Thriving in the pandemic: technology

George Crowdy – Fund Manager

George Crowdy explains why the technology sector has outperformed in the pandemic and argues that active investment is the key to unlocking this performance.

During the pandemic, many companies have faced profound challenges to their business models and day-to-day operations, yet others have performed well through the pandemic by delivering essential products or services.

One sector that has performed particularly well has been technology as we have all had to find new ways to live, work and entertain ourselves in the initial lockdown. The trend to digitisation that was already underway has sharply accelerated. Along with lower equity discount rates, this has driven the share prices of some 'big tech' companies to new highs, pulling stock markets with it. Some are even talking about a new tech bubble.

Yet this headline-grabbing performance is rather reductive – what is 'technology' and is it the secret sauce for fund performance? The key point is that technology is unique. Unlike other sectors, it impacts every single aspect of the world for individuals and corporates.

There are no companies that aren't being affected by technology – they are either leading or embracing the technological revolution, or they're being disrupted and were finding life extremely tough even before Covid-19. The changes are staggering, such as energy transition based on renewable and battery technology; electric and self-driving vehicles; cloud-based technology for remote working; e-commerce; digital payments; streamed entertainment; online booking systems; healthcare and wellbeing, including connected patient care and fitness apps; design and product testing; and so on.

All these examples are based on the same basic model, in which innovation and initial adoption lead to falling costs, which further increases adoption. Covid-19 has simply been another level of disruption and technology has provided solutions. For example, in the UK it took 10 years for online retail sales to go from 10% to 20%, and just 10 weeks to go from 20% to 30%! Critically, the technology had to be in place and scaleable.

So 'technology' isn't just the stock market sector – it includes all the companies that are applying it to their processes and products. Is Amazon a technology company or a retailer? Other than its e-commerce business, it has the market-leading cloud business (AWS) and its digital entertainment isn't 'retailing'. It has thrived in the pandemic, reporting 40% revenue growth in its second-quarter results, which represents $89bn in net sales in three months. It doesn't matter which sector it's in.

You may ask why a sustainable fund manager is banging on about technology and why we have significant tech exposure in our funds. Sustainable investing is about identifying companies that provide solutions to global challenges, while avoiding those that exacerbate these problems. In basic terms, along with strong financials, we look for companies that deliver a net benefit to society. This includes improving productivity and efficiency – doing more with less – supporting economic growth and standards of living.

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Having identified what we mean by technology and why it fits well with sustainable investment, is it simply a case of shoving as many tech companies as possible into our funds? Not at all – as active managers, we don't need or want to own all tech companies, just the ones that are high quality with durable growth and which provide a clear net benefit to society. This has been our approach for many years. Tech investing isn't about surfing lower equity discount rates. After all, not all tech companies are long-duration growth stocks – consider those companies that have been left behind, like IBM.

Neither is it about spotting the next 'big thing' and this remains true during the pandemic. Covid-19 has been a positive tailwind, but we look for companies with strong growth prospects over five years or more. While Zoom has undoubtedly had a brilliant year, the challenge for investors is to identify whether this is a one-off boost or will lead to a sustained uplift over several years.

There are clear technological trends that have been catalysed by Covid-19: digitisation, the cloud, e-commerce, digital payments, design and simulation software, and connectivity in healthcare and fitness data. The backbone of many of these trends is semiconductors, which are subsequently seeing accelerating demand. We own leading stocks across all these areas of technology, not just the household names.

Digital strategies for companies are no longer nice to have, but an existential risk if they are absent or flawed. Yet we are still in the early stages of the technological revolution. For example, despite cloud computing being around for over a decade, less than 20% of workflows are in the cloud; remote working will clearly change this. Sectors such as healthcare have even further to go. With so much potential, we will continue to have a meaningful active allocation to technology in our sustainable funds.

George Crowdy is co-manager of the recently-launched Royal London Global Sustainable Equity Fund. Find out more about our range of sustainable funds at rlam.co.uk/sustainable

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