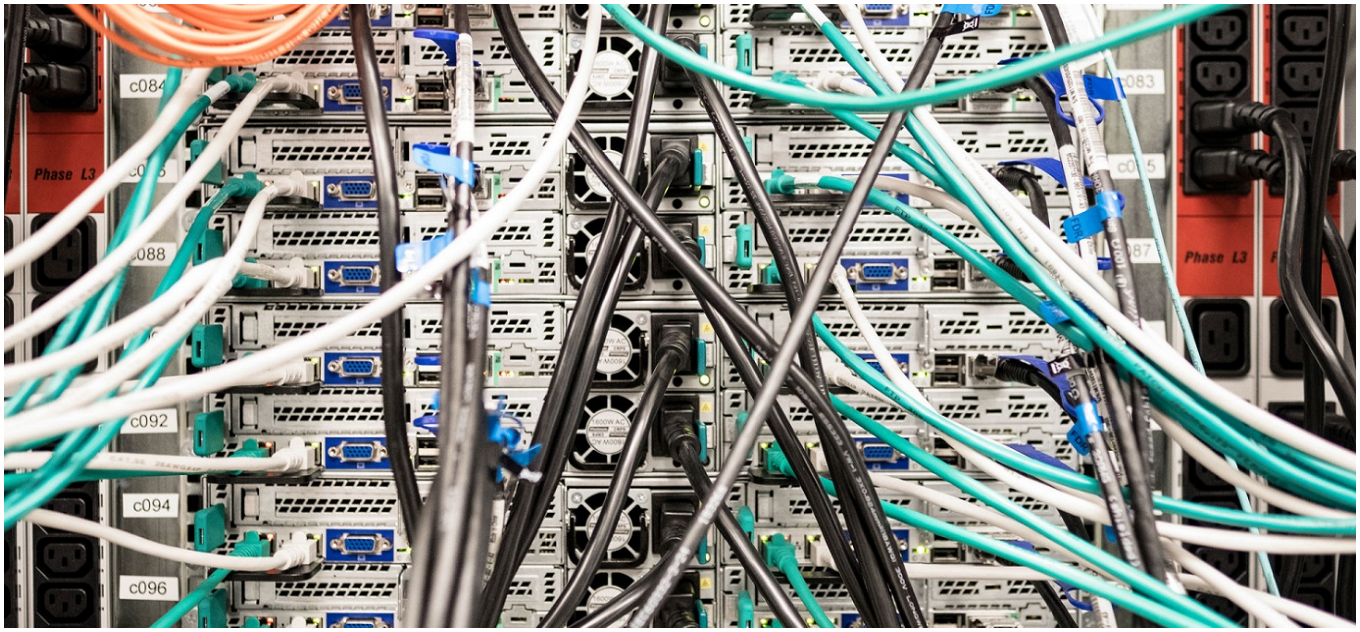

Investors can also diversify beyond technology by switching into our most preferred, more resilient sectors including consumer staples, industrials and utilities. (UBS)

Managing tech exposure amid industry headwinds

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Micron shares came under pressure on Monday after China warned the US memory maker's components pose "significant security risks" and told key infrastructure operators to refrain from buying the company's chips for "critical information infrastructure" over the weekend.

While the Philadelphia Semiconductor Index managed to eke out a gain of 0.4%, the ongoing geopolitical tensions amid the US's and China's race for tech supremacy are likely to add to near-term headwinds facing the tech sector.

We continue to hold a least preferred stance on global tech stocks as their valuations are stretched compared to history, other sectors, and in the context of real rates. The sector's recent outperformance also appears to be too strong for its relative earnings growth premium.

However, with tech and tech-related names accounting for around one-third of the MSCI All Country World Index, the sector remains an important part of a well-diversified long-term portfolio. We see several ways investors can manage their tech exposure in the current environment.

Replace direct exposure with capital preservation strategies. Structured investments with capital preservation features should be considered by investors with exposure well above the benchmark. Such strategies provide participation to price appreciation in the underlying stocks, while offering a certain degree of protection and can be useful in building a more defensive exposure with downside protection.

Rebalance tech portfolios toward areas where we see tactical opportunities. While we see risks around industries which are expensive after the recent tech rally, there are opportunities in more defensive parts of the sector, such as software and internet. We also see value in Asian semiconductor names in the belief that supply-demand dynamics are set to recover in the second half of the year with declining inventories and bottoming of prices. We favor memory chipmakers, leading-edge foundries, and select fabless designers in the region. Separately, companies effective at trimming costs, upgrading products, or delivering strong distributions to shareholders could reward investors with alpha generation in the post-pandemic era.

Look for beneficiaries of secular trends in strategic tech holdings. For growth-based investors and those who have below-benchmark allocations, we believe exposure to high-growth themes in the tech sector remains important. We think foundational technologies such as artificial intelligence, big data and cybersecurity (the ABCs of technology) should see faster adoption as enterprises and governments increase their focus and investments in the coming years. We also see rapid growth potential in metaverse and smart automation.

So, we advise investors review their tech portfolios as we remain cautious and selective on growth stocks. Investors can also diversify beyond technology by switching into our most preferred, more resilient sectors including consumer staples, industrials and utilities.

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