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Technology remains a worthwhile bet

POLAR CAPITAL TECH TRUST

Market cap	Discount/NAV
£2.87 billion	15 per cent

The rapid recovery in the fortunes of technology's global juggernauts has been one of the big trades of the year by investors. However, Polar Capital Technology Trust, the largest London-listed fund focused solely on the sector, has missed out on the best gains.

Why? Because it holds an underweight position in the biggest technology stocks that dominate America's equity indices and have led the rally — that's even though the likes of Microsoft and Apple are large absolute positions, accounting for just over 20 per cent of the trust's net assets by value. Over the 12 months to the end of April, the value of the trust's assets declined by 2.8 per cent, against a 2.9 per cent increase in the Dow Jones global technology index.

Backing "next generation" software companies proved a far bigger detractor. The promise of high future earnings growth has become harder to swallow when capital is more costly and risk less tolerable. Crowdstrike and Cloudflare, the American cybersecurity companies, lost 40 per cent and 45 per cent of their values, respectively, in the latest 12-month period. The pullback in corporate IT spending has been another hindrance. The trust's exposure to such companies sits in the mid-single-digits, compared with a negligible weighting within the benchmark.

The American technology powerhouses have had several catalysts in recent months. The flight to safety after the failure of Silicon Valley Bank pushed investors towards well-capitalised companies with billions of dollars on their balance sheets. The hope that the Federal Reserve might be nearing the end of its monetary tightening proved another fillip, if not slightly premature. The launch of ChatGPT last year, the breakout star of generative artificial intelligence, also has thrust forward companies capable of either helping in the manufacture of or incorporating the technology.

Yet the Polar trust also has the ability to capitalise on a slowdown in rate rises and the ascension of AI. Ben Rogoff, its lead manager, estimates that more than two thirds of the fund's holdings can trace a direct link with AI, most notably Nvidia, which became the first chip company to gain a market value of more than $1 trillion. A 6.7 per cent holding in the California-based Nvidia, the third largest for the trust, represents an overweight position compared with the benchmark.

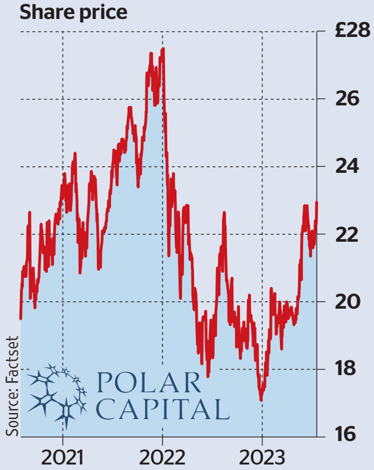
Less obvious are companies such as MongoDB, a software provider that has more than doubled in value since the start of this year and which recently announced a deal with Google to enable developers to build AI-driven applications on the latter's platform. A tie-up with Microsoft followed this week.

If inflation in the United States continues to cool, as it did sharply in June, there could be more upside for earlier-stage technology stocks. The average price/earnings ratio for the trust's portfolio is 24, based upon forecasts for next year, compared with a multiple of 23 for the top 100 companies in the benchmark.

The justification for a higher price? Greater potential earnings growth next year of 23 per cent for Polar's stocks, compared with just under 15 per cent for the same set of stocks in the index. Naturally, forecasts can be missed. But one consequence of technology companies tightening budgets in the downturn has been that more of the trust's early stage cohort that might have been two years out from breaking even have either arrived or look much closer to doing so. The performance gap has narrowed as the rally has gained steam, with the trust's assets rising by 31 per cent, against a 33 per cent rise in the yardstick it seeks to beat. Gains in the shares have not kept pace, leaving them trading at a 15 per cent discount to the NAV. It is a higher-risk bet, but it leaves enough room for the shares to rally further.

Pole position

Share price



Top ten holdings
Percentage of net assets

Holding	%
Microsoft	10.7%
Apple	9.8%
Nvidia	6.7%
Alphabet	6.5%
Meta Platforms	3.3%
Advanced Micro Devices	3.2%
Samsung Electronics	2.9%
Amazon	2.1%
TSMC	2.1%
Palo Alto Networks	1.7%

*at June 30

ADVICE Buy
WHY The shares provide a way to gain exposure to tech companies at a discount