Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors may not get back the full amount invested.

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Investment Insights from Silicon Valley

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*Source: Allianz Global Investors GmbH as at September 2015.

Investors the world over are worried about growth. Is China slowing? Is the US slowing? And if so, how severely? The technology sector may be better-placed over the long-term to deliver structural growth, but it is not immune from these concerns. Investors are correctly asking whether certain technology groups can sustain growth.

The market has, for some time, assumed that certain companies could sustain growth rates of 30-50% indefinitely. However, we believe that we are now starting to see limits to that growth, particularly among some medium-sized companies such as Yelp, Pandora, GrubHub and Twitter. While revenue growth has continued, growth in user numbers has stalled. The most recent example was Twitter – it saw its user growth stall in the final quarter of 2015, with 320m average active users monthly. This was the first time in its history that monthly active users hadn't grown.

Competition is undoubtedly a factor, but there are others issues at work. Google and Facebook are, to an important extent, cannibalising the intellectual property of other groups. They add in capacity in new areas and others suffer. Google, for example, aggregates ratings from all over the Internet and with it, attracts advertising spend. As such, it can be more cost effective to advertise through Google than through Yelp. The same might be true for YouTube versus Pandora.

In many cases, the companies under pressure are providing a valuable and useful service, but this is not a direct route to user growth. Many have tried a variety of different responses, but few have worked. Groupon, for example, has tried to move people to buy goods from its site, but it has failed to effect a real shift in buying behaviour – Amazon continues to dominate.

This seems like a gloomy picture and undoubtedly, these companies will continue to get squeezed. Nevertheless, they have a future. It just may not be the future they thought it would be. A comparison could be drawn with the publishing industry, where plenty of niche, speciality magazines exist. They are perfectly good businesses, as long as they are not run as growth businesses.

This will affect the way these businesses spend money. They need to be careful about investing for growth, and instead need to focus on monetising their existing user base. They need to get more money from each advertiser and provide enhanced servicing. This requires a change of mindset.

The advertising market

Part of the relative strength and weakness of these companies will come from the growth – or otherwise – in the advertising market. Groups such as Facebook and Google are generally on the right side of the trends mentioned above, but even they may struggle if the online advertising market slows. We are finding a lot of technology groups going for the same advertising markets. At some point this will affect returns and growth rates will have to moderate.

The Apple conundrum

The Economist recently reported that were Apple to trade in line with the S&P 500 p/e ratio, it would be worth $900 billion. Its current valuation? USD$526.68bn (11th Feb, source: Financial Times). But it too has a growth conundrum with the group facing a maturing smartphone market. Its recent results showed revenues failing to meet targets.

However, we remain relatively positive on Apple. We believe that it is transitioning from a growth business to more of an annuity business. It still has 1bn users, who are very loyal. As long as they upgrade with sufficient frequency, Apple still has a predictable earnings stream. That said, there will be disruption as the market recognises the change and the group's shareholder base transitions.

If Apple can come up with enough new features and get plenty of people to upgrade their smartphones and tablets, it could be one of the cheapest stocks on the market. It is also trying cloud storage, and now that it's more important to the business, it may try a little harder. They are trying the watch, the virtual reality headset, even the car. If they are successful at any of these ventures, the stock will be worth more.

The rock star CEO

Tesla CEO Elon Musk has hit the headlines in recent weeks for cancelling the order of a blogger who left a 'rude' critical review. The technology sector has always attracted its fair share of 'big personality' CEOs and, in general, we like to invest alongside these visionaries. They are innovators, with a clear idea of how they are going to make the world better. The great growth companies of the 1990s were all led by charismatic leaders – Bill Gates, Larry Ellison, Steve Jobs. There is no shortage of ego, but these leaders have all been exceptionally good at both selling their vision and making it a reality. Musk is no exception.

Having said that, we believe Elon Musk is having a difficult moment. We were previously big supporters of Tesla and owned a reasonable weighting in the shares. We have now sold all our holding, believing the company is enduring something akin to a mid-life crisis. Innovators also need to be pragmatic. It is a lesson that some have learnt the hard way. Steve Jobs, for example, came back to Apple for the second time with a more practical viewpoint.

Musk has gone too far in pushing his latest model. He has spent a lot of money building in exotic tools and yet it will probably remain a niche product. Capital expenditure is not matched by sales. The group needs to get the right balance of efficient manufacturing and technical wizardry. To do this, the company may need to go through a painful process. He doesn't have any real competition as it stands; it is all about finding a balance between practicality and pushing the envelope of innovation.

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