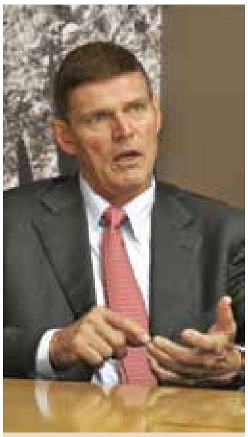

March 2015

Investment Insights from Silicon Valley

www.allianztechnologytrust.com

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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.

Introducing the Apple watch

Pre-orders for the much-hyped Apple Watch open on the 10th April. Those without the $10,000 for the gold-and-sapphire version may be more tempted by the basic Watch Sport, which starts at $350. Promising a battery life of 18 hours, the Apple Watch acts as an activity tracker, monitoring health statistics such as daily steps and pulse, alongside all the other functions expected of an Apple device – email checking, music and diary options.

Apple was already running with some momentum, having delivered 48% EPS growth year on year. How important will the Apple Watch become as a source of new revenue for the group? Certainly we think it will be moderately successful. At CEO Tim Cook's latest presentation, an informal survey suggested that around 10% of Apple's stock holders would buy the Apple Watch. If the equivalent number of iPhone users did the same, it would undoubtedly have an impact.

However, it is not going to be a game-changer in the way that a lower cost phone might be. We believe some innovation in this area might be in the pipeline, and may be announced before 2016. The potential for this type of blockbuster product is influencing our view of Apple, which remains our largest holding.

And something a little smaller...

The larger companies dominate headlines, but it is among the mid cap stocks that many of the most exciting opportunities are found. As a fund, we have tended to be structurally overweight in this part of the market. One of the best examples of the potential of mid-caps is in the security sector. It has seen phenomenal growth, yet relative to other parts of the market, the companies are still small. This suggests that there is still a lot of potential.

When we think of the enterprise hardware companies, such as IBM, they may have a capitalisation of $150bn or more. Among security companies, Palo Alto Networks is around $12bn, despite an 80%+ uplift in the share price over the past 12 months. FireEye sits at just $7bn. Check-point is only $455m. Security is just as essential as the products by Cisco, IBM or Oracle. We would go as far as to say that proper management of security is essential to the future of the Internet.

We believe that these security companies merit a significantly higher valuation, even if on a price to earnings basis they look relatively expensive. Much security technology is broken as it stands. Security systems give huge numbers of failure alerts, many more than companies can deal with realistically. Proper website analysers can bring that number down, so real threats can be identified.

It is also worth mentioning that there is a new security company – Sophos – coming to the market in the UK. We have a relatively low weighting in UK companies; they represent just 4.8% of our fund as of 23 March, but this could be an important company. It would certainly be of interest if it launched at a reasonable valuation.

The Amazon/Alibaba deal – a capitulation?

Amazon has long recognised the potential in China and has had a presence in the country for over a decade with its Amazon.cn site. However, it has yet

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to gain any meaningful traction against domestic incumbent Alibaba, which is estimated to have around 80% market share. (http://www.forbes.com/sites/quora/2014/05 /08/how-did-alibaba-capture-80-of-chinese-e-commerce/).

The news that Amazon is now to launch on Alibaba's Tmall site has been seen as a tacit admission that the challenge in China was too great. That may be true, but it is a positive move for the retailer. Amazon has struggled in China because it has poor brand recognition. In the US, people knew a lot about ecommerce and trusted the Amazon brand. In China, no-one had heard of Amazon.

Alibaba, in contrast, recognised from the start that the biggest problem it faced was consumer trust. Consumers didn't trust the sellers and had no faith that transactions would be completed. Alibaba launched an escrow service – Alipay – which dealt with the trust issue and has gone on to build its brand successfully.

The deal should address many of the problems that have held back Amazon in China. After all, Amazon still has a number of notable advantages: It has good prices, good execution and guaranteed delivery. All the reasons it is so popular in the US and Europe should also be appealing for Chinese consumers. Alibaba is simply giving it a seal of approval and that may be all it needs to expand.

Of course, it is also good news for Alibaba. It is certainly an acceptance of its enduring predominance in China. For investors, it remains probably the best way to benefit from the growth in the Chinese consumer.

Tech purge

There is also a darker side to relations with China. In February, 17 business groups wrote a letter to U.S. Secretary of State John Kerry and other government officials, urging them to take action to reverse "troubling" Chinese security requirements. They believe restrictions placed by the Chinese government will block out foreign-owned technology equipment from the country.

All of the major groups want access to the Chinese market. It is lucrative – estimated at around $465bn (http://www.bloomberg.com/news/articles/2015-02-06/business-groups-urge-u-s-fight-against-china-foreign-tech-purge) and it is fast-growing. However, the Chinese government has been clear in its desire to curb the use of foreign technology suppliers in the country.

This is already a problem for some companies. For example, Cisco's Asian business has been disappointing. Juniper has also had a difficult time, having built a relatively robust business in China. Chinese businesses don't tend to buy US communications equipment. They don't trust it. US companies can protect themselves to some extent, but they are not going to change these ingrained attitudes.

A war exists, albeit of intellectual property. It is certainly something we bear in mind in our stock selection. We still own some Cisco, but that it because we are feeling better about the upgrade cycle outside China, not because we believe China will be a strong source of growth.

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