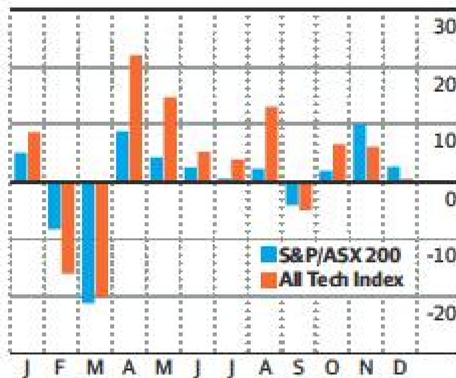
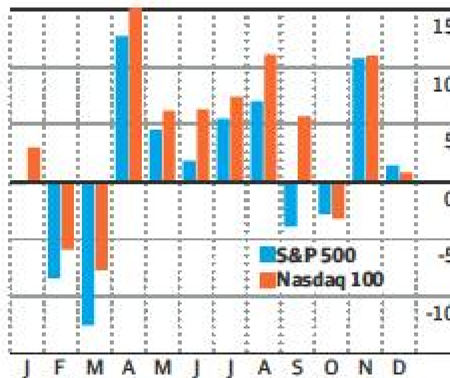
Tech stocks now face some testing times

William McInnes





SOURCE: BLOOMBERG

A savage appraisal of Appen's outlook following a nightmare on Wall Street for tech's megacaps dealt the local technology sector a blow yesterday as investor interest drifted to cyclical and value stocks.

The technology sector was easily the worst performer on the Australian sharemarket after the Nasdaq 100 sank 2.2 per cent, recording its biggest drop in more than a month.

The S&P/All Technology Index fell 59.2 points, or 2.1 per cent, and the S&P/ ASX 200 Index dropped 45.4 points, or 0.7 per cent, to 6683.1.

Unlike most of the year, when tech stocks were benefiting from the digital transition in the pandemic, they have lagged the past two months, as more economically sensitive stocks snatch market leadership.

''I think the market's had a bit of a rude awakening as to where the relative earnings growth actually is,'' said Eley Griffiths portfolio manager David Allingham. ''The need to crowd into non-economically sensitive stocks is a little less severe when you've got a more rosy outlook on the economic prospects.''

In November, the S&P/ASX 200 Index had its best month since it was founded, rising 10 per cent, while the S&P/ASX All Technology Index rose 6.1 per cent, not even bettering its October performance. So far this month, the S&P/ASX 200 Index is up 2.5 per cent, and the All Tech Index up 0.6 per cent.

''I don't think anyone's panicking out of tech yet but the question is whether there's something transformational happening here,'' Mr Allingham said.

''The leading indicators look bullish for global economic growth and there's a lot of evidence there's something more material here, which could go well into next year.''

A strong rally in bond yields could also prove an obstacle to investing in growth stocks, as the amplification effect on future cashflows and scarcity premium erodes, and the long-term cost of debt becomes higher.

''If people think bond yields are going to start rising, and they already are, I think you'll probably see incremental funding out of those long-term growth stocks,'' said Mr Allingham.

Appen yesterday warned its fourthquarter earnings had failed to pick up as they traditionally did and it downgraded its full-year underlying EBITDA guidance to $106 million-$109 million from $125 million-$130 million.

It said the revised guidance is equivalent to a guidance range of $108 million and $111 million applying the originally assumed exchange rate of US70¢ for the second half.

''COVID has clearly disrupted and reshaped the priorities and activities of our customers, especially in California, the home of our biggest customers, where pandemic lockdowns have recentlyintensified,''thecompanysaid.''It has also impacted our face-to-face sales and customer engagement practices.''

Analysts noted the downgrade was unusual, given its largest customers had reported very strong quarterly results.

''Facebook, Microsoft, Google, Amazon all beat consensus advertising revenue estimates in their latest quarterlies,'' said RBC Capital Markets analyst Garry Sherriff.

''Core customers are US technology players who represent 80 per cent of Appen's revenues and have seen a reacceleration in their search and advertising revenues in recent quarterly results. [It] begs the question – is it customer behaviour changing or also competitive pressures?''

Appen's shares plummeted 12.4 per cent to $26.20 yesterday, making it the worst performer in the benchmark. A number of other tech stocks also came undersellingpressure.Afterpayfell2.3per cent to $96.18, Megaport dropped 3 per cent to $13.12, Nearmap lost 3.2 per cent to $2.12, Xero slid 1.1 per cent to $139.51 and Zip Co. fell 2.8 per cent to $5.15.

There's also concern the growth of US tech companies could be capped after Facebook became the second American technology giant in as many months to have a monopoly case brought against it.

A lawsuit filed by the Federal Trade Commission (FTC) and state attorneys general led by New York wants to unwind two of Facebook's largest acquisitions, those of Instagram and WhatsApp, alleging they were intended to eliminate emerging competition.

The purchases of Instagram for $US1 billion in 2012 and WhatsApp for $US19 billion in 2014 were then approved but have since grown significantly. Facebook's shares fell 1.9 per cent to $US277.92 on the news, but investors are sceptical the FTC can make a substantial case, particularly as it follows a stinging loss in a monopoly case brought against Qualcomm.

A federal appeals court in August ruled in favour of the chipmaker and reversed a lower-court decision that the company abused its dominant position in the market for cellphone chips.

''The easy part is alleging it but the hardest part is proving it in court. People forget the FTC actually approved these acquisitions in the first place,'' Swell Asset Management chief investment officer Lachlan Hughes said.

''I think the one thing that is frustrating is the way these industries function is it's a winner takes all business,'' said Mr Hughes. ''The important thing is that consumers will decide the success of Facebook and not the regulators.''