Analysis: Once reliable technology sector drags down earnings

Caroline Valetkevitch, Reuters

(Reuters [1]) - This earnings [2] season, the U.S. technology industry is in an unusual position - dragging corporate America down, rather than lifting it up.

Wall Street [3] expects the tech sector's fourth-quarter earnings to be down 1.1 percent from a year ago, the first drop since the third quarter of 2009, even though overall S&P 500 profits are still forecast to show growth, according to Thomson Reuters [4] data.

Chip companies are expected to be among the worst performers because of softer-than-expected personal computer sales. Weak overseas demand and worries about the U.S. fiscal crisis have also likely caused corporations to put off IT spending.

"The lack of economic growth we've seen in Europe, the deceleration of emerging markets [5] - that has put a significant amount of pressure, particularly on technology," said Omar Aguilar, chief investment officer for equities at Charles Schwab Corp, in San Francisco.

Tech stocks [6] have struggled recently and further weakness could dent the bullish 2013 forecasts many strategists have for the U.S. stock market. But some investors and analysts say weak fourth-quarter numbers have already been baked into many tech stock prices and valuations are attractive.

Analysts at Bank of America Merrill Lynch wrote in a note this week that tech stocks [6] are undervalued by about 32 percent, more than any other sector, based on current forward price-to-earnings ratios. Every tech industry except IT services is trading well below historical levels, the note said.

Within tech, "you're finding a lot of cash-rich companies trading at reasonably cheap multiples. So to value investors like us ... it starts to seem intriguing," said Eric Kuby, chief investment officer at North Star Investment Management Corp in Chicago, whose firm owns Microsoft Corp and Intel Corp.

It is unusual for tech, the largest of the Standard & Poor's 500 index's 10 industry sectors and accounting for nearly 23 percent of earnings, to underperform. Tech has been in the top half of S&P sectors for the last four earnings periods and it has posted stronger profit growth than the overall market 83 percent of the time in the last 10 years, according to Thomson Reuters [4].

Apple Inc usually provides one of the biggest boosts to U.S. corporate earnings, but this time its December quarter profit is forecast to fall 3.8 percent year on year, compared with the S&P 500's overall 1.8 percent profit growth, according to

Thomson Reuters data.

Apple has only missed analyst earnings expectations four times in the last 10 years, two of those in the most recent reporting periods, Thomson Reuters data showed. Its shares are down again this week after reports the company is ordering fewer components because of lower-than-expected demand for its iPhone5.

But even Apple stock, which fell below $500 a share on Monday for the first time since February, is looking more attractive to value investors, Kuby said.

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The bulk of technology companies do not start to report results until next week, but Intel is due out on Thursday.

Among tech's sub-industries, 13 semiconductor companies are expected to report an aggregate 28.4 percent fall in quarterly profit and four semiconductor equipment [7] makers are expected to see a 50.7 percent drop, Thomson Reuters data showed.

Texas Instruments Inc was among top chip companies that have warned on the fourth quarter, along with Applied Materials Inc. Texas Instruments, which last cut its profit target in December, cited restructuring charges. The stock closed on Tuesday at $32.28, off its $34.24 high in March.

Others warnings have come from Cisco Systems Inc, Hewlett Packard Co and Qualcomm Inc.

The S&P 500 tech sector rose 13.2 percent in 2012, about the same as the S&P 500's 13.4 percent gain, but tech stocks by at least one measure have been underperforming since September. The SPDR XLK technology fund ETF ended last quarter with a loss of 6.1 percent, while the S&P 500 was down just 1 percent.

"The S&P 500 peaked in mid-September, had a pullback and it's already pretty close to that September high. Contrasting that, the XLK hasn't even come close to getting back to where it was in September," said Chris Burba, co-founder and chief technical strategist at miAnalysis Inc in New York.

(Reporting by Caroline Valetkevitch; Editing by Tiffany Wu and Andre Grenon)

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