AGF FUND INSIGHT

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Is It Time to Buy Tech?

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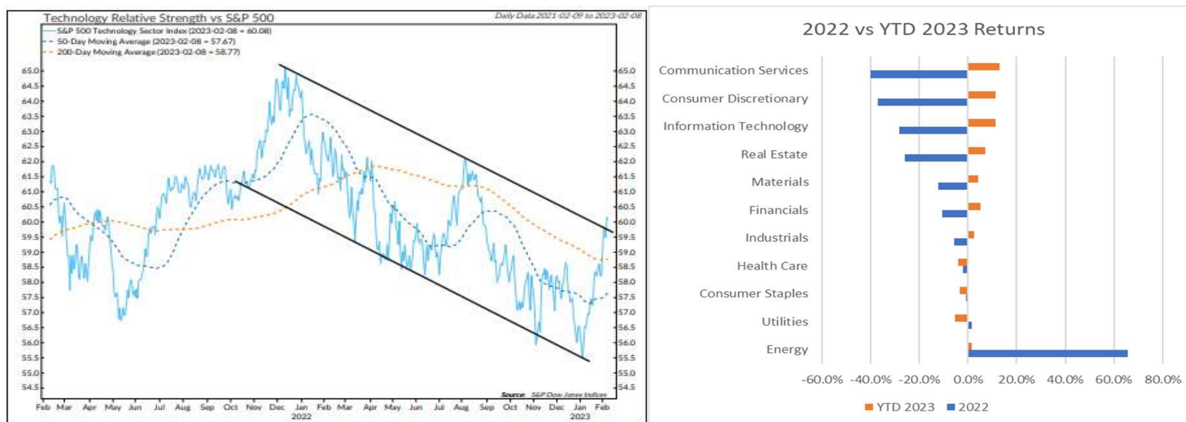
Recently, we have spent a lot of time meeting with clients, and undoubtedly the first question on everyone's mind is around the rally in technology to start the year. Thus far, the worst performers in 2022 have been the best performers in 2023.

As illustrated in Figure 1, the relative strength of the Information Technology sector has surged recently, and overall from a sector perspective, there has clearly been outperformance from the 2022 laggards so far this year, with Communication Services, Consumer Discretionary, and Information Technology (#1, 2, and 3 respectively the worst performing sectors of 2022) – currently #1, 2, and 3 respectively as the best performing sectors of 2023.

Figure 1 – Info Tech Relative Strength (LHS), Sector Returns 2022 vs. YTD 2023 (RHS)



Source: Ned Davis Research (LHS), Bloomberg (RHS) as of February 11, 2023. One cannot invest directly in an index. **Past performance is not indicative of future results.**

Throughout this period, our growth funds have generally kept pace with their peers and benchmarks so far this year, with AGF American Growth Class outperforming its peers and benchmark, while AGF Global Select Fund has modestly lagged. AGF U.S. Small-Mid Cap Fund has been approximately in line with its peers and benchmark, though it has had the strongest absolute performance of the three year-to-date. Our relative performance has generally kept pace in spite of a 14% underweight in Information Technology in both AGF Global Select Fund and AGF American Growth Class. In looking at the year-to-date attribution for AGF Global Select Fund, our Technology positioning and the Fund's cash position (currently 17%) represent more than 100% of AGF Global Select Fund's underperformance year-to-date (Figure 2, RHS).

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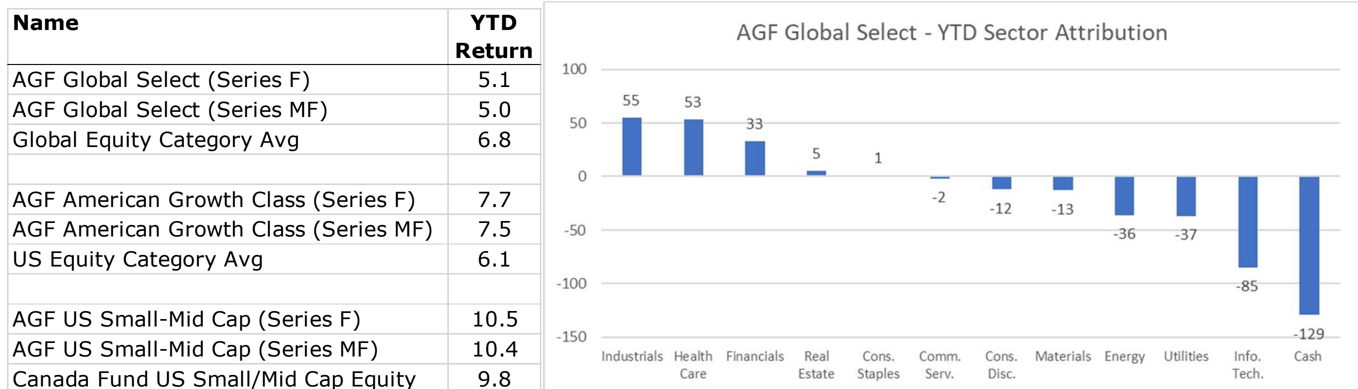
Figure 2 – AGF Growth Funds YTD Performance



Name	YTD Return
AGF Global Select (Series F)	5.1
AGF Global Select (Series MF)	5.0
Global Equity Category Avg	6.8
AGF American Growth Class (Series F)	7.7
AGF American Growth Class (Series MF)	7.5
US Equity Category Avg	6.1
AGF US Small-Mid Cap (Series F)	10.5
AGF US Small-Mid Cap (Series MF)	10.4
Canada Fund US Small/Mid Cap Equity	9.8

Source: Morningstar (LHS), Bloomberg (RHS), as of February 16, 2023. **Past performance is not indicative of future results.**

As such, a natural question that clients may be wondering is – are we missing the boat on Technology? Is it time to get back in? Has the 2022 regime – Energy as a market leader, caution around high valuation stocks – exhausted itself, and is it time to reconsider our substantial underweight in Technology?

The Pandemic Hangover

Firstly, let's take a step back and look at what has transpired in the Tech sector in recent history. Over the past decade, the sector has had healthy growth, which was then turbo-charged by the pandemic with a surge in demand in areas such as online shopping, social media, streaming services, cloud providers, and other work-from-home products and services.

Companies providing products and services in support of this demand saw substantial revenue growth, and in order to fulfill this rising demand, there was considerable investment in building out the infrastructure and also for the number of employees to support the greater capacity. According to Bank of America Merrill Lynch (Figure 3), it is estimated that the big tech firms had increased headcount by 82% from the pre-pandemic levels of 2019. Accounting for the announced recent layoffs, the employment is still 77% higher than the start of this decade, which is 20% higher than the real sales growth that has occurred. While the Q4 2022 tech results showed a slowing of revenue growth leading to cost reduction initiatives, our opinion is that there will be more cuts to come. It would not be unreasonable to think the robust pandemic-induced growth experienced in the last few years has brought forward demand and a consolidation phase is in order before growth resumes.

Figure 3 – Big Tech Still Bloated After Layoffs – Growth in Employees vs. Real Sales since pre-COVID

	2019-2022 growth		
	Employees	Employees after layoffs	Real sales
MSFT	44%	37%	37%
GOOGL	57%	47%	59%
META	94%	69%	49%
AMZN	93%	91%	66%
CRM	67%	51%	67%
Total	**82%**	**77%**	**57%**

Source: Bank of America Merrill Lynch, as of February 5, 2023

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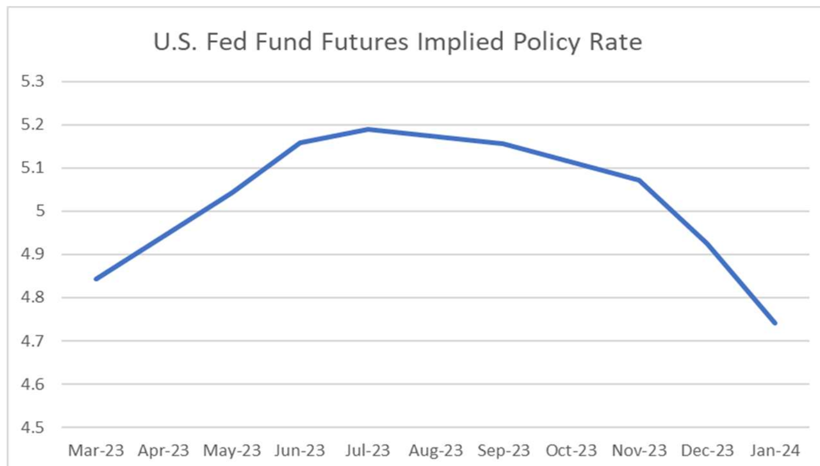
An example of this over-hiring is an early COVID darling which used to be a holding in our portfolio - Zoom Video**.** The company recently announced a 15% headcount reduction from 8,422 workforce. This headcount was almost quadruple the 2019 level of 2,245 employees and even after the lay-offs is still some threefold higher. There is no questioning the dramatic revenue growth Zoom experienced in the last 3 years with a tenfold revenue increase from pre-pandemic levels. Yet this dramatic growth phase has seemingly come to an end, with revenues going from triple digit growth to double digit growth and recently to single digit growth. Declining revenues suddenly seems like a possibility for this company. Consequently, we believe downsizing for this company may not be over.

There are many other companies facing the same challenges (including some that have had big rallies to start this year). And these challenges extend to non-tech sectors as well, with Peloton being an illustration of such a company.

Interest Rate Risk Remains

One of the primary drivers of shifting market leadership over the past several years has been inflation, and investor expectations of the path of interest rates. And while no one is doubting the substantial reduction in the inflation rate and likelihood of further progress, perhaps expectations of a "pivot" have come too far too fast. Currently, markets have priced in rate ***cuts*** in the 2nd half of 2023 – yet the inflation battle is not yet over, with services inflation remaining resilient and robust jobs growth in the services sectors demonstrating that the road to 2% remains uncertain. As such, if the market begins pricing out rate cuts this year, there may be further headwinds on long duration equities such as technology.

Figure 4 – Rate Cuts Priced In for H2/2023



Source: Bloomberg, as of February 11, 2023

History Would Suggest Not Yet Time for Growth To Resume Leadership

Finally, recall that in early 2021, shortly after we made the rotation into cyclical areas of the market (and went underweight Information Technology), we wrote about how value cycles have on average lasted 33 months. With the peak of growth stocks occurring in September 2020, this means that we are in the 29th month of this cycle.

However, an examination of the high inflation regime of the 1970's and 1980's might mean that the current cycle could end up being above average in length. In the 1970's/1980's, as the Fed fought inflation, growth continued to lag value in the one year after the Fed finished raising rates, as can be seen below.

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Figure 5 – Value led Growth After Last Fed Hike in the 1970's/1980's

Source: Bank of America Merrill Lynch, as of November 28, 2022. **Past performance is not indicative of future results.**

Staying Opportunistic but Prudent

So are Tech stocks a buy? The answer to this question is both yes and no. Should this question be posed to a trading-oriented investor, the answer would be yes – as we have seen, there has already been a healthy trading opportunity in tech stocks, and there will likely be more to come.

However, we are not trading oriented investors in managing our portfolios. Given the potential headwinds the group faces, at this time we are not prepared to have a substantial portfolio weight for the Information Technology sector. That is not to suggest that there are not opportunities within the tech sector, but rather that selectivity on the end market health to which those individual companies address, and the cost structures of those firms, will be the key aspects to identifying which companies have significant capital appreciation potential.

And we have been opportunistic recently in our tech exposure – some tech companies have made their way into our portfolios with exposure to sustainability which has a very healthy end market boosted by the U.S. Inflation Reduction Act earmarking expenditures of $370B and which is on top of the $740B figure companies intend to spending on green initiatives. But we will remain prudent to a broader increase in our technology exposure and highly cognizant of company valuations until we believe the coast is more clear. Signposts that we will look for include more evidence of downward pressure on revenue growth coming to an end, and interest rates having more clearly reached a cyclical peak.

Until then, we are okay with stepping aside and leaving trading profits on the table. The portfolios' history of returns have been achieved not only with participating in sustained upside moves, but also protecting on the downside – as such, we will continue to have a cautious posture to "spec tech" in a new era of ~5% interest rates, while remaining open minded to select opportunities.

With a "white sheet of paper approach", we will continue to be highly cognizant of the risks, but also to be flexible in order to participate in opportunities as leadership emerges in the marketplace.

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Figure 6 – Fund Performance vs. Benchmarks and Category Average

CAD (Annualized, net of fees) as of January 31, 2023	YTD	1 Year	3 Years	5 Years	10 Years
AGF Global Select Fund – F Series	4.6%	0.6%	15.0%	13.9%	16.9%
AGF Global Select Fund - MF Series	4.5%	-0.8%	13.4%	12.4%	15.2%
MSCI All Country World Index	5.3%	-3.2%	7.5%	7.7%	12.0%
Morningstar Global Equity Category	5.6%	-4.6%	5.5%	5.7%	9.1%
Quartile Rank - F Series	3	1	1	1	1
Quartile Rank - MF Series	3	1	1	1	1

Source: AGF Investments Inc. as of January 31, 2023. Morningstar as of December 31, 2022. One cannot invest directly in an index. The Series F includes a 1.22% Management Expense Ratio (MER), while the Series MF version of the fund includes a 2.59% MER, as of September 30, 2022. Morningstar Quartile Rankings are calculated as of January 31, 2023 and subject to change monthly. They are calculated based on the fund's total return percentile rank compared to other funds in the Morningstar global equity category. Percentile ranks are then mapped into quartiles with (1) representing 1-25, (2) representing 26-50, (3) representing 51-75 and (4) representing 76-100 percentile ranks. **Past performance is not indicative of future results.**

CAD (Annualized, net of fees) as January 31, 2023	YTD	1 Year	3 Years	5 Years	10 Years
AGF American Growth Class – F Series	5.3%	1.7%	18.0%	13.7%	17.3%
AGF American Growth Class – MF Series	5.2%	0.3%	16.3%	12.1%	15.6%
S&P 500 Net Index*	4.4%	-4.4%	9.6%	10.7%	15.5%
Morningstar U.S. Equity Category	4.2%	-4.8%	7.5%	8.2%	12.5%
Quartile Rank – F Series	2	1	1	1	1
Quartile Rank – MF Series	2	1	1	1	1

Source: AGF Investments Inc. as of January 31, 2023. Morningstar as of December 31, 2022. One cannot invest directly in an index. *On December 1, 2015, the Fund's benchmark changed from the S&P 500 Total Return Index to the S&P Net Return Index. The benchmark change was applied from that date forward. The Series F includes a 1.20% management expense ratio (MER) while the Series MF includes a 2.65% MER, as of September 30, 2022. Morningstar Quartile Rankings are calculated as of January 31, 2023 and subject to change monthly. They are calculated based on the fund's total return percentile rank compared to other funds in the Morningstar U.S. equity category. Percentile ranks are then mapped into quartiles with (1) representing 1-25, (2) representing 26-50, (3) representing 51-75 and (4) representing 76-100 percentile ranks. **Past performance is not indicative of future results.**

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CAD (Annualized, net of fees) as of January 31, 2023	YTD	1 Year	3 Years	5 Years	10 Years
AGF U.S. Small-Mid Cap Fund – F Series	7.4%	-2.8%	8.0%	11.0%	13.9%
AGF U.S. Small-Mid Cap Fund - MF Series	7.3%	-4.1%	6.6%	9.5%	12.4%
S&P MidCap 400 Index**	7.3%	7.1%	11.6%	9.7%	14.9%
Morningstar US Small/Mid Cap Equity Category	7.2%	-1.8%	6.5%	6.2%	10.6%
Quartile Rank - F Series	2	3	2	1	1
Quartile Rank - MF Series	2	3	3	1	1

Source: AGF Investments Inc. as of January 31, 2023. Morningstar as of January 31, 2023. One cannot invest directly into an index. ** On December 1, 2013, the Fund's benchmark changed from the Russell 2500 Total Return Index to the S&P MidCap 400 Index. The benchmark change was applied from that date forward. The MF Series includes a 2.55% management expense ratio (MER), while the Series F fund includes a 1.22% MER, as of September 30, 2022. Morningstar Quartile Rankings are calculated as of January 31, 2023 and subject to change monthly. They are calculated based on the fund's total return percentile rank compared to other funds in the Morningstar global equity category. Percentile ranks are then mapped into quartiles with (1) representing 1-25, (2) representing 26-50, (3) representing 51-75 and (4) representing 76-100 percentile ranks. **Past performance is not indicative of future results.**

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