

## Voiceover:

Hello and welcome to Fidelity Connects. The Fidelity Investments Canada podcast connecting you to the world of investing and helping you stay ahead.

Today we're talking about big tech with portfolio manager HyunHo Sohn. HyunHo discusses the current landscape in the technology industry, shares ideas for his portfolio, and explains if the tech sector will continue its impressive run in 2021.

He points out that people often think tech as growth tech, but HyunHo notes that tech is actually very diverse. Generally, HyunHo is valuation sensitive, however he does participate in IPOs if there is a good investment opportunity. Although fairly concentrated, HyunHo tries to invest in stocks using a more bottom-up perspective

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## [01:40]

**Pamela Ritchie:** I want you to situate us first, give us the situation of where we are with big tech, with technology. At this time last year, maybe March last year, it was really only about the FANGs on some level. To what extent are we still thinking about that? Where are we in the world of tech right now?

**HyunHo Sohn:** Interesting. People think of tech as growth tech dominated by the big internet companies, but actually tech is pretty diverse. People often ask me about rotation out of growth into value or cyclical that could impact on the tech sector. Actually, surprisingly, if you look at MSCI World Technology Index, it's actually making new high on a relative terms. That tells about diversity of technology, is not just about large-cap growth tech. There are more mature value technologies. It's not just internet. There's hardware and semiconductor, IT services, payments, lots of things going on in tech and driving the earnings growth in the long-term perspective.

## [02:57]

**Pamela Ritchie:** Let's talk about earnings. Many have looked at this earnings period and maybe the next one coming up, it's critical to understand where growth is. We're sort of at a standstill in a lot of our economies in certain areas. Tech obviously is powering us forward through these moments. What have you thought about the earnings thus far from some of the big players, some of the other players? How do you sum up what you saw in earnings this week?

**HyunHo Sohn:** [*Indecipherable-Growth based?*] it's pretty strong across the board. Apple released its earnings yesterday. iPhones, pretty strong. Not just iPhone, the Mac and iPad, and accessories and services all are doing very well, and the momentum seems to be continuing. Those supply chain electronic components and semiconductors, including consumer electronics, the PCs are very strong, but also an area that was impacted by

macro last year, things like automotive and industrial segments, it's now there are some signs of recovering quite nicely. In some areas people are talking about component shortage because of the strong demand. Software, we're talking about reacceleration of Cloud growth. We saw Microsoft results earlier this week, so overall demand seems to be very strong across the board in tech.

[04:34]

**Pamela Ritchie:** It's very interesting and I think one of the times you spoke to us in the last six months or so, we were talking about valuations in big tech being too high and you made the point that, when you look at it the way you're looking at it, they're actually not particularly expensive. How do you look at valuations generally and maybe break it down to different areas of tech, how you're seeing valuations right now?

**HyunHo Sohn:** Like other sectors or full market, within tech there's quite a big dispersion between high-valuation stocks and low-valuation stocks. If you look at middle-cap tech, actually the valuation of those middle-cap techs are not looking expensive, largely because the earnings and cash flow growth of the companies have been pretty strong. One example of Microsoft, actually stock has done very well. Their earnings growth has been quite strong, so multiple [indecipherable] hasn't expanded as much on a relative valuation multiple, P/E multiple actually gone down. Also other big tech companies have been strong earnings growth. So overall middle-cap tech valuation looking reasonable, but on the other side there are relatively new companies including new IPOs. High-growth tech companies benefit from COVID environment, particularly in the high-growth software space. The valuation multiple, we're talking about more than 20 times revenue multiples which is pretty high. There are a lot of companies that don't make profit and trading at a very high multiple now the market cap of 50 billion plus market cap. So there's a big dispersion within technology in terms of valuation.

[06:39]

**Pamela Ritchie:** Since you mentioned it there, let's ask a bit about these hot IPOs really across the globe. We've seen lots of them in China, hot tech IPOs and so on, is it an area that you run toward? Do you stay away from them? We might get into some details about the fund and your process itself. But first of all on IPOs. Are they too high for you? How do you approach that?

**HyunHo Sohn:** I'm generally valuation sensitive. I do participate in IPOs when there's a good investment opportunity, but in general terms, including IPOs, the generally new tech companies now tend to be priced very high which tell us about market sentiment, appetite for something new, good story. Those stocks are trading at a very high multiple and in many cases I think it's very difficult to justify. When I think about the fundamentals, there are a lot of new capital coming to support these new businesses, which is a good thing for the economy, but we need to think about supply of capital and return on capital as most supply coming in, competition amongst those new emerging companies heating up, which all lead to lower return on capital in the long term. I'm generally cautious about new IPOs, particularly in current stage of cycle when everyone seeking for something new, something interesting story that when I think we need to be more disciplined and more selective.

[08:35]

**Pamela Ritchie:** Continue that thought and describe your process, your approach and the fund itself. Is it a particularly concentrated fund? Just give us some of the outline.

**HyunHo Sohn:** I own around 60 names in the portfolio. It's not particularly concentrated, but I try to invest in stocks from a more bottom-up perspective. The fund is playing long-term growth trend in tech including the Cloud, AI, driverless cars, and EVs and 5G. They're all interesting things, but those trends are well identified in the market and people know that trend. The most important thing for me is what companies in the tech value chain are well capitalized to the growth trend, so what companies have good business models, sustain a business model, and what companies have moat and unique business model, things like that. In the end, companies generating earnings growth in the long term and then also I am valuation conscious. Even though company stocks are very interesting story, if valuation cannot justify the fundamentals, I cannot own those names. That's my approach and style.

[10:12]

**Pamela Ritchie:** Tell us a bit about your approach globally. A lot of the trends that you just mentioned are global trends, AI for instance, lots of these are well recognized and they are global. How do you take some of the trends and look into global, but local markets 'cause you really look across the world, don't you?

**HyunHo Sohn:** Yeah. There are interesting business models outside of North America and particularly in Asia. Internet business models that are local winners. Local, the consumer, what consumers demand and the way the companies serve consumers is slightly different in Asia versus other parts of the world. There are interesting local internet companies, payment companies in Korea and Japan which our fund is invested into. Also [indecipherable] internet is local challenging to the companies that are dominating the market. More even than business model, new product and services development is even more innovative in the world. Lastly on the hardware and semiconductor supply chain side, China has big ambition to grow their ecosystem, own technology ecosystem and there are a lot of government support to build national champions in the China tech ecosystem. There are beneficiary in China semis and semiconductor equipment companies that fund is investing in.

[12:01]

**Pamela Ritchie:** Can you give us some information on how allocated you are to China building its own ecosystem in a number of different areas? It's an area of opportunity for you; is it an area that you're largely allocated to? Is it more the U.S.? Where are you positioned?

**HyunHo Sohn:** In terms of fund composition, I'm still ... about 60 to 70% is allocated to North America, and Asia, including Japan, is about 20%. Japan and China and Europe, also investing in Europe and there are interesting businesses, underappreciated companies in Europe as well, so Europe accounts for about 10%. So that's the fund composition by geography.

[12:53]

**Pamela Ritchie:** Let's talk a little bit about what's already been done. There's been a lot of discussion about a technology transition has been pulled forward in a lot of industries really. We've all had to quickly get better at technology in various aspects of our lives. Is it mostly done? How big is the capex potential from here, and I might ask you to look directly at 5G for instance. How much work is still to be done in 5G, for example?

**HyunHo Sohn:** Firstly on the demand pulled forward, pent-up demand, we saw pent-up demand, very strong demand in PCs, smartphones, tablets to support working from home on the hardware side, but also on the software side, a lot of business, the critical application to support working from home, the collaboration tools like Zoom, more customer-facing app 'cause customer interface has dramatically changed from offline to online. So there's investment over there and productivity tools, secure connectivity, security software demand has also gone up a lot last year. There are still a lot more room to go. Thinking about Cloud, the migration, we are just second or third inning in terms of journey to Cloud migration, and business-critical applications such as finance or ERP and HR, those applications. The last year companies were dealing with the emerging situation, so those business-critical areas, but less of a priority last year but this modernizing the application is quite important for companies, the productivity in the long term, so the demand for those products will come back strongly in the mid to long term.

About 5G, 5G actually was one area that was impacted negatively by COVID, mainly because it's not about technology, it's mainly because of logistics issue because of the COVID. [indecipherable] project, remote 5G infrastructure rollout was delayed, but given continued strong the bandwidth as well as new applications such as more connected cars, connected factories. Actually I recently [indecipherable] talk about enterprise, the 5G network opportunity so there are a lot of demand for the 5G which will drive the growth in the medium term.

[15:55]

**Pamela Ritchie:** Can you break that down into industries for us? What are industries that will benefit from 5G? We can think of a couple of obvious ones. I'm thinking of ... do mining sectors ultimately need to get better connected with people under the ground, up to the top? Give us some examples of industries that still have a long way to go on this front, they have some spending to do presumably?

**HyunHo Sohn:** People talk about innovative things, and things get connected with the sensors and connectivity, all the data analyzed and can be used for a lot of things like predictive maintenance. It can be used as farming so to improve crop yield. A lot of data need to be analyzed, collected and analyzed so farming and manufacturing industry, automation, a lot of machines can be maintained in a predictive manner in a real time. That will improve the productivity over the long term. People talk about smart cities too. [indecipherable] we're going to see more connectivity there. So lots of applications.

[17:18]

**Pamela Ritchie:** When we think about ... sometimes we'll talk about rural broadband and governments are concerned about whether that's where they need to invest and to what extent they can, and there's a discussion there. Does the rollout of further connectivity across the world ... is it 5G connectivity? When we're talking about if they're going to build the system anyway for rural communities, is that automatically a 5G situation, or not necessarily?

**HyunHo Sohn:** Connectivity does not just necessarily mean the wireless, but also investment into wirelines will also continue. We talk a lot of 5G already, but things like Cloud connectivity, edge computing, all those things will also be the main growth area in terms of investment.

[18:16]

**Pamela Ritchie:** A very interesting question coming in here about probably the terms that we use. We talk about tech, but it seems more and more everything is tech. Every company needs to probably have a tech strategy so does that make every company tech? So the question is really, every sector uses technology, HyunHo do you differentiate a tech company from other sectors? How do you invest in those that are not classified as technology? Is that shifting? How do you look at that?

**HyunHo Sohn:** It's interesting. Actually it's crossover, it's line between ... basically everything is tech. Actually I look to find opportunities. It's not obvious, technology from traditional way of thinking, but consumer, finance, industrial and chemical, in those segments I try to find the opportunity. Actually Fidelity investment professional, the way our team is set up, we have a lot of other sector specialists like financials and health care, industrial and then we work together and exchange ideas. I get a lot of interesting ideas from my colleagues. Actually it's an important part of my investment process, discovering more differentiated ideas.

[19:55]

**Pamela Ritchie:** Let's talk a little bit about a turn towards a greening of the environment of perhaps more carbon-neutral processes of the future. A lot of that depends on incredibly innovative technology. Where do you see opportunities broadly within ESG, but I guess specifically in the energy transition, if at all?

**HyunHo Sohn:** I invest in quite a lot in electric vehicle supply chain. I think it's going to be ... the market is huge. We are in the very early stage of the penetration, and technology is ready to serve the big market and technology is improving every day. So we're going to be, a lot of opportunity in the electric vehicle supply chain. Look at the whole value chain. There are some areas where it could be easily commoditized and profit can be [indecipherable]. But there are certain areas, a handful of company can capture very high share of total industrial profits. So main area it could be semiconductor industry, very consolidated high entry barrier, significant R&D investment and capex is required. So areas like power semiconductor or the battery management IC systems, in those areas, and also there are specialty materials that are useful improving the battery efficiency. So those areas the fund is investing in.

[21:52]

**Pamela Ritchie:** Does that mean on the raw material side of things or a bit further along?

**HyunHo Sohn:** The specialty materials, specialty wafers to make the power semiconductors, so that's the area, yeah.

[22:08]

**Pamela Ritchie:** When you take a look at EV, are those trends that are across the globe? Do you look to India for instance? I'm sure there are areas where the EV infrastructure is happening faster, but is it being looked at broadly across the world?

**HyunHo Sohn:** Yeah, broadly across the world, but some regions are faster than others. China by far is the most advanced in terms of adoption. U.S. is following, and Europe, in terms of speed of adoption is late, later than China or U.S., but now the European OEMs are waking up so companies are accelerating development to EV, particularly like Volkswagen Group, now EV has become very important initiative for the whole group, and this issue is [indecipherable] potential issue for those traditional OEMs. So without shifting to battery-powered vehicle, the future for them will be very grim.

[23:29]

**Pamela Ritchie:** I'm interested to get your perspective on regulations to the tech industries across the world. To what extent are you concerned about it? Do you invest around it? Maybe a little bit globally too. I mean, Europe's been a big voice about it, but it does seem to be a bit of a global discussion these days. Can you give us your thoughts on tech regulation and the investment thesis there?

**HyunHo Sohn:** On regulation, I try not to take strong view on that. The reason is it's difficult to see how the regulation will go at first, and then impact of regulation, there are second-order, third-order impact, there are unintended consequences. So it is quite difficult and dangerous to take a strong view. For example, what happened in the GDPR in Europe a few years ago, that was kind of ... the motivation was to regulate big tech companies in terms of usage of the ... they probably still take that information, but what happened was the big tech companies became stronger. They were faster, more efficient in terms of complying with changing the regulation, so it actually helped the big tech companies. And also things like U.S. government putting a lot of pressure on China, actually people were worried about semiconductor companies will be hit by the U.S.-China tension and regulation but actually look at the semiconductor stocks, went through the roof. A lot of second and third-order impact on regulation.

My base case on regulation is under new U.S. administration, I think regulatory pressure will build up, and there will be some business models will get more impacted, particularly business models that rely solely on internet advertising or social media platform can be more impacted than the others because the new administration is considering way more responsibility to social media platform on their content. Things like that that there will be more regulation, but overall big tech companies have a lot more diversified business models than people think and capability to weather through the regulatory pressure. That is my base case.

[26:17]

**Pamela Ritchie:** It's great to get your thoughts on that. I want to finish out with questions about encryption, security technology. We've heard about some concerning breaches that were announced, maybe started earlier, but announced before Christmas this year. Is security, encryption an increasing area of interest for you?

**HyunHo Sohn:** Security overall is always interesting area. There's always number one priority of CIO or CSO survey, so the industry as a whole will continue to grow. The thing is from an investment perspective, security landscape changes very frequently and today's winners are not necessarily future winners. Also, there are a lot of investment needed in terms of product development as well as educating the customers. So a lot of R&D intensity, sales and marketing intensity is very high. That's why we don't find many security companies that generate sustainable profit. So that's the issue in terms of investing.

I do invest in security companies that are well exposed to security trend, but it's not pure play security companies. So the business model that existing infrastructure or existing platform that can lever to address security issues. So that type of business that I like to invest.

**Pamela Ritchie:** Excellent. Thank you very much. HyunHo great to see you again. Thank you for taking us through some of these fascinating ideas and your investment approach to all of them. Good to see you again. Have a good weekend.

**HyunHo Sohn:** Thank you. Have a good weekend.

[Ending: 28:18]

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