



October 2015

# 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\$4.5billion\* in assets.

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

## Markets rattled

These have been tricky times for investors in all sectors, and technology has been no exception. That said, it used to be that technology bore the brunt of any market slide and this time, encouragingly, the Nasdaq is marginally ahead of the S&P since the start of the crisis. This is a welcome indication of the increasing maturity and diversity of the technology sector.

Nevertheless, it is clear that investors are worried about the uncertainty associated with a potential interest rate rise and the situation in China. They have become more cautious as a result. We do not try and anticipate the direction of markets, but we are looking at whether this poor sentiment will spill over into the outlook for some of the companies in our portfolio.

This type of volatility can have an important effect on the psyche of company managers and they become less inclined to initiate large-scale technology projects. At the margins, the management of the technology companies in which we invest report some caution in spending from their customers. This may have other drivers, such as the increase in cloud computing, but – anecdotally - market volatility appears to be playing a role.

Nevertheless, we believe that most of the problems will be temporary and have taken the opportunity to top up in some favoured parts of the market, such as security companies. We have added some

smaller holdings as well, including CyberArk and Proofpoint, where valuations had started to look more attractive.

## Fitbit: outpacing its rivals

We bought Fitbit at its IPO in June of this year. The group's iconic activity tracker is currently seeing triple-digit sales growth year on year as a new breed of fitness-conscious consumers seek to measure their steps walked, kilometres run or steps climbed.

Shares in Fitbit's nearest rival GoPro have been disappointing, but we believe GoPro and the Apple Watch are more consumer products. In contrast, Fitbit's reach could extend far beyond the everyday fitness fanatic to occupy a new category of technology. It is part of a wider trend of health management by individuals that is only just beginning.

The involvement of insurance companies and employers could also drive growth for Fitbit. Insurance companies are increasingly offering financial incentives to those willing to wear the devices. In this way, they can offer cheaper premiums to those who are active and willing to take steps to manage their health independently. For companies in the US, medical insurance costs are among their most significant expense and devices such as Fitbit can offer a means to manage those costs. Expect to see companies increasingly encouraging employees to wear these type of devices as well.

This is no recommendation or solicitation to buy or sell any particular security.

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## The Indian connection

Just as Prime Minister Narendra Modi touched down in Silicon Valley at the end of September, we were paying a visit to India. We saw 30 different Internet companies during our visit. Most are still private, but there are still some exciting prospects for the future.

India has some great industries, but its progress in technology had been stymied by its infrastructure and distribution issues. However, the advent of wireless and 4G technology has inspired a whole generation of entrepreneurs. The key difference between China and India is that while China has put up barriers to international companies, India has embraced competition. This means that Facebook, Google and Amazon are alive and well and thriving in India. This has the added benefit that Indian entrepreneurs have learnt from the best and the Internet ecosystem is stronger than that of China. Companies are competing with the best of the world in their home market. If they are successful, they could have a real impact globally.

The internet could be transformative for the Indian economy, bringing efficiency and increasing employment. One clear example might be in transportation: Buses are unreliable and over-crowded across Indian cities. As such, Uber drivers have found significant demand for their services. Labour is cheap and people can take an Uber cab around the City. Not only is there a new and more efficient way to travel, another group of people have a way to make a living.

It is these types of productivity improvement that have drawn Modi to Silicon Valley. He sees the wave of innovation coming to his country. The technology models may be being developed in developed markets, but they are being taken and adapted by emerging markets.

## The Music industry

The RIAA's 2015 mid-year bulletin showed a surprising statistic: sales of vinyl records were the music industry's fastest growing segment in the first half of the year. This was another sign that while the music industry would seem to offer rich rewards for investors, it is not always easy to predict its trajectory.

For us, there is no question that internet music is a better system and will ultimately take over the music industry. User growth is still impressive, but no-one is making any money from it. It is an extremely competitive space. Spotify is losing a lot of money. Pandora's free model was doing well, but is being challenged by the artists. There is uncertainty across the business.

It is a struggle to find a model that is resistant to competition. The music industry is litigious and is also regionalised because of the different copyright laws. It will take a while to sort this out. Internet music will be the way people listen in the future, but it is not yet clear whether it will be a good investment.

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