# Allianz Technology Trust

- **ATT offers a relatively pure exposure to "innovative disruption", with the managers' investment process built entirely on the thesis that the next "mega-cap" businesses will be those who innovate the hardest**
- **Over the ten years since the team started managing ATT, the trust has outperformed the benchmark by around 90 percentage points. Over the last twelve months the managers' shift towards a barbell approach – overweighting both "value" and "growth" stocks – has led to c. 7% outperformance of Polar Capital Technology and the benchmark**
- **Walter Price (lead manager) estimates that the portfolio earnings growth for the next 12 months will be in the order of 41% - reflecting a cyclical upswing but also reflecting secular growth. He expects growth from his companies to level out at 24% pa in the next three years, and these are currently trading on average forward P/E valuations of 23x**
- **The trust's discount does widen at inflection points, the last spike having been seen after the Brexit vote when it reached mid-teens. At the current level of 4%, it remains slightly wider than its closest peer – Polar Capital Technology. Over the last ten years the team have proved they can add considerable value by identifying disruptive innovators, and we see no reason why this shouldn't continue for the next ten**

## Summary

ATT offers a relatively pure exposure to "innovative disruption", with the manager's investment process built entirely on the thesis that the next "mega-cap" businesses will be those who innovate the hardest. In his view, it is no surprise that the largest listed companies in the world are over-represented by technology businesses. Whilst the managers invest the majority of the trust's assets in the technology sector, they are having profound impacts on sectors such as automobiles, advertising, security, retail, and web services.

Walter Price and his team in San Francisco have developed a long-term track record stretching back several decades. They have managed ATT for ten years now, over which period the trust has outperformed the benchmark by around 90 percentage points (ATT NAV +340%, Dow Jones World Tech £ +250%). Taking a pure stockpicking approach means that strong outperformance will have to be weighed up by periods of underperformance and with a three-year tracking error of c.6%, ATT has been no different. The last twelve months has however seen a strong return to outperformance thanks to the manager's shift towards a barbell approach – overweighting both "value" and "growth" stocks – which has led to strong outperformance of Polar Capital Technology and the benchmark. Over one year, the NAV has increased 39%, outperforming the benchmark by 7.2%, and Polar Capital Technology (PCT) by 6.8%.

Looking forward, Walter estimates that the portfolio's earnings growth (for the 12 months from September 17) will be in the order of 41%. This is a reflection of a cyclical upswing from the likes of Apple, Amazon and the semi-conductors. But it also reflects the staggering secular growth that technology companies are capable of – Walter expects growth from his companies to level out at 24% pa in the next three years. This compares with P/E valuations of 23 X, which given the growth expectations, aren't too far-fetched.

ATT has assets of £287m. There are relatively few specialist Tech funds in the UK Trust and OEIC universe, but ATT is in our view differentiated from its peers both in its stockpicking flexible approach, but also because the managers are based in the midst of "the action" in San Francisco.

The trust's discount does widen at inflection points, the last spike having been seen after the Brexit vote when it reached mid-teens. However, the pattern that has emerged is that it snaps back relatively quickly, but generally remains slightly wider than its closest peer – Polar Capital Technology. The current discount of c 4% is well within the board's stated target of 7%. However, in our view, it is Walter's active investment process, flexibility and high-conviction approach (not to mention the local competitive advantage) that will be the key influence on returns going forward. Over the last ten years the team have proved they can add considerable value by identifying disruptive innovators, and we see no reason why this shouldn't continue for the next ten.

## Portfolio

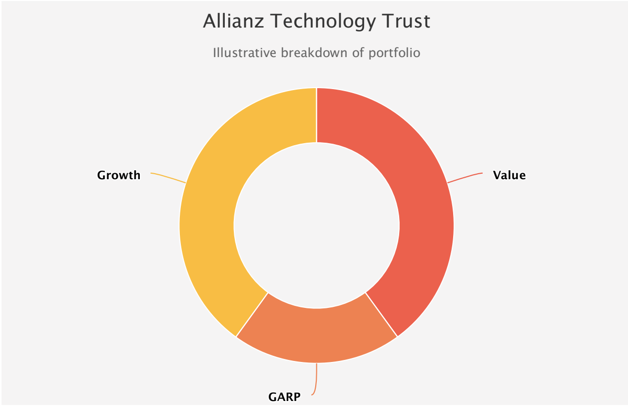
In Walter's view, disruptive innovation is the main driver of growth in western economies at the current time. He believes companies that innovate should be able to harness technology to provide new or lower-cost goods or services. Walter and his team specifically look for companies that are innovating fastest, replacing existing ways of doing things, products or services, as well as the way they are supplied to customers. He believes that we are in a particularly strong period for innovation, with a virtuous circle happening in one area, driving innovations in others. In his view, these include the widespread adoption of "the Cloud", the start of "AI" and strong leaps ahead in terms of battery technology and electric storage.

Walter references WPP's recent misfortunes ("Shares in Sir Martin Sorrell's advertising group fall by more than 10% as it slashes growth forecasts for second time this year" - Guardian, Wed 23rd August) as what can happen to disrupted incumbents. In his view, Google is negatively affecting many of WPP's clients as well as it and Facebook disrupting WPP's own advertising business. As well as the move from media to online channels, Walter aims to benefit from disruptors in manufacturing (laser technology and 3D printing), corporate infrastructure (software as a service, Cloud), and mobile phones. A more recent area of interest for Walter is artificial intelligence, which in his view will lead to disruptive changes in businesses involved in simple decision making or processes, as well as factories which have hitherto been less influenced by robotics. Improvements in vision systems will radically alter how robotics will work, opening up their use to many new applications.

China is a specific area of focus for the team, where over the longer term, they expect to see the same "winner takes all" scenario developing in this huge market. In the past year, holdings have seen a lot of movement – with Walter cutting all of his Chinese holdings after Trump was elected. Walter concedes that this was an error, and he has since built up the portfolio's weighting again to c 6.5%. His main holdings here include Alibaba, Tencent, Baidu and JD.com.

Many of these areas are included in the growth part of the portfolio, which of late has become ever more of a barbell. As the graph below shows, c 40% of the portfolio is exposed to what Walter believes are very high-growth companies, whilst on the other side, c 40% of the portfolio is exposed to "value". As we discuss in the performance section below, it is the value areas of the portfolio that have enabled ATT's NAV to outperform peers over the past six or so months.

By adopting a barbell portfolio and running with a concentrated stockpicking approach has meant that in a "winner takes all" world that the technology companies seem to inhabit, Walter isn't trying to own the winners in every single category. He shies away from areas which don't offer the highest growth opportunities, and where he has less confidence of him being able to pick a winner. In this way, the portfolio can be seen to represent the team's 20 highest conviction investments in each of growth and value.




Source: JPMorgan

"Value" is an area of the market that, over the past three to four years, Walter has been increasingly happy to embrace. As such, he believes (and recent strong returns would support this) that there are two ways to make money in technology. At c. 40%, "value" stocks represent an increase since we last covered the trust in February, and according to Walter is an overweight relative to the sector. This section of the portfolio represents technology companies which don't demonstrate heady growth characteristics, but which Walter believes are undervalued, and from which he can generate high double digit returns. The added advantage of having a reasonable portion of the portfolio in this "value" bucket, is that it is likely to protect capital in more uncertain times, or when growth is suffering from a bout of volatility.

Within the value bucket, Walter includes holdings in semi-conductors such as Micron, which he believes to be undervalued,

TOP TEN HOLDINGS AS AT 31ST AUGUST

| NAME | % |
|---|---|
| Apple | 7.6% |
| Amazon.com | 6.3% |
| Facebook | 4.2% |
| Micron Technology | 4.1% |
| Workday | 3.8% |
| Square | 3.1% |
| Proofpoint | 3.1% |
| DXC Technology | 3.0% |
| Microsoft | 2.8% |
| Servicenow | 2.8% |
| **TOTAL** | **40.8%** |

Source: Allianz Global Investors

but is enjoying a cyclical upswing following a period of disciplined management in terms of pricing and capacity investment. Apple remains in the value portfolio, but Walter has been taking profits of late, selling into the strength in share price leading up to the launch of the iPhone 8. Samsung continues to be a top-ten holding, since the activities of Elliott in mid-2016 triggered a buying signal for Walter.

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 free rein to invest in companies wherever they are, and whatever sector they belong to.

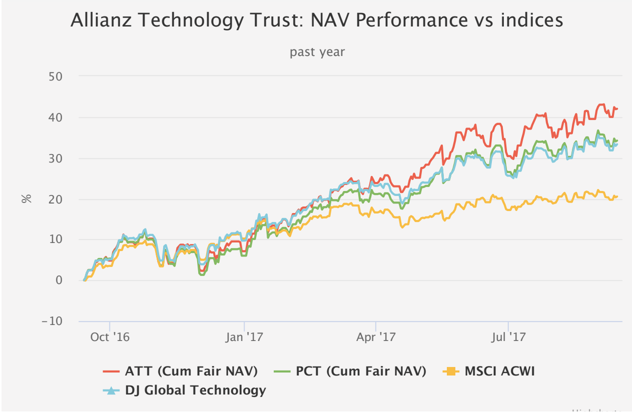
Relative to the benchmark and PCT, Walter continues to have a bias away from the "mega-cap" names. Relative to PCT, the trust is significantly more concentrated (54 vs c.122 stocks). Walter and the team continue to believe that they have a competitive advantage in being located in the San Francisco "Bay Area", where seven out of the top-ten largest technology companies in the US are based. They believe that being on the doorstep is a huge help to be ahead of the crowd in identifying the world's most innovative companies.

Looking forward, Walter estimates that the portfolio's earnings growth (for the 12 months from September 17) will be in the order of 41%. This is a reflection of a cyclical upswing from the likes of Apple, Amazon and the semi-conductors. But it also reflects the staggering secular growth that technology companies are capable of – Walter expects growth from his companies to level out at 24% pa in the next three years. This compares with P/E valuations of 23 X, which given the growth expectations, aren't too far fetched.

## Performance

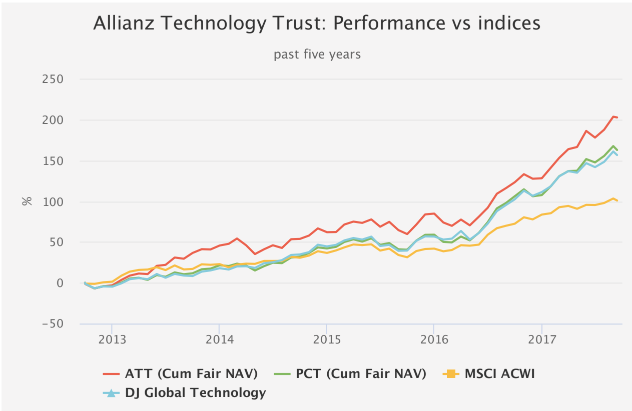
Technology stocks continue to lead equity markets around the world. This has been fundamentally a function of their superior growth characteristics – something that looks set to continue with Walter's earnings expectations for the next twelve months of his portfolio of 41%. As we touch on above, Walter has been building up his allocation to value names, which he believes will act as a buffer should growth expectations suffer a shock, or the market suffers from an extraneous event.

As the graphs below show, the trust has performed very strongly in absolute and relative terms. Walter Price and his team in San Francisco have developed a long-term track record stretching back several decades. They have managed ATT for ten years now, over which period it has outperformed the benchmark by around 90 percentage points (ATT NAV +340%, Dow Jones World Tech £ +250%). Over one year, the NAV has increased 39%, outperforming the benchmark by 7.2%, and Polar Capital Technology (PCT) by 6.8%. Walter attributes this to a strong showing from his value names, to which he is overweight relative to the benchmark and PCT.



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. Over five years, the trust is up 201%, relative to the benchmark return of 158% and PCT's return of 163%.



Source: Morningstar

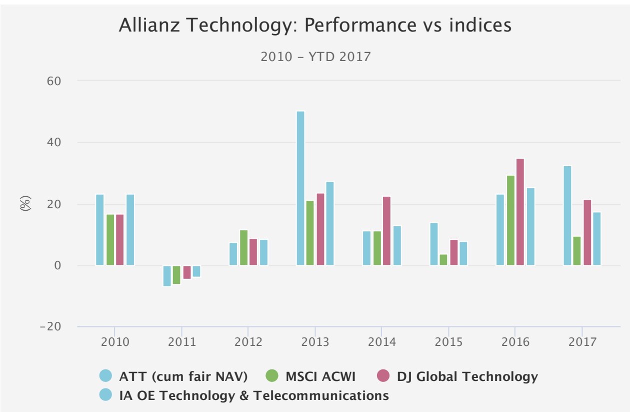
Using Morningstar, we have constructed a peer group of all funds who have been running for five years or more in the IA Technology sector, as well as the three investment trusts. As the table below shows, ATT is the best-performing fund over one and five years by quite a margin.

Taking a pure stock-picking approach, as Walter does, means that strong outperformance will have to be weighed up by periods of underperformance - and with a three-year tracking error of c.6%, ATT has been no different. The graph below illustrates the last few years' relative performance against wider equity markets but also the benchmark and the open-ended peer indices provided by Morningstar. 2013 was a standout year thanks to Walter's very high mid-cap weighting. This mid-cap exposure had the opposite effect during 2015 and 2016, where the trust underperformed the benchmark down to an underweight position in large-cap stocks.

| INV TRUST AND OEIC PEER GROUP (ORDERED BY 5 YR PERF) | | | | | | |
|---|---|---|---|---|---|---|
| NAME | 1YR TR (NAV) | RANK | 3YR TR (NAV) | RANK | 5YR TR (NAV) | RANK |
| Allianz Technology Trust | 42.6 | 1 | 87.8 | 4 | 207.6 | 1 |
| Fidelity Global Technology | 29.5 | 6 | 104.1 | 1 | 191.5 | 2 |
| Pictet Digital | 25.4 | 10 | 87.6 | 5 | 173.4 | 3 |
| Polar Capital Technology | 35 | 2 | 94.4 | 2 | 166.7 | 4 |
| L&G Global Tech Index | 29.9 | 5 | 81.3 | 8 | 155.6 | 5 |
| Henderson Global Technology | 32.3 | 3 | 84.2 | 7 | 148 | 6 |
| AXA Framlington Global Tech | 28.6 | 7 | 88.6 | 3 | 142.9 | 7 |
| Cavendish Tech-nology | 32.1 | 4 | 85.9 | 6 | 137.7 | 8 |
| Invesco Global Technology | 28.4 | 9 | 66.7 | 9 | 119.2 | 9 |
| Herald Investment Trust | 28.6 | 8 | 60.1 | 10 | 107.7 | 10 |
| Aberdeen Global Technology | 20.8 | 11 | 55.8 | 11 | 99.1 | 11 |
| Fidelity Global Telecoms | 3.8 | 12 | 25.6 | 12 | 52 | 12 |

Source: Kepler Partners, Morningstar

Walter tries to mitigate the downside by spreading risks and moving the portfolio away from more volatile mid-caps or themes at times in the cycle – with the continued increase in the allocation towards "value" being a case in point. 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.




Source: Morningstar

## 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. The team took on the mandate for ATT in 2007, meaning this is their tenth year behind the wheel. 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). 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.

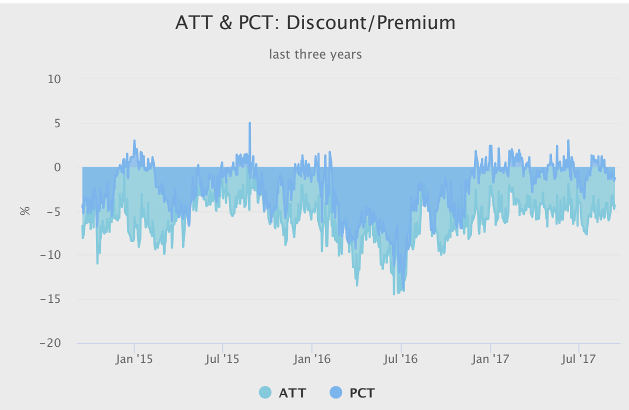
## Gearing

The trust is not currently geared and does not currently have a gearing facility in place. If it were to be employed, 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 proved to be a huge opportunity, when both ATT and Polar Capital Technology's discounts widened out to the mid-teens. 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.4% - and only slightly wider than PCT's discount.

ATT has issued shares on occasions in the past, issued from treasury at a small discount subject to a variety of parameters set by the board. They issued 300,000 shares during 2015 and 40,000 again in February this year. All of these were issued at a small discount to NAV, having been bought back at a much wider discount.




Source: Morningstar

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 above 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.

## Charges

The trust has a fixed investment management fee of 0.80% of its market capitalisation and a performance fee calculated as 12.50% of outperformance of the NAV against the benchmark. The company's OCF last financial year (2016) was 1.0%. The performance fee element is capped at a maximum of 2.25% of the trust's NAV at the year end. Importantly, a performance fee will only be paid if its 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. In this way, Walter has to make up any under-performance from previous years before any performance fee is due.

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