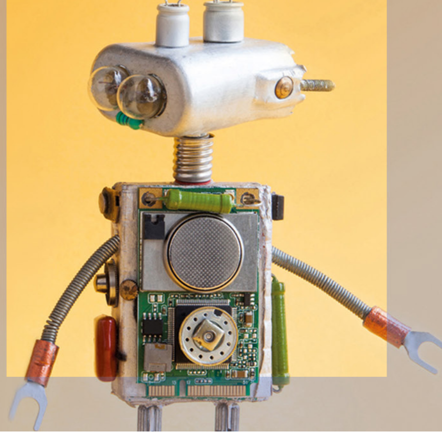

Active is: Investment Insights

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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.

Surprising strength

This is no time to be complacent. The world faces significant economic challenges and the route back from the Covid-19 outbreak is likely to be long and painful. However, it is notable that the share prices for many technology companies have held up well during the recent volatility in markets. For those concerned about the potential for over-valuation in the sector, it is worth exploring the reasons for this surprising resilience.

Key to recent share price performance is the current discount rate (the rate used to price future cash flows.) If the rate is low, future cash flows become more valuable and vice versa. By dropping interest rates and resuming quantitative easing, the Federal Reserve has taken the discount rate down dramatically. It is now 25-30% lower than it was at the start of the crisis – in other words, future earnings have become more valuable.

At the same time, steps taken by policymakers have dramatically reduced the risk of corporate bankruptcy. The government has sent free money to employers in terms of 'forgivable loans', as long as they keep employees on the payroll.

With the discount rate and the risk of default lower, if corporate earnings remain the same, investors might expect an appreciation in share prices. For many companies, however, earnings have moved lower or, in some cases, disappeared altogether. In this case, the lower discount rate has little impact and share prices are still lower.

However, for many technology companies earnings haven't fallen and in some cases – Netflix, Zoom, the gaming companies – are notably higher than they were pre-crisis. That is not to say the sector is immune from the fall out: we see it affecting some companies' ability to chase down new business and advertising spend is undoubtedly lower, but for the time being, this largely explains the strength of share prices.

Technology is also on the right side of a number of structural trends, accelerated by the crisis. For example, it has pulled the transition to the cloud forward by a number of years. Companies have recognised that they need the increased flexibility created by cloud-based systems. Those with cloud capability have been able to dial up or dial down their business far more easily than if they had to buy, say, 25 new servers to cope with increased demand. Server capacity has been further impacted by problems with the China supply chain. Where spending is resuming – and we believe the spending freeze is about to break – it is being directed towards efficiency. Against this backdrop, we believe the recent performance of technology relative to the rest of the market is no accident.

Environmental technology

A welcome side-effect of lockdown has been a fall in pollution: there has been a widespread reduction in traffic and air travel. It is no surprise that many are looking at how this environment might be maintained once the lockdown measures are lifted. Could it be a catalyst for the adoption of electric cars, for example?

It is clear that working patterns won't simply return to 'normal' once lockdown has been lifted. Few are in a hurry to get back to the office or to business travel, finding that they are just as efficient working from home. We have found video conferencing to be just as good as being at a conference with 100 other people. Technology giants such as Google, Facebook and Twitter have all told their employees that they don't have to come back to the office. This might suggest no significant shift in demand for alternative transport options.

On the other hand, in China, where office workers have returned, the traffic has started to pick up as lock-down has eased and pollution levels have started to creep higher. People are using cars rather than public transport to go to work. This has seen consumers become more thoughtful in the type of cars they are buying, which has increased demand for low-end electric cars. We may see this replicated across the world as part of the 'new normal'.

Contact tracing

Many governments across the world have brought in the US technology giants to support their track and trace systems to prevent second wave infections once lock-down measures are eased. This would seem to suggest a thawing of previously fractious relations between governments and technology companies.

In many ways, companies such as Google are in a prime position to provide the kind of data governments need to halt the spread of Covid-19. Google has 1bn on its site every day, often tracked via its maps function. Rather than using browsing data as a tool to sell products, it can be used to show whether someone has been in contact with another person with Coronavirus symptoms.

To date, this hasn't been enough to halt the high profile anti-trust movement against big tech, but if it is seen to do the right thing on Covid-19, it may improve its reputation more generally.

Renewed trade war

While the world has been focused on the Covid-19 outbreak, President Trump has been threatening a resumption of the US/China trade war. This is partly in response to a perceived failure by China to halt the outbreak in its early stage, but also to shore up his core vote ahead of an election. This has rattled financial markets and remains an ongoing threat to the technology sector.

Unfortunately, we don't see this going away. Many people are upset with China's lack of transparency and it is a sure-fire vote winner. At the moment, Huawei has been the battle ground, but this may spread. It is something the technology sector may have to live with, but it is likely to accelerate the move away from China for many technology supply chains.

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