Allianz Technology Trust

- **The US election and the shift from Growth to Value has not dented ATT's strong performance with the NAV up c.6% year to date relative to the benchmark return of 4.1%, and the MSCI World £ return of 1.0%**
- **Walter has increased to 36% the proportion invested in "value" names, as part of his barbell approach. Walter believes that 2017 will see an ever increasing focus on fundamentals as the key driver of stock prices. 2016 was a period where Walter saw several holdings produce excellent results and yet saw their ratings degrade. Now that the pain has been felt, Walter feels that good stock picking (which he views as his team's strength) is likely to be better rewarded that it was in 2016.**
- **The discount remains around 5%, significantly wider than Polar Capital Tech. In our view Walter's active investment process and high conviction approach (not to mention the local competitive advantage) will continue to help him stay ahead of competitors going forward.**

Summary

ATT had a strong year last year, benefitting from sterling weakness but also good growth from underlying companies. Although so far this year the growth style has performed well, 2016 saw a marked shift from Growth growth to Value value as an investment style . At the time of writing, and perhaps against expectations, this has NOT had a negative effect on the trust. Indeed, the trust is performing extremely strongly with the NAV up c.6% year to date (to 3th February) relative to the benchmark return of 4.1%, and the MSCI World £ return of 1.0%.

Walter reports that the portfolio has the highest weighting to "value" names that it has ever had – with around 36% of the portfolio. This still represents a small underweight relative to the benchmark, but represents a significant proportion of the fund relative to historic levels. The team are benchmark aware, not benchmark driven. Walter offers a "barbell" approach, in which the mid-cap "high-growth" holdings are balanced by larger capitalisation "value" names. In the mid-ground, Walter owns a portfolio of "growth at a reasonable price" providing an engine for NAV growth, without huge expectations / multiples baked in.

Other recent changes to the portfolio driven by Trump's election include continued investment in cloud orientated companies. Walter believes that the new president will be focussing on productivity improvements (and less government), which should help several of his holdings. On the other hand, Walter immediately cut Chinese holding back almost entirely from 10% to c. 1%. The other change made to the portfolio as a result of the election was to robotics and automation companies (which should see increased demand from American companies on-shoring production).

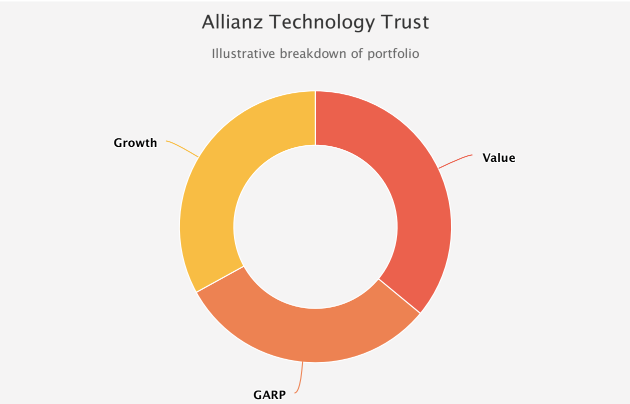
Allianz Technology Trust (ATT) has assets of £235m. There are relatively few specialist Tech funds in the UK Trust and OEIC universe, but ATT is in our view differentiated from investment trust and OEIC peers both in its stock picking flexible approach, but also in that the managers are based in the midst of "the action" in San Francisco. Performance over the short term has been good in absolute terms, but Walter has struggled recently against the benchmark. Over five years however, the trust has beaten closed and open ended peers, and the benchmark by a significant margin.

Having widened considerably after the Brexit vote, ATT's discount has narrowed to c.5%, which is in line with its longer-term average and well within the board's stated target of 7%. However, it once again trades at a marked discount to its closest peer – Polar Capital Technology. In our view Walter's active investment process, flexibility and high conviction approach (not to mention the local competitive advantage) will continue to help him stay ahead of competitors going forward.

Portfolio

We spoke to Walter recently to get an updated view on his positioning. As we all know, the Technology sector is ever widening in terms of its reach through the global economy, and has delivered startling growth over the past few years. However, it also carries significant risks for investors. Mindful of this, Walter offers a "barbell" approach, in which the mid-cap "high-growth" holdings are balanced by larger capitalisation "value" names. In the mid-ground, Walter owns a portfolio of "growth at a reasonable price" providing an engine for NAV growth, without huge expectations / multiples baked in. The team are benchmark aware, not benchmark driven, and see themselves as having pretty free rein to invest in companies wherever they are, and whatever sector they belong to, as long as they are amongst what Walter considers the best companies in the world in their particular niche.

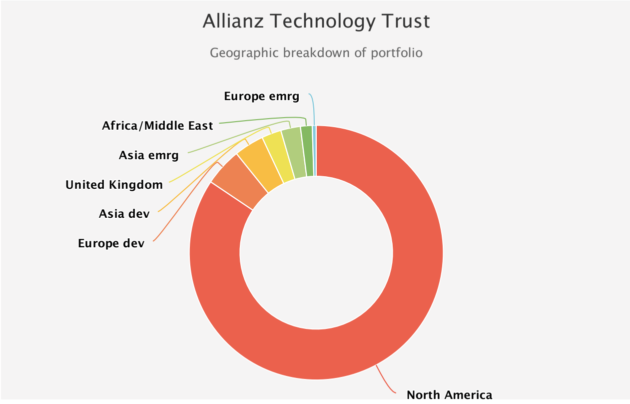
Walter reports that the portfolio has the highest weighting to "value" names that it has ever had – with around 36% of the portfolio. This still represents a small underweight relative to the benchmark, but represents a significant proportion of the fund relative to historic levels. Within the value bucket, Walter includes holdings in semi-conductors which he believes trade on a 30/40% discount but the sector is continuing to benefit from more disciplined management in terms of pricing and capacity investment. Walter believes that the market is seeing shortages in supply of D-RAM (especially with the launch of the Apple iphone 8 later in the year) as well as NAND Flash (particularly used in cloud computing). Walter has been investing in equipment manufacturers and expects a re-rating. Walter has been building up a position in Samsung since mid-2016 where he took the activities of Elliot as a buying signal. It is now in the top ten holdings.



Source: Allianz Global Investors

Walter has historically had a bias away from the "mega-cap" names, and this continues today. He is materially overweight the index in mid-cap names, which he believes will be able to deliver 30%+ growth in the coming year. Relative to Polar Capital Technology, the trust is significantly more concentrated (63 vs c.125 stocks). Unsurprisingly for a Technology fund, the vast majority of the trust's assets are invested in US listed companies. 7 out of the top 10 largest technology companies in the US are based in the San Francisco "Bay Area" where Walter Price and his team operate from.

Walter and the team continue to believe that they have a competitive advantage in being located here, given the well-developed ecosystem serving Technology companies located there. Given that it is Walter's ambition to be ahead of the crowd in identifying the world's most innovative companies, he believes that being on the doorstep is a huge help.



Source: Morningstar

Walter continues to be a strong supporter of Cloud orientated companies. Companies he owns in this space are Amazon, Workday, and Microsoft. He believes that the new Trump presidency will be focussing on productivity improvements (and less government), which should help several of his holdings including CSRA which is a mid-cap governmental contractor helping the move to the cloud.

Chinese holdings have at times been a significant part of the portfolio. When we last reported back before the presidential election, China was estimated at c 10% of the portfolio. When Trump was elected, Walter immediately cut this holding back almost entirely to c 1%. The other change made to the portfolio as a result of the election was to robotics and automation companies (which should see increased demand from American companies on-shoring production). Names which Walter invested in very recently include Teradyne and Cognex (a robotic vision system). In terms of risks to the portfolio from the new president, Walter felt that Apple and HPQ could be at risk from any extra taxes for companies producing their products abroad, but Walter felt that at the current stage, the risks are relatively small. Indeed, Walter continues to add to Apple believing that after a slower start to 2017 the iPhone 8 will deliver very strong earnings growth once again. Walter also believes that Apple will use any cash it is able to repatriate (pending any new rules from the new president) will be used to buy stock back.

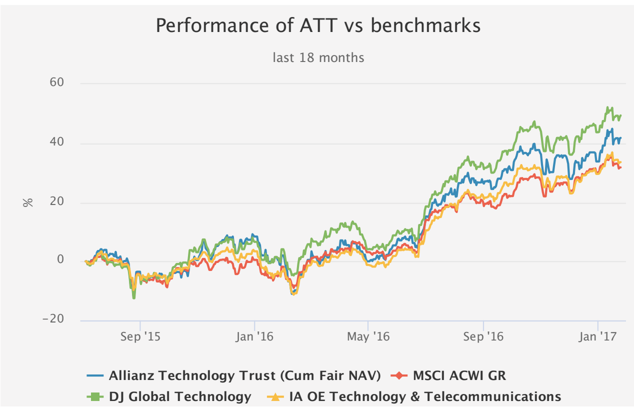
Walter has been cutting back his exposure to Facebook, which although still a decent sized position, he feels it will not be amongst the winners from a broader use of "video". In Walter's view, Google's Youtube and Netflix will be dividing the spoils from consumption of video over the internet. Walter believes that Augmented/Virtual Reality theme is poised to accelerate in 2017 due to declining hardware costs, more software availability, new mobile phones from Apple and Google, and ongoing work by Microsoft and Tesla paving the way for this theme to deliver attractive growth.

Looking forward to 2017, Walter believes that there will be an ever increasing focus on earnings growth as the key driver of stock prices. 2016 was a period where Walter saw several holdings produce excellent results and yet saw their ratings degrade. Now that the pain has been felt, Walter feels that good stock picking (which he views as their strength) is likely to be better rewarded that it was in 2016.

Performance

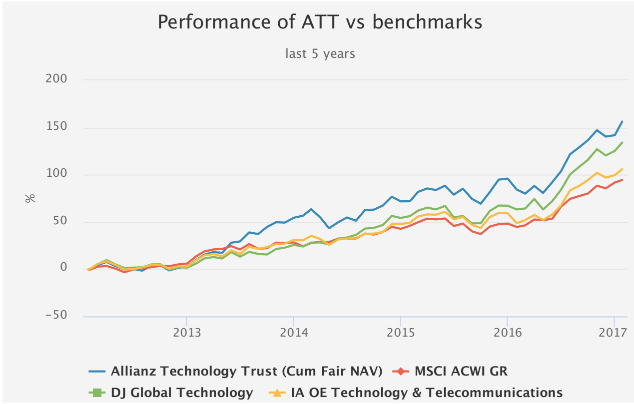
Technology continues to be one of the strongest drivers of growth in the world economy. During 2016, the trust underperformed the benchmark by quite a margin – with a NAV return of 23.7% relative to the Dow Jones Technology benchmark of 34.8%. This underperformance, we understand, was down to an underweight position in large-cap stocks which are a large percentage of the benchmark, but in Walters view don't merit the weighting from an investment perspective. As the graph below shows, over eighteen months, Walter has outperformed the broader indices and peers, but underperformed the Technology benchmark.

During 2016, not owning mega-cap stocks such as IBM, Taiwan Semiconductor Manufacturing, Texas Instruments, Hewlett Packard Enterprises (HPE), and Advanced Micro Devices hurt relative performance. As we allude to in the portfolio section, Walter has had a decent allocation to the mega-cap value stocks which have driven the index performance, but not enough to keep up with the benchmark. Walter reports that a rotation from Technology stocks into Industrials in the latter stages of the financial year was very painful for them. To some extent, this has reversed in 2017 so far, with Internet and e-commerce companies such as Amazon reporting extremely strong performance's over Christmas.



Source: Morningstar

Over the longer term the team's stock picking, as well as judicious exposures to mid-caps during 2013, has led to the trust outperforming closed and open ended peers, as well as benchmarks, by a significant margin.



Source: Morningstar

This is an active stock-picking fund, and so in any one year, the performance can deviate quite considerably from the benchmark and peers. Whilst Walter tries to mitigate the downside by spreading risks and moving the portfolio away from more volatile mid-caps and sectors at times in the cycle. In our view Walter's active investment process, flexibility and high conviction approach (not to mention the local competitive advantage) will continue to help him stay ahead of competitors going forward.

Dividend

The trust does not currently pay a dividend, and we understand it is currently not the board's intention to do so.

Management

Walter Price leads the specialist team of four portfolio managers. He has been investing in technology companies for over 35 years, and has worked with co-manager Huachen Chen for over two decades. They have consistently applied the same approach to their investment research, looking for disruptive innovators that can generate strong returns for investors from 'creative destruction'.

The team live and work in the San Francisco area where a great number of the world's technology companies are located, a factor which they view as an essential for quickly identifying changes in relentlessly competitive markets. In aiming to identify major trends, they believe that since the mid 1980's they have correctly identified new trends in PCs, networking, wireless communications, storage systems, Internet, and cloud computing – all ahead of the crowd. The team follow the same investment rationale that they have done for many years. They aim to identify major trends ahead of the crowd, participating in stocks that have the potential to become tomorrow's Microsoft, Cisco or Apple. They believe in having a relatively concentrated portfolio, a bias towards mid-caps (and underweight large caps relative to the benchmark). Relatively early on they identified Cloud computing and "software as a service" as a development within the technology sector of a magnitude that only happens every 15 or 20 years. They are ambivalent as to whether they are growth investors, or value- aiming to capture the total return potential from all sorts of stocks in the technology world.

The team lean on Allianz's proprietary "Grassroots" market research network, which enables them to commission reports and market research from journalists, analysts and other professionals which has in the past proved useful with consumer related products.

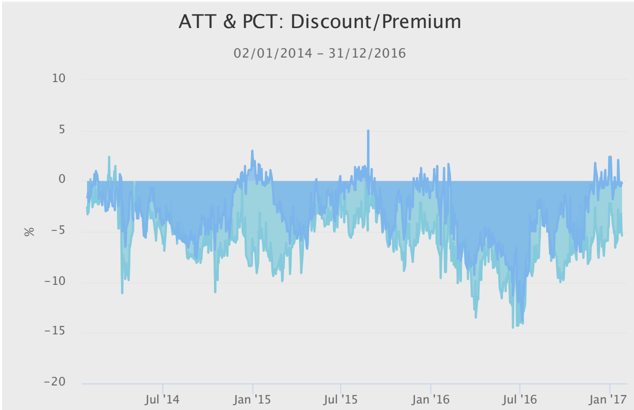
Gearing

The trust is not currently geared, and does not currently have a gearing facility in place. Gearing is not expected to exceed 10% of net assets but may at times increase to 20%. Similarly, the proportion of the company's net assets held in cash or liquid investments will not exceed 15% of net assets but may be increased at times to a maximum of 30%.

Discount

Discounts for thematic trusts can be fairly volatile, but at times can also reflect sector views rather than those on a specific trust. June 2016 was just one of those occasions when both ATT and Polar Capital Technology widened out to mid-teen discounts. Both trusts have seen their discounts narrow once again, although ATT has historically traded at a meaningful discount to its larger and more liquid competitor, Polar Capital Technology. As the graph below shows, at times this differential has been quite significant, and at others less so. The trust's current discount is towards the narrower end of its range at c.5% - although at a significantly wider discount than PCT once again.

The board of ATT have a stated discount target of c.7%. Whilst this isn't a hard target, the board have stated that they will look to buy shares back when "the discount is wider than 7% and where there is demand in the market for them to do so". The DCM has helped ensure that the rating has remained relatively stable over time. It is worth noting from the graph below that in more difficult market periods the discount has widened out to a level approaching (and sometime surpassing) 10%, but we believe that the fact that historically the rating has subsequently recovered relatively quickly is illustrative of the strong investor following that Walter and his team have been able to attract. The ultimate long term discount control mechanism is a continuation vote: shareholders have the opportunity to vote at the AGM at five yearly intervals whether to continue the Company. The next continuation vote will be in April 2021. ATT is able to issue shares from treasury at a small discount subject to a variety of parameters set by the Board. They issued 300,000 shares during 2015, with the last issue being of 10,000 shares on 11 Sept 2015. All of these were issued at a small discount to NAV, having been bought back at a much wider discount.



Source: Morningstar

Charges

The trust has a fixed investment management fee of 0.80% of the trust's market capitalisation and a performance fee calculated as 12.50% of outperformance of the NAV against the benchmark. The company's OCF last year was 1.1%. The performance fee element is capped at a maximum of 2.25% of the trust's net asset value at the year-end. Importantly, a performance fee will only be paid if the trust's NAV is higher than that at which any previous performance fee was paid and if performance in that year is ALSO ahead of the benchmark on a cumulative basis.

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