Trade Booster

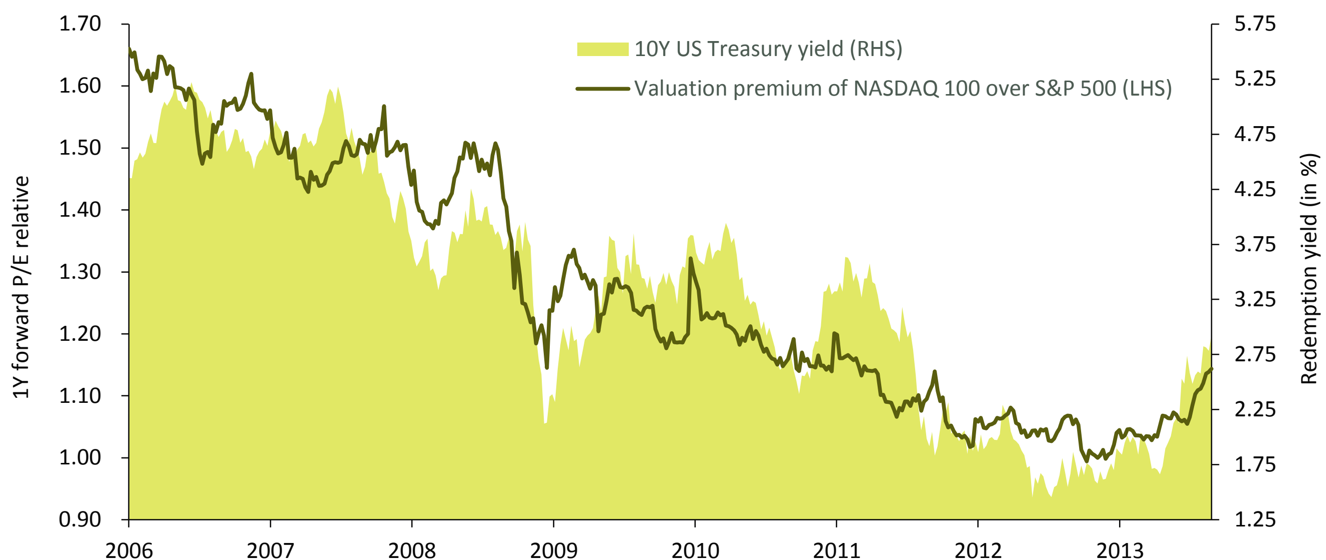
10 September 2013

QE taper raises the valuation premium on technology

boost
Free-thinking ETPs

Summary

- **Technology sector's valuation premium over the broader market remains low and has the potential to rise further as tapering worries persist**
- **Rising refinancing costs undermines sentiment on debt-fuelled sectors in broad benchmarks. Cash rich and low gearing instill confidence in the outlook for technology**
- **Investors bullish on US technology stocks may consider the Boost NASDAQ 100 3x Leverage Daily ETP (QQQ3)**



Source: Boost ETP Research, Bloomberg. Data to 6 September 2013

The NASDAQ Composite has risen 21% this year, outperforming the S&P 500 by 5%. Behind technology stocks' out-performance over the broader market, may be the growing concern that rising credit costs could disrupt the refinancing needs of many companies in the broader market indices; which to-date, have sustained their liquidity requirements through regular rolling of outstanding debt. Given that technology stocks are primarily equity financed, the sector is less debt-dependent in an environment concerned by QE tapering. Investors who share this view may consider buying the Boost NASDAQ 100 3x Leverage Daily ETP (QQQ3).

Comparing gearing levels between technology stocks and the broader equity markets show a stark contrast. On an aggregated basis, the amount of debt (net of cash) on the balance sheet of companies in the S&P 500 amounts to nearly twice their operating earnings. While relatively low by historic standards, this is partly distorted by the exceptional low interest rates, which for many investment grade corporate issuers have, until last year, been as low as 3% or less. In response to the exceptionally low borrowing costs, US companies issued a record of USD 1.4tn in new corporate debt[1]. Now, with average investment grade corporate bond yields rising above 5%, refinancing parts of the debt amassed over the last couple of years will come at a much higher price for 2H 2013. If recent upbeat economic data from Europe and China suggests the need for higher investment requirements, then corporate funding through the bond markets will likely undermine profit growth near term. In contrast, the gearing for tech companies, are low and more often than not, negative due to cash balances held in excess of debt. This is mainly because debt issued by

[1] Gross issuance of debt maturing in more than one year

technology companies is less about optimising the capital structure than it is about minimizing the tax bill on corporate actions. For instance, through a USD 17bn bond sale in April, Apple has been able to fund its multi-billion share buyback plan without becoming fully subject to corporation tax (which would have been levied had Apple fully funded itself through repatriating some of its overseas cash reserves which are estimated to be in excess of USD 100bn).

As stock markets have risen, NASDAQ's 5% outperformance over the S&P 500 (YTD to 6 Sep 2013) has resulted in the forward P/E multiple to expand rapidly to 15.5x, while the S&P 500 the P/E multiple has hovered around 13x. With valuations hovering around the mid-teens, stocks do not look cheap. However, technology stocks' valuation premium over the broader markets do not appear to be excessive in a historic context. As the chart shows, the valuation premium of the NASDAQ 100 over the S&P 500 has fallen significantly since 2006, and has nearly disappeared by the end of last year. While this year the valuation premium has risen to 19% since Fed tapering talk in May, it is nowhere nearly as high as the 65% premium the market was prepared to pay back in 2006. With bond yield today still looking artificially suppressed in spite of the ~100 bps rise seen this year, its positive correlation with the technology sector's valuation premium over the broader market may suggest that a further re-rating of technology looks likely. As Q3 earnings season nears, technology stocks may be in a much stronger position to surprise the market than other stocks in the broader market in an environment where borrowing costs are rising.

boost™
Free-thinking ETPs

Disclaimer

This communication has been provided by Boost ETP LLP which is an appointed representative of Mirabella Financial Services LLP which is authorised and regulated by the Financial Conduct Authority.

The products discussed in this document are issued by Boost Issuer PLC (the "Issuer") under a Prospectus approved by the Central Bank of Ireland as having been drawn up in accordance with the Directive 2003/71/EC. The Prospectus has been passported from Ireland into the United Kingdom and is available on the websites of the Central Bank of Ireland and the Issuer. Please read the Prospectus before you invest in any Exchange Traded Products ("ETPs"). Neither the Issuer nor Boost ETP LLP is acting for you in any way in relation to the investment to which this communication relates, or providing investment advice to you. The information is not an offer to buy or sell or solicitation of an offer to buy or sell any security or investment. You are advised to seek your own independent legal, investment and tax or other advice as you see fit.

The value of an investment in ETPs may go down as well as up and past performance is not a reliable indicator of future performance. An investment in ETPs is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.

ETPs offering daily leveraged or daily short exposures ("Leveraged ETPs") are products which feature specific risks that prospective investors should understand before investing in them. Higher volatility of the underlying indices and holding periods longer than a day may have an adverse impact on the performance of Leveraged ETPs. As such, Leveraged ETPs are intended for financially sophisticated investors who wish to take a short term view on the underlying indices. As a consequence, Boost ETP LLP is not promoting or marketing Boost ETPs to Retail Clients. Investors should refer to the section entitled "Risk Factors" and "Economic Overview of the ETP Securities" in the Prospectus for further details of these and other risks associated with an investment in Leveraged ETPs and consult their financial advisors as needed.

This marketing information is derived from information generally available to the public from sources believed to be reliable although Boost ETP LLP does not warrant the accuracy or completeness of such information. All registered trademarks referred to herein have been licensed for use. None of the products discussed above are sponsored, endorsed, sold or promoted by any registered trademark owner and such owners make no representation or warranty regarding the advisability on dealing in any of the ETPs.