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# Investment Insights from Silicon Valley

[www.allianztechnologytrust.com](http://www.allianztechnologytrust.com)

## Walter Price

Lead Manager, Allianz Technology Trust. With over 40 years of experience of investing in technology companies, Walter Price has witnessed the evolution of the technology sector from the birth of the personal computer to the arrival of the internet and now the shift to cloud computing. Based in San Francisco, giving him close proximity to many of the world's most innovative companies, he heads up the Global Technology Team which manages US\$4.4billion\* in assets.

\*Source: Allianz Global Investors GmbH as at Nov 2014. This is no recommendation or solicitation to buy or sell any particular security.

## Chinese stock market in crisis

The domestic Chinese market has been in meltdown since the Government announced short-selling restrictions. This is obviously a concern. We have around 5% of our portfolio in China, albeit in Hong Kong listed shares rather than the 'A' Shares market. There is a real question over the extent to which this will impact the wider economy.

The economy is undoubtedly slowing and, while we don't believe there will be a recession, there is pressure on certain sectors. Some companies selling into China's economy will be vulnerable. For example, sales in the auto industry, where competition is increasing, have been disappointing. A number of industrial companies – such as Otis Elevators – have shown real weakness. There is pressure on luxury goods because of the crackdown on corruption.

However, most of our holdings are Internet companies, where the slowdown may well be beneficial. These companies are still seeing strong revenues because pricing is generally better on the internet. There are still lots of great deals at a time when consumers are becoming more price-sensitive. For example, online travel is currently only 10-20% of the travel industry and is growing fast. There are other discounting sites, where people can buy, for example, 4G phones with 80% off the retail price. This type of cut-price shopping is still strong.

## The beginning of the end for Apple's outperformance?

Apple shares have seen a significant dip since the group announced its results in mid-July. On the face of it, this is slightly baffling. Its results were still well within its guidance. Certainly, the company missed projections for revenue forecasts and its iPhone sales were not as strong, but it is still predicting £1bn in sales for the Apple Watch.

Part of the problem is that Apple has been exceeding expectations for so long, an expectation that it will beat expectations is now baked into the share price. One analyst suggested that Apple shareholders had become 'spoilt' by the company constantly beating estimates.

We believe it probably is the end of Apple's outperformance. While there is good new user conversion within the US, outside the US, it is mostly a replacement cycle. In China, for example, Apple has been successful at getting the high end of the market, but we are sceptical about the extent to which it will make inroads further down the value chain. It has strong competitors in Xiaomi and others.

In China, the price differential between Apple and other products is significant. The iPhone is often 3x the price of its rivals. Apple may have a better look and feel, but this will constrain Apple's ability to grow in China.

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## Microsoft writes down Nokia

Microsoft has written down \$7.6bn in connection with its Nokia deal as the reprioritisation of the business continues. This is more than the \$7.2bn it paid for the phone group in the first place and confirms our view that this was one of the worst deals in corporate history.

The premise on which the deal was done was fundamentally flawed and the consultants who dreamt it up were guilty of woolly thinking. Certainly, Nokia was the number two player in the phone business, but their analysis neglected to note that Apple makes 90% of the profits in the mobile phone business. The second largest player makes no money at all. Microsoft spent its giant cash pile on a business that has no return.

The same is true in the search business. Google may only have 60-70% market share, but it also makes around 90% of the profits. Search is a scale business, so the market leader makes all the money.

This write-down shows that Microsoft's new management has decided to cut their losses and focus on the next stage. There is real promise here: Existing corporate clients are more likely to move to the Microsoft cloud than those of their rivals simply because they already have Microsoft technology. This is what will create value for Microsoft in the longer term. This is where Microsoft engineers should focus their time and attention, not on trying to compete with Apple in the cell phone business.

## Stock focus: Splunk

Big data is big news. The ability to analyse and interpret unstructured data is vitally important for companies. 'Unstructured data' are those signals that are going in and out of a company, visits to the website, the type of person who is browsing, the type of pages they are clicking on. All this data has long been available, but it hasn't been stored or analysed.

Splunk does this job for companies. It puts tags on the data and then uses those tags to answer questions that may be asked of the data. This is particularly useful in certain industries. For security companies, for example, it can monitor the normal activities of staff, spotting any deviation to highlight security threats. If a member of staff normally logs on between 9 and 5, but suddenly starts logging on at 3am, Splunk's technology would raise a red flag.

The other main use for Splunk technology is in the analysis and interpretation of data coming from the Internet of Things. As we have said before, the 'Things' are a network of physical objects that collect data, which can be sent to the manufacturer, operator or other connected device. For example, Splunk can analyse the technology coming from an aircraft engine, enabling the company to predict when parts need replacing. This is incredibly valuable information for companies, potentially saving them

significant repair and maintenance costs. Perhaps more importantly, it may also be able to prevent engine failure.

The other potential use for Splunk technology is in the analysis of healthcare data. It may be able to make all sorts of causal links that haven't been made before. This is a very exciting area of technology.

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