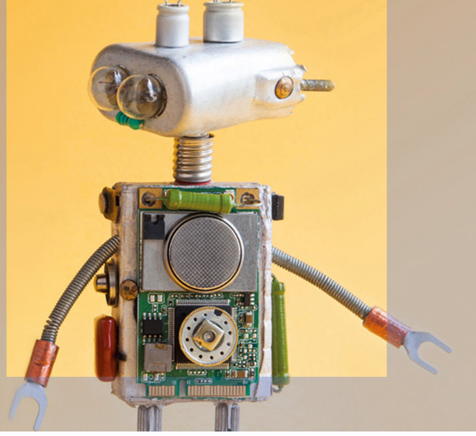

Active is: Investment Insights

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JUNE 2018

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.

Investment Insights from Silicon Valley

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 billion* in assets.

*Source: Allianz Global Investors GmbH.

Results season

This was the first earnings season since the US corporate tax cuts came into effect. There was a notable positive impact on company results, though the impact on share prices was muted given relatively high expectations.

For the companies in our portfolio, we saw that Apple's results were better than expected, though companies in its supply chain continued to struggle. Apple was slow to cut back on its suppliers, but when it finally bit the bullet, the impact on orders and contracts was quick and brutal.

This was in notable contrast to the fortunes of Apple itself, where unit sales were better than expected. The real surprise for us was the services business, particularly iTunes and iCloud which both grew ahead of expectations. Having said that, we recognise that the handset 'super-cycle' seems to be off the table. From our research, people appear to be holding on to their iPhones for as long as they can. The new models haven't yet provided the incentive to upgrade - users appear ready to do so only when their phone breaks or they get a good deal from their mobile network carrier.

Other observations

Elsewhere amid the company updates, we saw that the cloud computing theme continues to expand, with providers generally meeting or exceeding market expectations. Given this remains around 40% of our portfolio, this is encouraging. We also saw growth accelerating at Amazon. This is unusual in a £20bn business and we would normally expect momentum to fade. We also noted that, in spite of the ongoing negative publicity, Facebook's advertising revenue has continued to hold up. Buybacks have accelerated as corporate tax cuts have given companies more cash.

Security companies also had a good quarter, after a relatively weak period for the sector. Companies finally appear to recognise the severity of the security threat – and the potential fines for non-compliance - and are spending money on improving their systems. There could also be a lift from the new EU General Data Protection Regulation (GDPR), though this hasn't yet been reflected in results. Companies are going through the legal exercise from GDPR, changing their screening, informing users, gaining consent to tracking and data sharing, but haven't started on data leakage systems or implementing new software. That will be the second phase.

Elon Musk and man management

It has been a tough few months for Elon Musk. An analyst conference call deemed 'truly bizarre' made headlines and sent the Tesla share price lower. Perhaps more worryingly, there has been a stream of senior management departures from the electronic car maker, including important engineering and sales personnel. The concern is that the departures will threaten the expansion of mass market production of the Model 3 saloon car, seen as crucial to the group's future success and profitability.

The technology industry is no stranger to unique personalities. Steve Jobs or Jeff Bezos might equally be put in this category. As a sector, it attracts driven individuals, focused on solving some of the world's most important problems. This can be inspirational for those who work with them, but can also cause problems.

In particular, it can often be incompatible with day-to-day man management. We do not believe the problem is insurmountable, but it does need to be addressed. Corporate culture can have an important influence on shareholder returns. Technology companies rely on attracting the best engineers, the best thinkers, to sustain growth in the long-term. Part of that will be remuneration, but the next generation is increasingly focused on quality of life and want to work at a place where their views will be heard.

Another question is whether technology companies need these big personalities at the helm. Certainly, the most successful companies have tended to have visionary leaders. Our view is that we want to see a user of technology at the helm of a technology business. A leader needs to understand the technology a company is building. Often, the replacement of a technology leader and innovator with a sales or marketing-led leader has heralded the start of a shift in a company's fortunes. The ideal scenario is usually to have a visionary in charge, with capable deputies to manage the day to day minutiae of running a business.

Areas of focus

We are particularly interested in the potential for technology to revolutionise healthcare systems. Many healthcare systems remain inefficient and anything that promises to improve productivity should have a bright future. For example, there was a strong period of growth for a number of companies when electric patient records were adopted in the US.

Among others, we are currently looking at a company in the UK that allows virtual consultations with doctors and health care professionals via text and video messaging through a mobile app. This could really improve the productivity of doctors and allow them to see more patients. It may also be better for patients. If the technology works, there could be far-reaching implications for healthcare systems around the world.

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Please note that we can only offer information and are unable to provide investment advice. You should contact your financial adviser before making any investment decision.

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