What is (and isn’t) working within technology stocks?

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Key Takeaways

- Nvidia’s strong performance in the first half of 2024 has been a determining factor in the performance of technology-focused ETFs, with more weight to Nvidia resulting in stronger performance and less weight resulting in weaker performance.
- WisdomTree has three broad-based technology-oriented thematic ETFs: the WisdomTree Artificial Intelligence UCITS ETF (WTAI), WisdomTree Cloud Computing UCITS ETF (WCLD) and WisdomTree Cybersecurity UCITS ETF (WCBR).
- The market performance of software-oriented strategies has been challenging, but the use of AI will rely on software and cybersecurity solutions, indicating the importance of these areas in the AI megatrend.

Why is [insert name of technology-focused ETF] underperforming in 2024?

This is a recurring question that we are facing in June 2024. Part of the reason is that, while we spend all this time trying to formulate more complete exposures to different technology-oriented thematic equity areas, Nvidia has been performing so strongly that performance so far this year has been determined by:

- More weight to Nvidia = stronger performance in the first half of 2024
- Less weight to Nvidia = weaker performance in the first half of 2024

We readily admitted the risk of being ‘too exposed’ to Nvidia within ETF strategies in March 2024 when Nvidia was hitting a market capitalisation of $2 trillion. Roughly three months later, we sit looking at Nvidia with a market capitalisation of around $3 trillion. If there is a risk, it hasn’t yet materialised in the form of significantly negative returns.

Three broad-based technology-oriented thematic ETFs can tell us a lot

When we think about ‘technology-oriented’ ETFs in our thematic range, we tend to discuss:

- The WisdomTree Artificial Intelligence UCITS ETF (WTAI): This strategy is designed to track the total returns, before fees and expenses, of the Nasdaq CTA Artificial Intelligence Index. Companies in the eligible universe are classified into three groups based on each company's position in the AI value chain and its estimated revenue exposure to AI.
- The WisdomTree Cloud Computing UCITS ETF (WCLD): This strategy is designed to track the total returns, before fees and expenses, of the BVP Nasdaq Emerging Cloud Index. This index is rebalanced back to equal-weight twice a year and focuses on business-oriented cloud computing firms that derive more than 50% of their revenues from cloud computing. It is a diversified array of Software-as-a-Service (SaaS) companies.
- The WisdomTree Cybersecurity UCITS ETF (WCBR): This strategy is designed to track the total returns, before fees and expenses, of the WisdomTree Team8 Cybersecurity Index. The focus is on pure-play cybersecurity companies that deliver exposure to at least one of eight distinct cybersecurity themes defined by Team8. The index is monitored at semi-annual rebalances each year.

These strategies tend to provide most of their exposure within the software and semiconductors industries. While Nvidia is the first semiconductor name that people are thinking about – and have been thinking about for about 18 months – there is a much longer tail of notable companies that can benefit significantly if consumers and businesses are inspired to update their hardware and buy AI-enabled devices, largely laptops and smartphones. Apple just announced its 'Apple Intelligence' suite of functionality, completing the picture and allowing even those in the Apple universe of products to have this option.[1]

It's also interesting that, if one is looking at the market performance, it feels like people cannot get far enough away from most software-oriented strategies. WCLD and WCBR, of late, have been running into the wind by way of performance. However, if people are really excited about AI – essentially what we will be using the Nvidia chips for – how it will be used will be through software, so we will also need a lot of cybersecurity solutions to ensure a safer experience.

As we watch the software space today, we seek to find those companies that embrace AI and are providing innovative solutions that appear to stack up strongly against the large, generalised foundation models, be it GPT-4o, Microsoft Copilot or Google Gemini, to name a few.

Current consensus, forward guidance and returns

If we create a list of all the constituents within WTAI, WCLD, and WCBR, we can order it based on changes to forward guidance as of the most recent quarterly earnings report. The thinking here is that companies that are particularly confident in their prospects this year will be raising guidance more significantly, and then, if management is really concerned about their prospects, they will be lowering guidance. When reading recent earnings announcements, there has been a lot of focus on guidance for the coming quarter and the rest of 2024. In a sense, guidance represents a data point that bakes in a company's forward-looking expectations.

In Figure 1:

- Six of the 10 best forward sales revision firms, post guidance, were in a semiconductor-related sub-industry. Nvidia was there, but people may not have immediately predicted the presence of Ambarella, Analog Devices, Teradyne, Broadcom or QUALCOMM. Teradyne, Nvidia, Broadcom, Ambarella and QUALCOMM delivered double-digit returns seven days after their announcements.
- The tides of returns in software stocks can change quickly, and we see Monday.com, Q2 Holdings, AppFolio all raising guidance, at least a small amount. Monday.com and Q2 saw their shares up by more than 20%, each, seven days after their announcements.
- Software-as-a-Service has been tough. UiPath, Fastly, and Sprout Social are examples of companies in WCLD that all lowered their revenue guidance in their most recent announcements. These three companies' shares were down more than 35% seven days after this information hit the tape.
- Of the companies in the 10 Worst Forward Sales Revision firms, post guidance, Salesforce got significant negative attention – we think too much. Salesforce basically met consensus expectations and then lowered guidance a small amount. To see a company of this stature – companies that use Salesforce for their client data cannot simply stop on a dime – losing 20% of its market capitalisation in one day is a huge move. Maybe one interpretation is that the market wants to see more from Salesforce concerning generative AI integrations.

Figure 1: Current consensus, forward guidance and returns

Grouping	Company Name	Sub Industry	Sales Surprise vs. Median Consensus Estimate	UpcomingFPEnd	Fwd Sales Revision Post Guidance	1 Day Return	7 Day Return
10 Best Forward Sales Revision Firms, Post Guidance	Teradyne, Inc.	Semiconductor Materials & Equipm	6.0%	30/06/2024	10.8%	8.2%	12.9%
	Analog Devices, Inc.	Semiconductors	2.8%	31/07/2024	5.4%	10.9%	7.8%
	NVIDIA Corporation	Semiconductors	8.2%	31/07/2024	5.2%	9.3%	20.9%
	Ambarella, Inc.	Semiconductors	0.9%	31/07/2024	4.4%	20.6%	19.2%
	Broadcom Inc.	Semiconductors	3.3%	31/07/2024	2.1%	12.3%	20.5%
	AppFolio Inc Class A	Application Software	4.6%	30/06/2024	2.0%	12.0%	9.0%
	monday.com Ltd.	Systems Software	3.3%	30/06/2024	1.9%	21.4%	32.8%
	QUALCOMM Incorporated	Semiconductors	0.9%	30/06/2024	1.7%	9.7%	10.0%
	Q2 Holdings, Inc.	Application Software	1.3%	30/06/2024	1.6%	15.2%	20.5%
	Kratos Defense & Security Solutions,	Aerospace & Defense	10.9%	30/06/2024	1.5%	5.8%	6.9%
10 Worst Forward Sales Revision Firms, Post Guidance	Salesforce, Inc.	Application Software	-0.1%	31/07/2024	-1.2%	-19.7%	-24.2%
	Freshworks, Inc. Class A	Application Software	0.8%	30/06/2024	-1.7%	-19.6%	-24.3%
	ZoomInfo Technologies Inc	Interactive Media & Services	0.5%	30/06/2024	-1.8%	-24.2%	-18.9%
	Rapid7 Inc.	Systems Software	0.5%	30/06/2024	-2.4%	-17.0%	-16.8%
	Akamai Technologies, Inc.	Internet Services & Infrastructure	-0.3%	30/06/2024	-2.6%	-11.0%	-10.6%
	Sprout Social, Inc. Class A	Application Software	-0.5%	30/06/2024	-2.7%	-40.1%	-40.8%
	Definitive Healthcare Corp. Class A	Health Care Technology	-0.8%	30/06/2024	-3.6%	-26.2%	-24.8%
	Intel Corporation	Semiconductors	0.1%	30/06/2024	-4.4%	-9.2%	-13.1%
	Fastly, Inc. Class A	Internet Services & Infrastructure	0.4%	30/06/2024	-6.0%	-32.0%	-58.7%
	UiPath, Inc. Class A	Systems Software	0.6%	31/07/2024	-11.4%	-34.0%	-57.9%

Sources: WisdomTree, FactSet. As of 17 June 2024, we sought companies within WTAI, WCLD, and WCBR, as constituents and looked at their most recent earnings announcement, any change to forward guidance and subsequent returns from that announcement to try to gauge reaction to that specific announcement. **Historical performance is not an indication of future performance and any investments may go down in value.**

Conclusion: The megatrend is bigger than Nvidia

It's possible that market participants are starting to believe that Nvidia is bigger than anything. We must remember that building out compute infrastructure is merely one step in the AI journey. The bigger and more important step involves considering what we will use this compute infrastructure for.

In the near term, we have seen companies announcing an array of options for those looking for AI-enabled smartphones. Samsung, Apple, and Google are all tossing their respective hats into the ring here. Additionally, AI is starting to be infused into the operating system of new laptops and tablets. We are watching the sales figures for these devices because if we see significant sales in 2024 heading into 2025, it goes a long way to making AI ubiquitous. It will make using AI-enabled applications more normalised and speed up the transition to the next stage of computing. We'll also have to keep thinking about cybersecurity throughout.

WTAI, WCLD, and WCBR, albeit in different ways, capture different parts of this technological evolution.

[1] Source: "Apple Intelligence Preview." Apple.

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