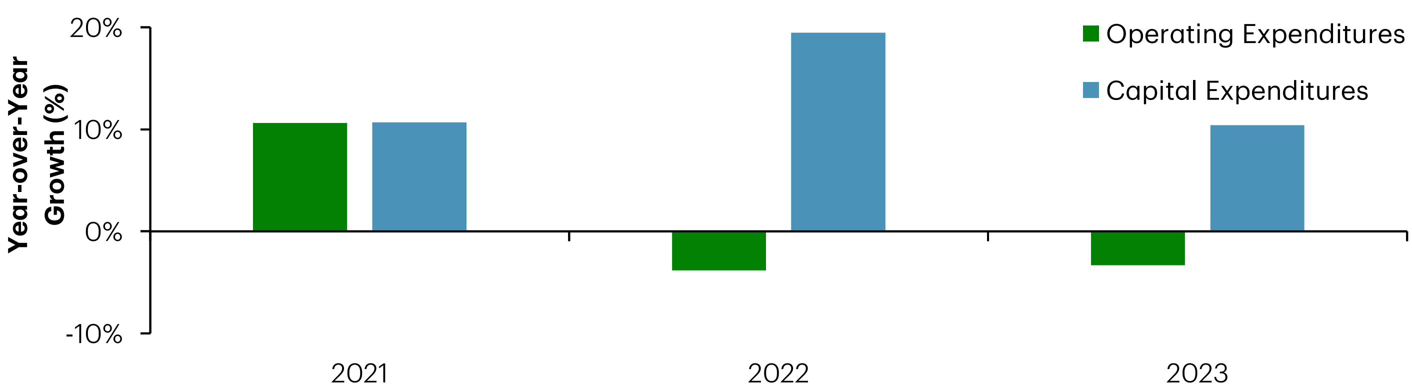
- An allocation to the Technology sector may be able to help investors gain exposure to secular growth trends, innovation and change in the world that can compound at a faster rate than the broader markets.
- While predicting the path forward for any sector in 2024 is challenging, we are expecting a strong first half of the year as major companies focus on keeping operating expenses low.
- TD Global Technology Leaders ETF may be an entry point worth considering for investors looking to gain exposure to high growth potential and leading companies within the Technology sector.

The Technology sector may be an exciting area for investors looking to participate in the growth of cutting-edge innovations in areas such as Telecommunications, Financials and Consumer Services, Healthcare and more. As the buzz surrounding the sector continues to grow, we sat down with **Vitali Mossounov**, Portfolio Manager and Global Technology Analyst at TD Asset Management Inc. ("TDAM") to answer some key questions about what to look forward to in Technology, and how investors looking for exposure can get involved.

Q: How has the Technology sector done so far in 2023?

2023 followed a very challenging 2022, but we have been able to see a return to near pre-pandemic levels for the sector over the year. Sales strength and revenue growth have decelerated in the aftermath pandemic era peaks. Costs have also increased, particularly as companies underwent mass hiring to manage significantly increased demand. Towards the end of 2022 and into 2023, many Technology companies pivoted to a focus on fundamentals through financial discipline. By undertaking cost-control measures such as mass layoffs, some Technology companies have seen increased revenue and declining expenses, which have resulted in improved profitability (**Chart 1**).

Chart 1: "Big Tech" Spending – Shifting from Operating Expenditures to Capital Expenditures[1]



[1] Operating expenditures are a company's more day-to-day expenses, including everything from rent to research & development, but a not inconsiderable portion of a company's operating expenses is payroll (which is even higher for software companies where human capital is fundamental). Capital expenditures tend to be more long term, but often involve the purchase of facilities or physical fixed assets like machinery or property purchases - or Data Centers as in the case of Technology companies.

Note: 2023 Information as of Q2 earnings. Source: FactSet Research Systems, TD Asset Management Inc.

Technology sector earnings and margin advantages continue to widen against the broader market. If we were to look only at headlines, it might seem as though only a few key stories are driving the market when in fact, the fundamentals underneath have been driving the sector. Breadth in technology appears solid, and the past year of efficiency measures has been broadening into the rest of the equity market as well.

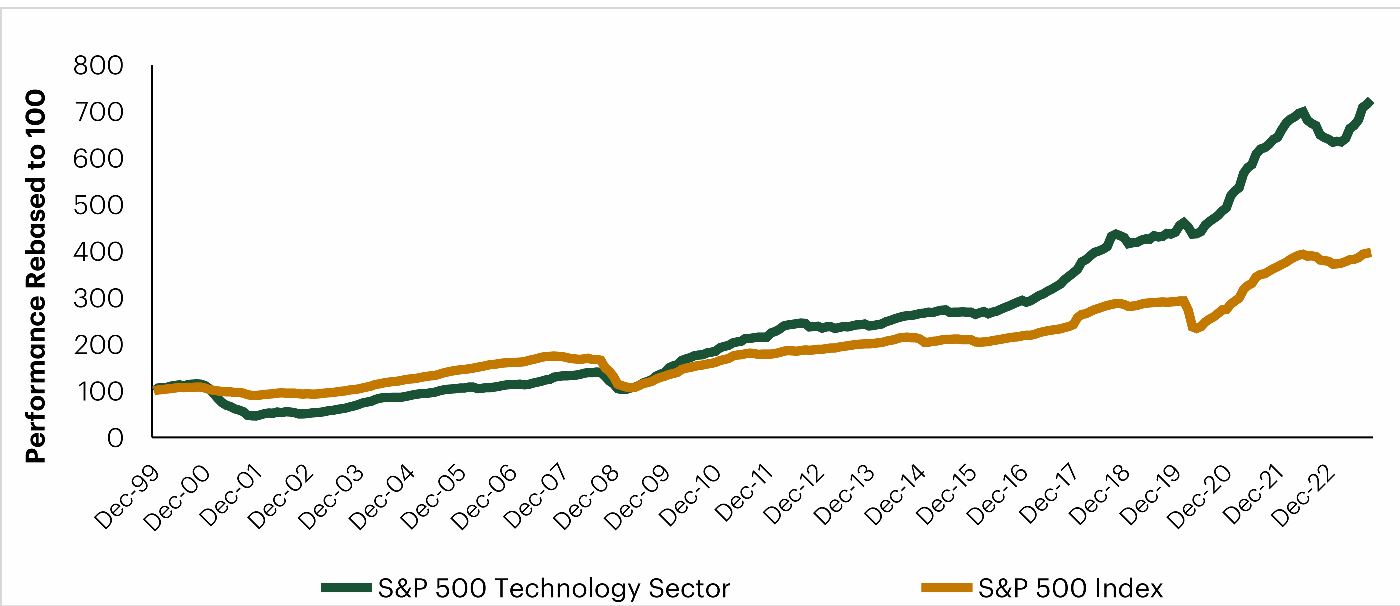
Q: Will interest rates be less of a driver going forward?

As central banks hiked rates in 2022, investors became increasingly concerned that the higher discount rates would impact long duration stocks in the Technology sector. However, today rates remain elevated and yet many Technology stocks are now approaching all-time highs. Thus, while rates can certainly have an impact on performance in the short-term, the general belief that high interest rates automatically mean low Technology sector stock prices may not tell the whole story. It may also lead investors to miss out on attractive entry points. We see company fundamentals returning to the forefront for Technology stocks going forward.

Q: What is the forecast for the sector in 2024 amid recessionary concerns?

Though challenges remain in the economic outlook for 2024, we expect to see revenue growth into the start of next year. Technology stocks may be challenged in second half of 2024 if companies lose discipline and increase spending, however, coming out of this earnings season, major companies appear to be focusing on keeping operating expenses low and further reducing them where possible, which we believe is a good sign going forward. With financial discipline being the new mantra in Silicon Valley, and highly scalable business models in general, we believe the profitability gap between the sector and the rest of the S&P 500 Index could widen even further (**Chart 2**).

Chart 2: Consensus Earnings-Per-Share[2]



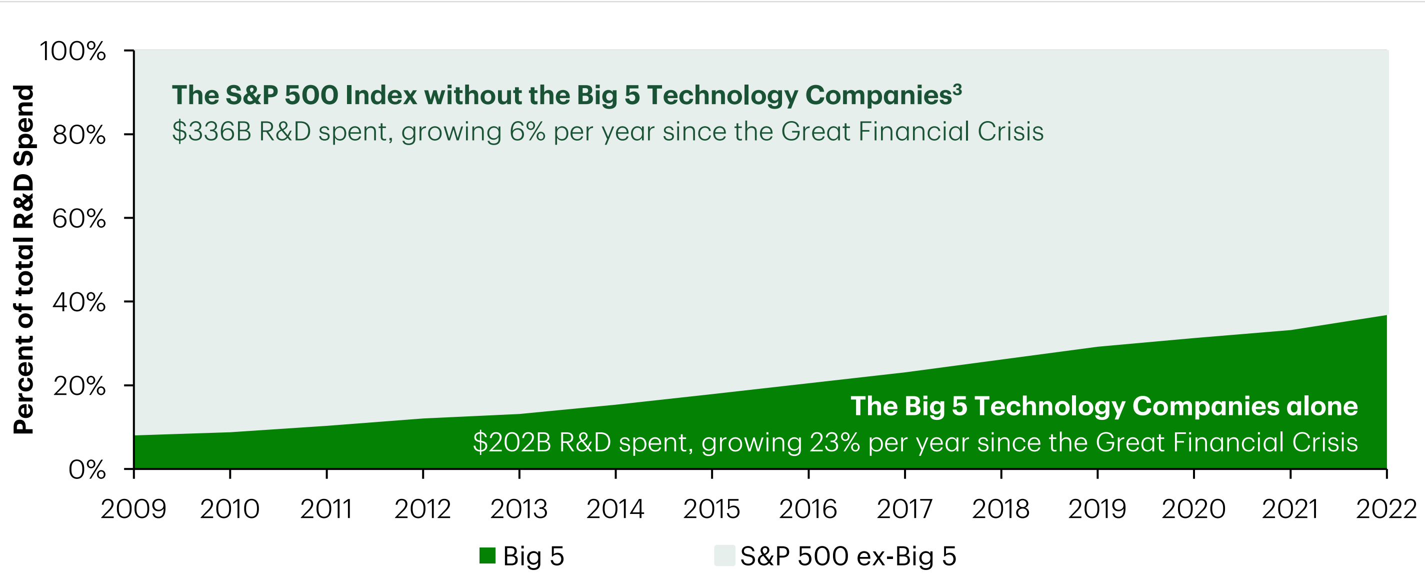
[2] Earnings = Next Twelve-Month Earnings Estimate on a Monthly basis. Rebased to 100 and calculated from January 1, 2000.
Source: FactSet Research Systems, TD Asset Management Inc. Data as of October 31, 2023.

Q: What might be the impact of artificial intelligence ("AI")?

ChatGPT will see its first anniversary at the end of November, and in its wake, we have seen Technology companies introduce AI capabilities within their offerings seemingly overnight. Investors have had the past year to become more comfortable with this groundbreaking technology and we are beginning to see companies reap the rewards. Generative AI, which refers broadly to artificial intelligence programs that are capable of generating text, images and more through studying input data, has marked the start of a massive shift in technology and companies are clamoring to optimize their products accordingly.

The major beneficiaries of AI will be those with significant research and development budgets, high levels of data, and innovative products that can best utilize this powerful technology, such as Microsoft Corporation's Copilot and Adobe Inc.'s Firefly, the success or failure for both of which are likely to drive sector sentiment. Enterprises will be the primary adopters of generative AI technology, representing growth opportunities within the biggest players in the Technology space (**Chart 3**).

Chart 3: Research and Development ("R&D") Spend for S&P 500 Index Companies



[3] The Big 5 Technology Companies includes Microsoft Corporation, Apple Inc., Alphabet Inc., Amazon.com, Inc. and Meta Platforms, Inc.
Source: FactSet Research Systems, TDAM. Data as second quarter earnings results for the index constituents. As of October 31, 2023.

Q: How should investors approach this sector? Where should they look and what should they buy?

Investors should always consider their time horizon when evaluating whether a sector is aligned with their financial goals. For investing over the longer-term, Technology can offer meaningful growth opportunities. Generative AI in particular may strongly bolster the sector moving forward as it enables companies to create new, monetizable products, and doing so within operationally efficient companies to drive higher earnings growth by increasing operating leverage.

TD Global Technology Leaders ETF ("TEC") may be worth considering for investors looking to participate in the Technology sector. TEC is invested in over 200 leading technology-related companies in a wide range of sectors across the globe. This can help with portfolio diversification providing access to new and emerging technology themes as well as investment in quality large and mid-cap companies. While TEC holds established technology companies such as Apple Inc., Microsoft Corporation, Alphabet Inc. (Google), NVIDIA, and more, it also seeks to add value by including emerging technologies across diverse themes such as cybersecurity, automobile innovation, blockchain technologies, among others.

For more information, please contact your investment professional.