Why tech investors should keep an eye on China and the Fed

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Don't be distracted by the recent well-publicised earnings misses of several tech-sector and tech related giants – stocks did well in October overall. There are larger geopolitical, macro and company-specific factors at play that call for a nuanced approach to technology and tech-related stocks.

Equity market volatility belies the overall positive trends

Despite a volatile October, US stocks finished the month in positive territory. The markets were buffeted by the many headlines on the macro, political and individual company levels, resulting in well-publicised volatility. But overall, global, US, and European equity markets have been broadly positive in local currency terms.

Even the tech-heavy Nasdaq 100 index had a solid October. Several large, tech-related mega cap names in the US reported earnings results that were below consensus expectations. However, in general it has been a positive reporting season so far.

Approximately half of the S&P 500 companies released earnings during October, and 70% of those reported surprises/beats.[1] This shows resilience in the face of inflation and an economic slowdown. We believe strong earnings were the primary driver of positive market performance for October, but we expect continued volatility and a high level of uncertainty around earnings until the macro picture becomes clearer.

Key takeaways

- In general, US companies have had a positive earnings season, despite several large, tech-related mega cap names reporting results below expectations.
- Investors should expect continued volatility and uncertainty around earnings until the macro picture becomes clearer.
- New US government restrictions on the sale of semiconductor technology to China may cause further volatility, but we anticipate the biggest impact on Chinese-listed firms.
- We caution against tying broad market movements to news around specific companies, especially in light of large geopolitical and macro factors at play.

China is back in the headlines

China recently wrapped up its 20th National People's Congress (NPC), and China equities

1. Source: Bloomberg SP 500 Positive Surprise Index. Data as at 28 October 2022.

have struggled. Following the NPC, there has been a significant drawdown across listing domiciles for China equities (namely A-shares, Hong Kong-listed stocks and US ADRs).[2] Granted, the NPC did not produce any surprises in terms of President Xi Jinping's election or major policy initiatives. But investors were clearly surprised at the degree to which loyalists were placed in positions of power at the expense of reformists. This effectively eliminated any expectation for near-term easing of the "zero-Covid" policy that has hampered China's economy this year.

The US Biden Administration enacted new semiconductor restrictions with two major components:

- Restrictions on Chinese companies' access to more advanced chips used in AI and supercomputing functions, and the semiconductor production equipment (SPE) used to manufacture them
- Additional Chinese companies have been placed on the "unverified" list for export restrictions.

Historically, the US has attempted to keep China two generations of technology behind. But with these new restrictions, the US is clearly aiming to further inhibit China's ambitions to be a leader in the semiconductor industry (as part of China's "Made in China 2025" strategy).

The new restrictions may cause additional price volatility in the tech industry as investors digest the effects on individual companies. This could likely indirectly impact the entire industry, but we expect the greatest negative effects to be confined to Chinese-listed names.

The broader macroeconomic backdrop is murky at best

Central bank interest rate policy continues to dominate the market. The US Federal Reserve continues down its rate hike path, though several Fed officials have recently hinted at a slowdown. There is growing recognition of the lag between when interest rates are raised versus when these hikes are actually felt in the economy. The financial markets are also increasingly concerned about liquidity conditions. As a result, most investors are now expecting a 50-basis-point hike at the last Federal Open Market Committee meeting of the year, followed by a pause.

Inflation is still high, but inflationary drivers are a mixed bag. Consider what the data show in jobs, housing and other areas:

- US employment stayed above trend, though the labor market remains tight, adding to inflationary pressures. Consumer spending in services is strong.
- Commodity prices are up slightly in October, but still well off their highs of the summer.
- Supply chain constraints eased, as evidenced by a significant decrease in shipping rates and reduction in port congestion. In the port of Los Angeles, there were just four cargo ships waiting to unload in late October, down from a high of 109 in January.[3]
- The US housing market has begun a major slowdown, which could spill over into the broader economy.

Bottom line: be selective when weighing company-specific news against larger themes

Equity performance was resilient in October, despite the hits to several US-domiciled mega-cap names with large index weights. Clearly investors are being buffeted by multiple factors, but we would caution against tying broad market movements to news around specific companies, especially in light of large geopolitical and macro factors at play.

2. Source: Bloomberg. Proxies: A-shares, CSI 300; Hong Kong-listed shares, Hang Seng Index; ADRs, MSCI China ETF. Data as at 28 October 2022.
3. Source: Wall Street Journal, 21 October 2022.

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Data as at 30 June 2022.*

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