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Investment Insights from **Silicon Valley**

www.rcmtechnologytrust.co.uk

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With over 40 years of experience of investing in technology companies, Walter Price has witnessed the technology sector improve user productivity through the revolution in semiconductor design, the birth of the personal computer and the arrival of the internet. 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 billion* in assets.

Technology in the news

Microsoft has long understood the necessity of shifting its business from its weakening core markets to newer and higher growth areas. To date, its execution has been erratic; there have been ill-judged forays into the mobile phone world, for example. However, Microsoft's turnaround has taken a leap forward with the appointment of Satya Nadella, who becomes Chief Executive Officer this month, replacing the outgoing Steve Ballmer.

Nadella joined Microsoft in 1992 and has a good track record in the areas where the business needs to focus: cloud computing and enterprise technology. He put Microsoft's search business on a more solid footing, which at the time had appeared to be a daunting - if not impossible - task. The most successful technology businesses have tended to have users of technology as leaders - The late Steve Jobs is perhaps the most high-profile example. Nadella is an engineer who understands technology, rather than being simply a financial manager or sales person. As such, he also commands the respect of the developers in the group.

We expect Nadella quietly to forget the episode where Microsoft tried to be a mobile phone company and focus on the right areas of key growth markets. Investors should forgive companies these kinds of mistakes, just as they forgave Google for buying Motorola.

The Trust currently has a position in Microsoft, as we have already started to see improving earnings at the group: the group's enterprise business is performing well, and while we would not argue that personal computing is likely to be a growth area, for the time being it seems to have stabilised. Microsoft should also be a beneficiary of a loosening in corporate spending.

At the moment, we have a relatively conservative price target on Microsoft, but if it can establish itself as a solid competitor to Amazon in cloud computing, move away from mobile phones and generate stronger growth, it could easily attract a rating of double its current 10x earnings.

Buybacks

Buyback levels in the US market reached record highs at the end of 2013 and the technology sector has firmly participated in the trend. Notably, Apple has launched a $14bn buyback programme, which has attracted criticism and approval in equal measure. Some suggest the money could be better spent. Others would like to see more, though billionaire activist investor Carl Icahn – one of Apple's biggest shareholders - has now dropped his proposal for Apple to extend its buyback programme even further.

In general, we like buybacks if they are meaningful, shrink the company and add to earnings. We don't like those merely designed to compensate for share options. Apple's share buyback programme has added around 5% to earnings and as such is welcome. That said, for the time being it has moved the stock as much as likely to do so and Apple really has to focus on new products.

There are three main product areas: TV, services and the forthcoming larger-screen iPhone. The latter could see strong

*Source: Allianz Global Investors Europe GmbH as at December 2013. This is no recommendation or solicitation to buy or sell any particular security.

demand especially in Asia where Apple has established new carrier deals and may positively surprise the markets as a result. It may provide some growth when, at the moment, markets are pricing in almost no growth at all. Many larger companies such as Apple are trading on low multiples relative to the wider market. If there is any growth at all, there could be a re-rating in the shares.

The Trust did not hold Apple for a long time, and this contributed to relative performance during the sharp decline in Apple's shares. We now have a small holding - 2-3% of the fund versus its 10-12% weighting in the benchmark - and are waiting to see how the next round of product development will be received.

LinkedIn disappoints

Just as expectations are too low for some technology giants, they are too lofty for some companies considered 'high growth' by investors. LinkedIn is now wrestling with this problem and its sales forecasts disappointed the markets at the start of the year. The company had attracted an ambitious valuation of $25bn, which implied an extremely high growth rate. It still grew strongly, but its suggested growth is now around 40% per year rather than the 50% per year expected by the more optimistic analysts.

The recruiting business of LinkedIn is robust, but has seen some slowing of growth. It has recruited for Google and Microsoft, but other companies have been slower to adopt Internet recruiting. The problem for the group now is to find a way to use the database of contacts on the site for marketing. This is a delicate process because people do not use LinkedIn to be besieged by sales people and will reject it if it goes too far. LinkedIn hasn't yet worked out how to achieve this balance.

In general, there are two main areas where companies disappoint: there may be poor execution, or a fundamental issue in the business. Twitter, for example, recently hit its earnings targets, but without growing its user base. In other cases, it may be that costs are needed to sustain high revenue growth. We are more tolerant of the latter than the former. It is difficult to generate high revenue growth without a company growing its sales force, for example. With LinkedIn, we believe the recent rout could be a buying opportunity.

Emerging trend - security

Department store Target saw the credit card details of 20 million Christmas shoppers stolen over the period from 27 November to 15 December. The theft was particularly troubling in its sophistication. It was highly organised, rather than a lone hacker and showed the vulnerability of large organisations to increasingly complex fraud. By January, Target had already introduced new security systems and was calling on other retailers to bring in Chip and PIN, common in the UK, but rare in the US.

Incidents like these are becoming increasingly common and security will be a big growth area for 2014. Companies need to spend on security to retain competitiveness as customer dissatisfaction grows. Companies such as Gemalto and FireEye are poised to be key winners from this trend. Both are now important positions in the Trust's portfolio.

All sources Allianz Global Investors Europe GmbH unless otherwise noted.
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