

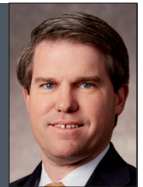
INVESTMENT WEEK

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Market Analysis: Europe/US

George Sertl on US Technology



In 2013, US stock prices ascended faster than underlying earnings. With corporate earnings growth ranging in the low to mid-single digits and most broad-based stock indices up over 30%, the bulk of the year's gains came from an expansion in the price multiple rather than from growth in economic values.

Market appreciation has moderated thus far in 2014, but valuations have not materially changed since the start of the year. Most stocks are trading in a range of fair to full value now. As value investors, we are looking for companies that are cheaply valued – not fairly valued – so finding stocks trading at a distinct discount to underlying worth has become more challenging.

Though the long-term return potential has fallen, we still think there are select opportunities in US stocks,

particularly in the tech sector.

When people think about technology, what often comes to mind is the bubble of the 1990s and early 2000s where many of the companies were selling at skyhigh valuations despite unproven business models.

The sector was priced very high, and many companies lacked financial discipline.

But tech companies have evolved a lot over the years. Following the tech bubble, many management teams learned to re-focus on return on capital and became more shareholder-friendly.

The technology sector is much less capital intensive than it was and has higher cashflow margins, leading to better returns on invested capital. Companies are returning cash to shareholders through dividends and buybacks, and are abusing shareholders less with

issuance of stock options.

Fundamentals within the sector are vastly improved in terms of better financial health, profitability and cheaper valuation levels. Compared to the broader market, the technology sector has a lower debt-to-capital ratio, higher return on equity, and lower P/E ratios.

Within the technology sector, the risk/reward dynamic looks very interesting in the mega-cap segment, defined as a market capitalisation of at least \$100bn. Some examples include: Apple, Cisco Systems, IBM, Microsoft and Oracle.

These companies have dominant market positions, global reach and technological leadership.

Despite superior business economics and balance sheets, they each trade at below-average P/E multiples

in the low-to-mid teens, compared to about 16 times for the broader market.

We think some people have written these companies off as future dinosaurs and even that is still open to debate, but they are being priced as though they are closer to death than they certainly are, so the risk/reward balance looks quite attractive.

George Sertl is managing director of Artisan Partners and a portfolio manager on the US value team.

Bull Points

US tech stocks have a quality and valuation advantage

Risk/reward particularly attractive for several global tech companies

Bear Points

Some investors see big tech companies as future dinosaurs

It is a challenge to find cheap stocks

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Return on Equity (ROE) is a profitability ratio that measures the amount of net income returned as a percentage of shareholders equity.

Price-to-Earnings (P/E) is a valuation ratio of a company's current share price compared to its per-share earnings.

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