



June 2016

# 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.

## Technology builds new markets

One of the key differentiating factors of technology – and why it is such an exciting place to invest – is that it has the power to create new markets. Certainly, this may happen sporadically in retailing, or construction, or oil and gas, but permanent, ongoing disruption is a characteristic unique to technology.

Some of these stories are well-understood and have largely been reflected in valuations. For example, we believe the move to mobile and online retailing is recognised by investors (though in some cases, the pace of growth may have been underestimated).

But technology is creating new markets all the time. As new industries emerge, there is often significant value up for grabs. It is not always clear early on who will be the winner from significant technological change; there may be several winners and early adopters may not always triumph.

We are currently making these judgements about the emerging security sector. This is clearly set to be a powerful sector. Barely a week goes by without a major organisation experiencing some kind of data breach, with all the associated threats to their business. This is the price of living in a connected world.

While the market could be \$14-15bn in size, getting access to it hasn't proved easy. There are no major dominant players: For Cisco, for example, security only represents around 10% of its business. This is an area where medium-sized companies may

prove very important. Equally, it is unlikely to be an area where the 'winner will take all': there are several companies that could grow rapidly. We currently favour Palo Alto Networks and Salesforce.com and there's room for other cloud-based software companies in this area.

This is happening across myriad sectors – cloud computing is changing the landscape for enterprise computing, mobile retailing for advertising, plus innovation such as the connected car.

## A reminder in difficult times

This should be a reminder of the importance of technology's place in a portfolio. Investors would be forgiven for wavering after a difficult start to the year in markets, but markets are still prone to treating technology as a cyclical sector. The reality is different; far from depending on growth in the wider economy, technology is one of the few sectors grabbing a greater share of the global economy with technology vendors capturing more business and consumer spending.

As we see it, the technology sector offers many different types of opportunity: While Amazon and Facebook, for example, might fit the traditional view of a 'growth' stock, Microsoft and Apple could be considered more 'value' companies. For all these companies, the drivers of growth extend far wider than simply the economic environment – the move to the cloud for Microsoft, the upgrade cycle for Apple. Plenty of technology companies now pay healthy dividends, The diversity of technology companies has been over-looked in the recent market volatility.

This is no recommendation or solicitation to buy or sell any particular security. A ranking, a rating or an award provides no indicator of future performance and is not constant over time.

**Allianz**   
Global Investors



## Executive pay – the right incentives

Executive pay has become a significant issue across the globe. Goldman Sachs and Deutsche Bank have been forced to face down shareholder revolts over executive pay and corporate excess. BP's chief executive has also come under fire for his pay packet. This is an important issue for shareholders and fund managers alike.

In an ideal world, chief executives in Silicon Valley would have around half their compensation tied up in the stock. However, there are problems with this. As technology companies attracted higher valuations, stock options were less appealing. It was difficult to attract talented employees when the stock options weren't likely to be worth much unless the company created vast new value. As a result, there has been a trend towards Restricted Stock Units (RSUs) in more recent years.

The problem with all stock-based compensation is that employees will leave if the shares are doing badly, which can be self-reinforcing. Also, some chief executives have taken this to extremes, which has proved dilutive for shareholders. Nevertheless, we still like to see a significant portion of manager pay tied up in a company's stock. There should be a balance between giving money to shareholders, to existing management and to new management.

In general, share-based compensation on the whole is what drives executives to work as hard as they do. If executives have success in building a company, they should get a big pay day. As long as long-term considerations are not set aside in pursuit of short-term share price appreciation, it works well as an incentive.

## Samsung issues a challenge

It has been a buoyant quarter for Samsung. The world's largest mobile phone maker by volume reported higher-than-expected first-quarter earnings on the back of a good reception for its new Galaxy S7 and Galaxy S7 phones.

This marks a significant turning point for the company, which has seen a two-year decline in its mobile business, progressively losing market share and seeing its profits slide as a result. Could it now finally start to challenge Apple, and low-cost Chinese rivals such as Huawei?

This is undoubtedly good news for Samsung, which is slowly stabilising and gaining back market share. However, it has a lot of lost ground to regain. It has lost out to less expensive vendors in emerging markets. It has been forced to re-engineer its products at a more cost-effective level and this is the first sign that its strategy is working.

However, we are still sceptical about Samsung's ability to beat some of its rivals in the longer term. We have greater respect for Apple and Huawei. Huawei, for example, spends around half its resources on research and development. It's an engineering-led

company, growing 50-100% per year. It is difficult to see how Samsung is going to compete in the long-term.

<sup>1</sup> <http://us.spindices.com/indices/equity/sp-500>

<sup>2</sup> [https://www.msci.com/resources/factsheets/index\\_fact\\_sheet/msci-world-index.pdf](https://www.msci.com/resources/factsheets/index_fact_sheet/msci-world-index.pdf)

All sources Allianz Global Investors GmbH unless otherwise noted. This is no recommendation or solicitation to buy or sell any particular security.

**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. Competition among technology companies may result in aggressive pricing of their products and services, which may affect the profitability of the companies in which the Trust invests. In addition, because of the rapid pace of technological development, products or services developed by these companies may become rapidly obsolete or have relatively short product cycles. This may have the effect of making the Trust's returns more volatile than the returns of a fund that does not invest in similarly related companies. Past performance is not a reliable indicator of future results. 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. The views and opinions expressed herein, which are subject to change without notice, are those of the issuer and/or its affiliated companies at the time of publication. The data used is derived from various sources, and assumed to be correct and reliable, but it has not been independently verified; its accuracy or completeness is not guaranteed and no liability is assumed for any direct or consequential losses arising from its use, unless caused by gross negligence or wilful misconduct. A security mentioned as example above will not necessarily be comprised in the portfolio by the time this document is disclosed or at any other subsequent date. This is a marketing communication issued by Allianz Global Investors GmbH, an investment company with limited liability incorporated in Germany, with its registered office at Bockenheimer Landstrasse 42/44, D-60323 Frankfurt/M. Allianz Global Investors GmbH is registered with the local court of Frankfurt/M under HRB 9340 and is authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin). Allianz Global Investors GmbH has established a branch in the United Kingdom, Allianz Global Investors GmbH, UK Branch, which is subject to limited regulation by the Financial Conduct Authority ([www.fca.org.uk](http://www.fca.org.uk)). Details about the extent of our regulation by the Financial Conduct Authority are available from us on request. Allianz Technology Trust PLC is incorporated in England and Wales. (Company registration no. 3117355). Registered Office: 199 Bishopsgate, London, EC2M 3TY.