Are Technology Stocks Still a Good Place to Be?

Technology stocks were among the worst performers in 2022 but led the U.S. equity market rally during the first half of 2023, accounting for more than 78%[1] of the entire equity market's gain—in large part because of the excitement around artificial intelligence (AI) as well as the effectiveness of internal cost cuts. Is the latest revival just a short-term surge, or is a new growth phase ahead for technology-related industries? While we never recommend "chasing performance" or listening to the "noise" of big headlines, here's why we believe in the technology sector aside from AI and with a longer-term perspective.

Integral to Entire Equity Market. Technology companies comprise more than 28% of the total S&P 500® Index as of June 30, 2023.[2] Equally important, technology is a growth sector driving innovation and productivity gains throughout all sectors and industries—transforming health care, industrials, financials, real estate, automotive, retail, media, transportation, defense, energy, construction, agriculture and more at unprecedented speeds.

Driven by Secular Trends. Secular drivers of change are not going away, making technology increasingly ubiquitous. Virtually every company in every industry is looking to use technology to get closer to its customers, innovate more quickly and operate more efficiently. An exponential proliferation of data and digitization amid an evolving financial landscape, advances in medical treatment, revolution in manufacturing, and structural shifts in where we work and the way we consume goods and services is providing long-term upside potential for technology companies capitalizing on data storage, security, analysis, infrastructure, digital transformation transitions and more.

> *"People get focused on a new great tech innovation. You can replace AI and ChatGPT with bitcoin, metaverse, NFTs or 3-D printing. I caution everyone that until there is revenue, earnings and a product, the hype can be more dangerous than an opportunity."*
>
> *Robert Stimpson, Co-Chief Investment Officer and Portfolio Manager of Oak Associates Funds*

Targeted Growth Sub-Sectors. Within the technology sector, there is great opportunity for investment diversification. While some sub-sectors, such as personal computers, may be mature, others, such as semiconductors, automation & robotics, advanced driver-assistance systems, cloud computing, Internet media & services, data centers, software, electronic components, 5G wireless, financial technology and cybersecurity are still areas considered to have long runways of growth ahead. As just one example, worldwide end user spending on public cloud services is projected to rise 21.7% to $597.3 billion in 2023.[3] AI will surely be a powerful theme, too, but it's only one of many, and it's still in its infancy.

Supported by Fiscal Policy. In 2022, the Creating Helpful Incentives to Produce Semiconductors and Science Act (CHIPS Act) was signed into law, creating the largest publicly-funded research and development (R&D) program in U.S. history. Providing unprecedented support for the technology sector, the CHIPS Act appropriated approximately $280 billion to bolster U.S. semiconductor capacity, catalyze R&D, and create regional high-tech hubs and a bigger, more inclusive STEM workforce.

Wide Capitalization Investment Choices. The mega-cap technology companies that drove the U.S. equity market rally during the first half of 2023 have high quality and defensive attributes, including strong free cash flow, high barriers to entry and high visibility revenue models—especially attractive given an uncertain economic outlook. But looking beyond the technology titans for unsung innovators can be rewarding, too. Small-cap, niche-focused technology companies can often support higher valuations over time, with better execution, an ability to fend off competition and appeal as a quality acquisition candidate.

"The technology sector has long been one of our favorites and remains so today. The secular growth, innovation and superior profitability characteristics relative to the other S&P 500 sectors make it possible to offer two separate funds with very different investment profiles."

Jeff Travis, Portfolio Manager of Oak Associates Funds

Attractive Fundamentals. Technology company fundamentals remain robust, supporting the longer-term growth prospects of the sector. Despite a recently escalating interest rate environment, technology companies overall tend to have higher profit margins and lower debt to service ratios compared to companies in other sectors. Instead of debt, much of these companies' financing has been through the issuance of equity and/or larger cash balances. Further, the technology sector boasted the highest returns on equity of any sector in the U.S. equity market, as measured by the S&P 500® Index, through the first half of 2023.[4]

Additionally, the fourth quarter of 2022 saw hiring freezes and layoffs sweep through the technology sector. However, many technology companies have weathered the economic slowdown and flourished in 2023 by cutting costs, increasing efficiencies and renewing focus on the bottom line, thereby growing revenue and earnings. Indeed, about 75% of technology companies reporting first quarter 2023 earnings and sales results in the spring of 2023 exceeded market expectations, well above historical averages for the sector.[5]

"Growth stocks, including technology companies, tend to have more persistent earnings power and stronger profitability than cyclical value names in a cooling economy. But inflation and interest rates remain headwinds, albeit comparatively short-term challenges. That's why long-term strength and quality of earnings are increasingly important, and stock selection critical. And so it pays to be a selective investor."

Robert Stimpson, Co-Chief Investment Officer and Portfolio Manager of Oak Associates Funds

Specialized Products/Services. Technology companies thrive on innovation, typically offering niche, or specialized, products or services. Notably, in 2022, merger and acquisition activity surged in the enterprise information technology field.[6] Overall, technology, media and telecommunications deals accounted for 30% of all global deal values in 2022.[7] In the U.S. alone, technology sector deal activity slowed but remained strong in the first half of 2023 with 577 deals made valued at $39.4 billion compared with 1,681 deals made valued at $362.5 billion in 2022.[8] Key factors driving activity included the opportunity to leverage new technologies already developed by others and the need to sustain innovation, expedite advances and replace lost revenue from maturing products.

Reduced Inflation Impact. For several reasons, technology stocks are generally well-positioned to perform well in the decelerating but still-sticky inflationary environment that exists. First, technology-enabled innovation helps offset the impacts of inflation for companies in a wide variety of industries. Second, innovative technology companies typically have pricing power. And third, inflation often encourages businesses to invest in technology to reduce costs and improve efficiencies.

Why Oak Associates' Technology Sector Investment Strategy is Different

At Oak, we believe that sustainable long-term growth for investors is best achieved through a concentrated portfolio of companies and sectors. Our stock selection process centers on identifying multiple drivers of growth and engaging in fundamental research to uncover the right businesses within the right technology sub-sectors. We then take meaningful positions—targeting underappreciated value and seeking long-term growth through compounding of high-conviction holdings that are independent of typical index results. Oak Associates Funds has been specializing in U.S. equity investing for more than 35 years based on an investment philosophy centered on the core tenets of investing for the long term, concentrating in our best ideas and remaining fully invested.

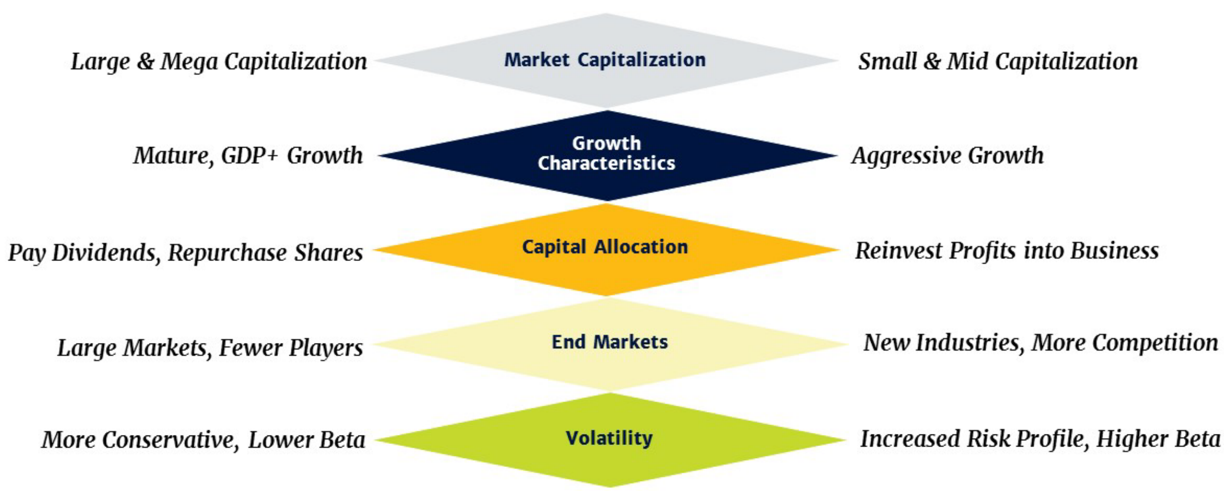
UNIQUE FUND CHARACTERISTICS

Red Oak Technology Select Fund (ROGSX)

- Mature
- Blue Chip
- Leading Well-Known Companies

Black Oak Emerging Technology Fund (BOGSX)

- Nascent
- Emerging
- Pure-Play Niche Companies



These characteristics are features of the underlying holdings that the respective funds consider.

SHARED FUND CHARACTERISTICS

Independent of Any Index/25-40 Holdings
Long-Term Focus/Low Annual Turnover
Culture of Conviction/Fully Invested

[1]https://www.statista.com/chart/30318/sector-contributions-to-sp500-return/. Technology stocks are here defined as a combination of the information technology and communication services sectors of the S&P 500® Index. [2] https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview [3]https://www.fidelity.com/learning-center/trading-investing/big-tech [4]Bloomberg, August 7, 2023
[5] https://www.goldmansachs.com/intelligence/podcasts/episodes/why-the-ai-driven-tech-rally-has-legs.html
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