# US technology: Secular growth, on sale

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**Chief Investment Office WM**
Jeremy Zirin, CFA, Head of Investment Strategy Americas
David Lefkowitz, CFA, Senior Equity Strategist Americas

Source: Dreamstime

*The US technology sector is attractively valued, in our view, given its solid long-term earnings growth prospects, still favorable cyclical outlook, aggressive cash distributions to shareholders, and exposure to secular growth drivers.*

**At a glance**

- The US tech sector currently trades at a P/E that is roughly in line with the US market vs. its relative average valuation premium of 22% over the last 25 years.
- This lower-than-normal valuation appears unjustified given secular growth drivers and continued growth in enterprise tech demand.
- Below-average aggregate sector earnings volatility, strong balance sheets, and a focus on increasing dividends and share repurchases are all attributes that should propel sector valuations higher.

**A compelling trade-off between risk and reward**

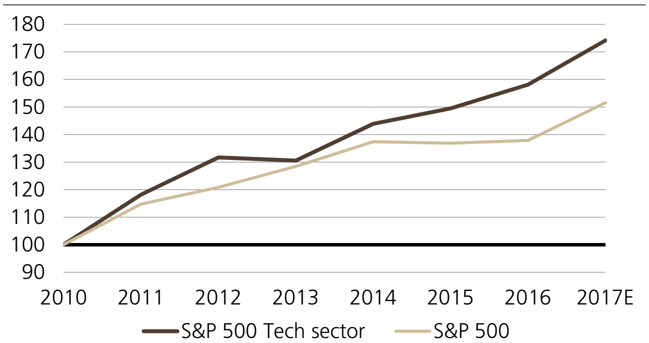
We believe the US technology sector is currently trading at an unjustified low valuation relative to the broader market despite better growth prospects. Since 1989, when IT sector P/Es have been between 15x and 20x (it is currently trading at 17.5x), the median 12-month-forward return has been 15%. In addition, the sector's free-cash-flow yield of 5.7% is 70 basis points above the S&P 500 index yield. Tech companies are aggressively returning this cash flow to shareholders. The sector has a total yield (share buybacks and dividends) of 5.2%, which is higher than the S&P 500's total yield of 4.8%. We expect the robust cash distributions to continue.

In our view, earnings growth for the sector will likely outpace the market over the next few years based on secular growth drivers such as mobility, cloud computing, cyber security, online advertising, and e-commerce. Continued labor market gains and a better outlook for global profit growth should continue to support enterprise spending on IT equipment and services. We believe these cyclical drivers can propel increases in enterprise spending for the next several quarters.

**Recent developments**

Fourth quarter results for the tech sector were strong with earnings per share up 11%, the fastest growth in two years. First quarter growth looks like it will be even faster, again outpacing the market. The sector has large overseas cash holdings and could get a modest boost from policies to enable repatriation of this cash at discounted tax rates. The cash could spur additional M&A activity and stepped-up share buyback programs, both of which would be positive for the sector.

**Tech sector EPS growth has outpaced the broader market**
Earnings per share, indexed




Source: FactSet, UBS, as of April 17, 2017

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