

Information Technology Stocks vs. S&P 500

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Long-term fundamentals are positive

Technology continues to grow as a share of GDP and is likely to do so well into the future. Globalization and its impact on competition are limiting the ability of corporations to raise prices. At the same time, a global shortage of skilled labor and historically low unemployment should put upward pressure on wages and downward pressure on profit margins. In order to maintain margins, corporations are likely to enhance productivity by increasing capital spending in general and information technology (IT) spending in particular. We believe the winners in this global growth environment will be those corporations that can maintain their profit margins as top line growth rises.

In addition, the expansion of free market capitalism is creating dynamic growth in developing countries as they move from subsistence economies to industrial economies. As these countries advance up the knowledge curve, the demand for technology should burgeon.

Technology itself should create demand for more technology. With technology rapidly innovating, corporations will likely continue to add new technologies to their business models to remain competitive and out of fear of being left behind. As prices come down for existing technologies and as new innovations come to market, consumer spending on

high tech gadgets is likely to continue as well. In addition, technology is likely to help provide solutions for containing healthcare costs, pollution control and energy development

Valuations are attractive

At 18 times forward earnings and with better growth prospects, the IT sector of the S&P 500 index is inexpensive relative to small cap stocks (Russell 2000) trading

at 19 times earnings. However, relative to the S&P 500, the IT sector is at best neutrally valued.

IT underowned?

The IT sector currently comprises 16.3% of the S&P 500, which is above the 11.3% mean going back to 1972. However, as technology has become a larger share of GDP, IT earnings as a percent of the S&P 500 earnings have risen to 10.6% from

INFORMATION TECHNOLOGY VS. S&P 500 MONITOR

Valuation	Current Bias	Tendencies
Median Valuations	Neutral	Earnings, cash flow and sales yields
Relative Valuations	Positive	Relative to inflation and interest rates
Relative Forward P/E	Neutral	Relative to the S&P 500
Relative P/E vs. Russell 2000	Positive	Relative to small cap stocks
Economic Catalysts	Current Bias	Tendencies
Economic Cycle	Neutral	Up-cycle favors IT
Market Cycle	Positive	Late-cycle favors IT
Earnings Revisions	Positive	More stocks reporting positive earning revisions
Relative earnings growth	Positive	Relative forward earnings positive
ISM Index	Neutral	Expanding manufacturing sector is positive
IT New Orders	Positive	High and rising is positive
IT New Orders/Shipments	Positive	Rising is positive
IT Production/Total Prod.	Neutral	High and rising is positive
Tech. Capacity Utilization	Neutral	Rising is positive
Fed Policy	Neutral	Underperforms after last tightening
Dollar	Positive	Weak dollar (y-y change) favors IT
Price Action	Current Bias	Tendencies
Relative Momentum	Positive	IT Sector vs. S&P 500
Long-Term Mean Reversion	Neutral	Underperformance is positive
Relative Volume	Positive	NASDAQ vs. NYSE Volume
Breadth (Hi/L0, AD,)	Positive	Breadth in line with price trend is positive
% Bullish Ratings	Positive	Above 60% is bullish
Tech % Total Funds	Positive	Low = pessimism = bullish
NASDAQ Short Interest	Positive	High shorting is positive
Analyst Sentiment	Positive	Bearish consensus is bullish
Overbought/Oversold	Neutral	Overbought is bearish
Ned Davis Research Sector Rank	Positive	Ned Davis Sector Model

Sources: Bailard Research, Ned Davis Research, Yardeni Research

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the long-term mean of 5.9%. Given the rapid growth in relative earnings, one could argue that the IT sector should be a bigger share of the market index.

Economic and market cycles are positive

Historically, the IT sector tends to do well in the latter stages of a bull market and when the economy is still in an up cycle. Although economic activity has slowed, we do not envision a recession and believe global growth and exports will offset the current slowdown in housing. Asian demand for technology continues to expand. IT orders, production and shipments are also continuing to improve. Finally, with a more accommodative Fed, we think that the likelihood of an extension of the economic cycle is high.

Relative momentum is improving

From December 31, 2001 to July 31, 2006, the IT sector of the S&P 500 index underperformed the index as a whole by over 34%. It also underperformed the Russell 2000 small cap index by 65%. With the excesses of the late 1990's wrung out, IT was poised for a period of outperformance, which finally appears to have started. The IT sector has been trending higher and outperformed the S&P 500 by 16% from July 31, 2006 to August 31, 2007. Technology stocks have once again come back into favor. This sector has held up relatively well in the recent downturn, and sectors that stabilize first tend to rebound the strongest. If, as we expect, stocks move higher, IT could lead the way.

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