Herald Worldwide Technology Fund

What we are seeing
July 6th, 2020

Economies across different geographies are going through unprecedented challenges. Unemployment levels are at record levels around the world. Government debt levels are testing the limits to fiscal policy. Nevertheless, the equity markets have bounced sharply upwards from their lows, driven by strong performance in the technology sector and the health sector.

In our prior notes we highlighted some of the key factors in favour of the technology sector during the current crisis and longer-term, namely, the fortress-like balance sheets of some of the companies, their experiences with diversifying and managing supply chains in times of crisis, and of course the mass migration to "work from home" driving an explosion of demand for a myriad of cloud-based apps and services. Therefore, justifiably, the technology sector is outperforming the broader market.

Buybacks are another factor which have been supporting share prices in the technology sector. However, Stock-Based Compensation is fairly widely used in the technology sector, so a certain number of the buybacks is to offset the dilution.

Disaggregating factors driving the market is always difficult. The charts below are a focused view into buyback activity in the S&P 500 over a long period. The data shows, the progression of the technology sector's buyback activities over time to the point that the companies in the technology sector accounted for over 30% of the amount spent on buybacks by S&P 500 companies during the last two years.

We believe many of the companies in the technology sector are highly responsible stewards of capital. The best companies continue to make long-term investment in R&D, capex, and acquisitions to drive growth and at the same time, return capital to shareholders through buybacks and dividends while maintaining conservative balance sheets.

We remain bullish about the long-term prospects of investing in the technology sector. We look for companies which are well positioned to generate long term growth. At the same time, we look for management teams which balance growth with a focus on long term sustainable profitability without diluting shareholders' interests through the aggressive issuance of shares and stock options.

Chart 1 shows the trend in buybacks for the different sectors in the S&P 500 for the period 2000-2019, essentially spanning the last tech bubble in 2000 and the financial crisis in 2008-2009.

This chart clearly shows the substantial drop in buybacks in 2009 but 2018 was a particularly strong year due to the passing of the Trump tax laws in December 2017.

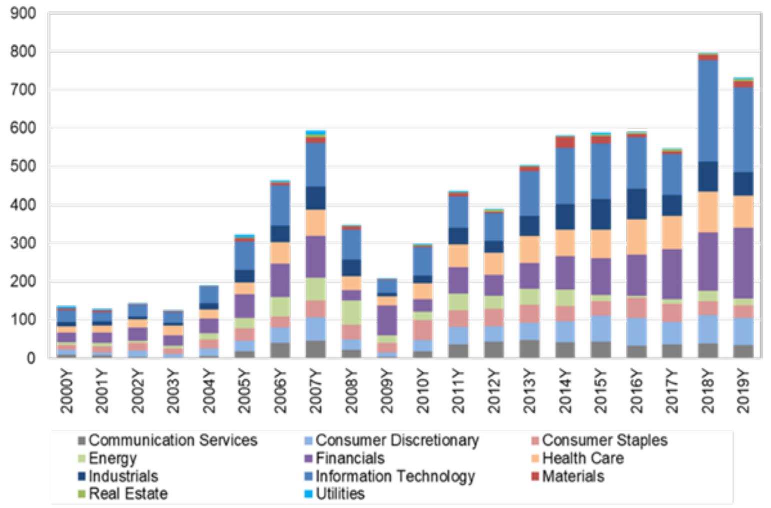


Chart 1 : units are $billion

Chart 2 shows the absolute value spent on buybacks and dividends by the S&P Technology sector. It's value of buybacks more than doubled in in 2018, following the passing of the Trump tax laws in 2017. Buyback amounts remained over $200B in 2019, exceeding all prior years, except for 2018.

The chart also shows the steady increase in the dividends paid by the S&P Technology sector.

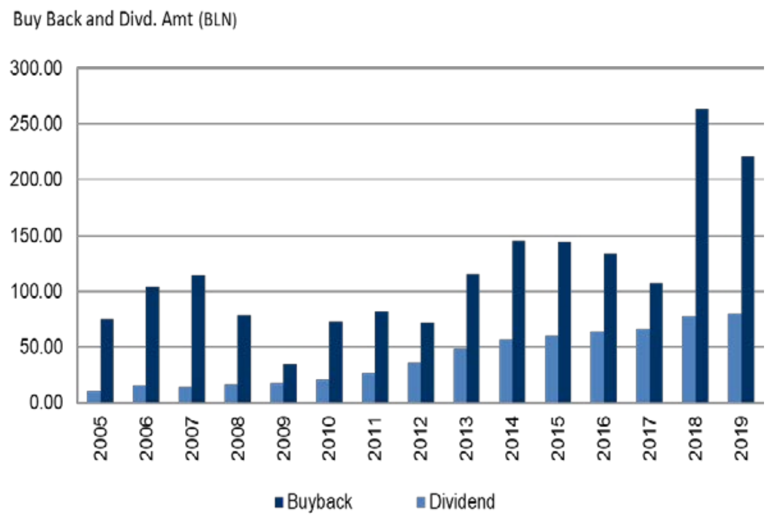


Chart 2

Chart 3 shows the combined Buyback and Dividend Yield for the S&P Technology sector.

Buybacks have always accounted for a larger amount than dividends. Nevertheless, dividend yields have been between 1-2%. In the environment of low government yields, the technology sector has been providing both growth and yield.

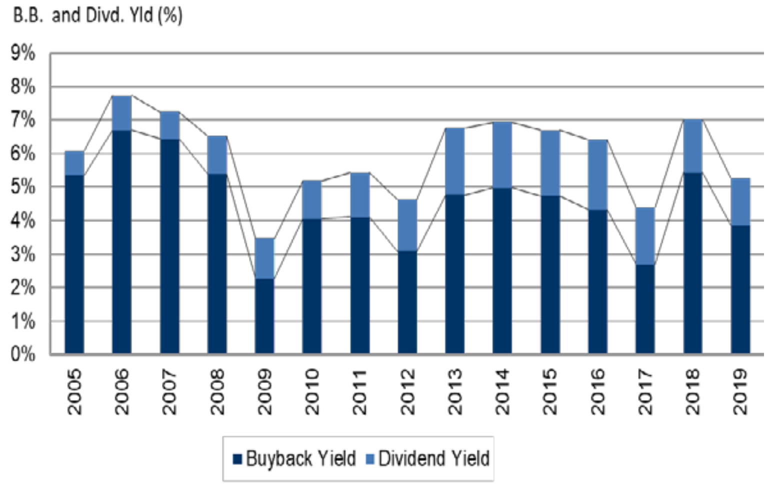
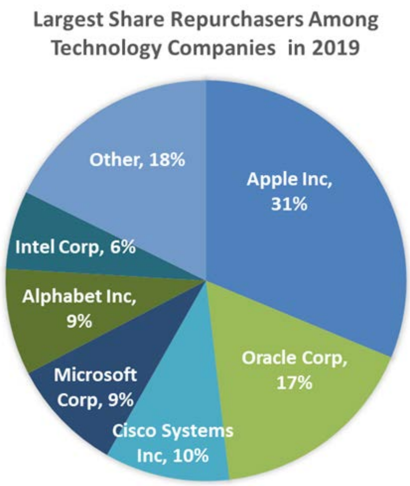


Chart 3

Chart 4 shows the technology companies which accounted for the largest amount of the ~$220B in buybacks in 2019*. This chart shows that only 6 companies accounted for 82% of the buybacks in within the technology sector in 2019. *Source: Bloomberg	 Chart 4

In Summary

Buybacks in the S&P 500 have amounted to over $700B per annum during the past two years. The Technology sector has accounted for 33% and 30% of the buybacks in 2018 and 2019. Gross buybacks in the technology sector have been $263B and $220B in 2018 and 2019 respectively, while share issuances have only been $14B and $20B in those years.

Buybacks have continued into Q1, 2020. The technology sector accounted for close to 30% of those buybacks in Q1.

We expect buybacks in the technology sector to continue due to the strong balance sheets, and high free cashflows of many of the companies in the sector. We also expect companies to maintain and/or increase their commitments to dividends over time. However, the volume of buybacks is likely to reduce as the one-time benefit from the impact of the Trump tax laws and repatriation of foreign earnings will diminish over time. A reversal of the tax laws will obviously be negative for profits, valuations, and buybacks.

It is noteworthy only 6 companies within the technology sector accounted for 82% of the $240B of buybacks in 2019. Out of these companies, 4 of the 6 have been core holdings of Herald Worlwide Technology Fund ("HWTF") for many years.

Among our 34 equity holdings in HWTF, 14 companies have reduced their shares outstanding during the last two years while 17 have increased their shares outstanding. Among those reducing their shares outstanding, the most notable are Teradyne, with a 15% reduction in shares outstanding, followed by Apple with a 13% reduction in shares outstanding.

Stock-based compensation is widely used in the technology sector to incentivise employees. We recognize the importance of using equity to incentivise employees and support its use. At the same time, we believe issuance of shares should be done prudently to ensure shareholders' interests are not diluted excessively.

We remain big believers in the long term opportunity for captial growth by investing in the technology sector. At the same time, we are also big believers in responsible stewardship of capital and a focus on companies which are well positioned to grow but are also fundamentally, sensibly valued. The use of buybacks and dividends continues to increase among companies in the technology sector. We believe these factors help support share prices longer term.

Important Information

The objective of the Fund is to achieve capital growth by investing in the securities of issuers in the technology, communications and multi-media sectors which the Investment Manager believes offer

potential capital growth. This report has been issued on behalf of Herald Worldwide Technology Fund, and has been approved by Herald Investment Management Limited, its investment manager. Herald Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Market and currency movements may cause the value of shares, and the income from them, to fall as well as rise, and you may get back less than you invested when you decide to sell your shares. Certain statements in this report constitute 'forward-looking' statements. Such statements, including the intended actions and performance objectives of the Fund, involve unknown risks, uncertainties and other factors which may cause actual results, performance or achievements of the Fund to differ materially from those implied by such forward-looking statements.

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