

While most investors feared that the US economy was overheating just a few weeks ago, some are now calling the end of the current economic cycle, putting huge pressure on growth stocks and specifically on the Tech sector.

Even if we acknowledge that we could head into softer growth in 2019 mainly due to China and the consequences of the trade war with the US, we believe that **the probability of a global recession is very low.**

US treasuries and credit spreads have been very quiet during the market sell-off (except for special situations like Ford) and spreads remain tight in all zones, suggesting that the expansion cycle is still well underway.

Also, the FED remains on path to raise rates as the US economy continues to grow at a healthy pace (3% and more). Inflation is on the rise, albeit very modestly, knowing that unemployment is at its lowest in the last 40 years. The current level of US interest rates is not a threat to the US economy.

In Europe, there is a lot of political noise, as usual. Despite a marked slowdown since the start of the year due mainly to lower investments by corporates, consumer demand remains steady. Price pressure is increasing and this is why the ECB will continue its projected policy path.

In all, China is the big question mark right now but there are no signs of a sharp slowdown and the government is monitoring closely any sign of credit stress. So, in our view, the world economic growth remains steady with good fundamentals and the probability of a recession is, again, very low.

That being said, should the economic slowdown be more severe than what we expect, **we have decided to dive into the valuations of the tech sector**, more specifically those of semiconductor companies that have been in the eye of the storm over the last few weeks for their exposure to cyclical verticals (auto, industrials...).

Following a couple of uninspiring guidelines from the likes of Texas Instruments, AMD and AMS, earnings and valuation multiples have come down quickly and sharply. The **median 2019 PE of the semiconductor space is now slightly above 12x** (vs. 17-18x earlier this year), which is arguably cheap but also probably discounts upcoming earnings shortfalls (by 10-15%).

In our view, this valuation multiple is close to factoring in a brutal economic slowdown in 2019 which investors would have to slash 10% off companies' 2019 revenues (meaning that many semiconductor companies would report negative growth in 2019!) and cut the median operating margin of semiconductor companies (15.6%) by 200bps, leading to 20% earnings downgrades.

And importantly, this multiple leaves little scope for hope of a settlement between the US and China or for a reacceleration of the industry growth following the Chinese softening. As we often say, Tech companies are in a **secular growth cycle** as technology is becoming ubiquitous in our daily lives and as they are about to "take over" massive businesses such as the auto industry (electric and autonomous cars boast a lot of technology content), the financial services industry (with the rise of fintech) and

healthcare (Tech giants are getting increasingly present in the space, from digital devices with medical features to online pharmacy).

So any temporary revenue growth slowdown and valuation multiple compression could be used as an opportunity to increase exposure to a Tech industry whose **weight in global GDP will arguably keep rising over the years.**

From a tactical standpoint, while we expect volatility to remain elevated toward the mid term elections, it's worth noting that statistically, mid term elections year have been the weakest of the four-year presidential cycle, with correction in Q2 and Q3 before a Q4 rally (source NDR). We are therefore a few days away of (potentially) the best part of year in terms of seasonality, that is after the 6<sup>th</sup> November.