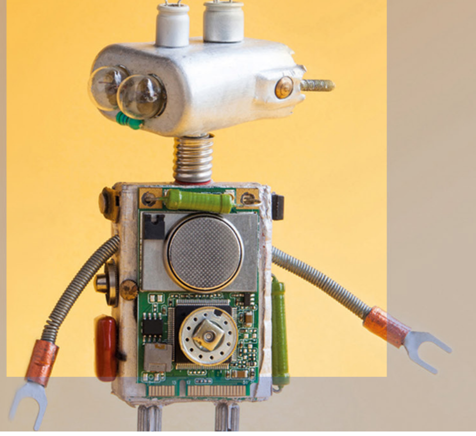

Active is: Investment Insights

www.allianztechnologytrust.com

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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.

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.

Investment Insights from Silicon Valley

China's rising 'Star'

China's 'Star' market opened for trading in July. Shanghai's new science and technology-focused equities exchange has been designed to rival the US Nasdaq and help direct funding to China's technology sector.

The Chinese authorities are putting plenty of effort into encouraging companies to raise capital on the new exchange. It has seen some early success. More than 140 technology and science companies have signed up to list and the 25 companies that listed on the first day of trading collectively raised Rmb37bn (around £4.3bn).

However, the exchange faces some significant hurdles. It remains very difficult to move money out of China. As such, while companies can raise money on the exchange, they may be limited in how they can use that capital. For example, it may be difficult to use it for large cross-border acquisitions.

So, for the time being, larger companies are still likely to list elsewhere, though some may seek a dual listing in Shanghai and Hong Kong. The new exchange seems likely to attract smaller, domestically-focused companies. In spite of its early success, it is difficult to see it as a long-term rival to the Nasdaq while these capital controls remain in place.

To some extent, the same problems arise for all investors in domestic Chinese markets. It is always an issue to get money in and out of the market. We run a lot of our money in the region directly through our office in Hong Kong, where our traders are practiced at finding liquidity (where stock can be readily traded without significantly affecting prices).

A good idea versus a good investment?

There are significant doubts emerging about the profitability of a number of recent, popular IPOs. While their business models are undoubtedly disruptive, analysts are increasingly concerned that their path to profitability is unclear. Does this matter? Is a good idea enough to make a good investment?

Certainly, some IPOs seem to have succeeded in spite of this lack of profitability. Amazon, famously, did not make a profit for around 14 years after its IPO. In this case, investors were willing to focus on its potential for disruption rather than its current profitability. This is even more acute in the private equity market, where companies can attract significant capital and high valuations in spite of losses.

Value. Shared.

Allianz Global Investors

However, we believe this is only sustainable in the short-term. Profits move share prices; it's not just about revenues. That was the mistake many made during the technology bubble of the early 2000's. Some larger companies may get away with it in the short-term and in some cases profitability is being deliberately deferred. Either way, we believe the potential for profitability needs to be in place to make investments sustainable in the long-term.

Our models look at a company's value and cash flow when profitable and discount that back to its value today. If there is no path to profitability, that's difficult to do. For us, return on investment is vital; if a company is going to achieve high growth over the long term, it needs to add sales people and knock on a lot of doors. This will dent short-term profitability, but should increase sales. However, if customers aren't using the product, the investment is obsolete.

Korean reparations

Trouble is brewing between South Korea and Japan, which may have an impact for the technology sector. A South Korean court ruling last year allows for individual claims over wartime servitude to be made against Japanese companies. The South Korea people have ongoing grievances about the way they were treated during Japanese rule, which lasted from 1910 to 1945.

Japan has refused to pay, saying its liabilities have already been settled. Instead, it is opting to reduce its exports to Korea. This includes elements such as semi-conductor components and associated raw materials. In a tit-for-tat response, South Korea's state-run pension fund – the third largest in the world – has said it will review more than $1bn of investments in Japanese companies.

However, it means Korean companies are shutting down factories because they can't get hold of the components and materials they need. Samsung, for example, is starting to shut down some of its plants.

It could lead to a shortage of memory chips, which will have an impact across different parts of the technology sector. In particular, this is likely to push the price of memory chips higher (by reducing supply) at a time when the price had been in structural decline.

Is China's slowing growth a concern?

China announced its slowest growth in 27 years in July. Trade tensions have clearly had an impact on the country's manufacturing sector. Many still believe that once the US and China have thrashed out a trade agreement, everything will go back to the way it was. That isn't true. There is a vast deficit and tariffs aren't likely to solve the problem by themselves.

One solution, favoured by the US, is for Chinese companies to commit to building plants in the US. The trouble is that the Chinese market has been subsidised by the government, so it costs far less to manufacture there. However, China needs to reduce its trade imbalance not just with the US, but with the whole world. Companies are likely to keep moving factories out of China until this happens.

Addressing this imbalance is likely to take many years and the political fall-out will continue. The Chinese economy will continue to go slower until exports become a smaller percentage of the economy.

For the time being, the weakness in the Chinese economy is hitting certain sectors, notably autos and advertising. Chinese technology companies have re-rated lower as a result.

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.

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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