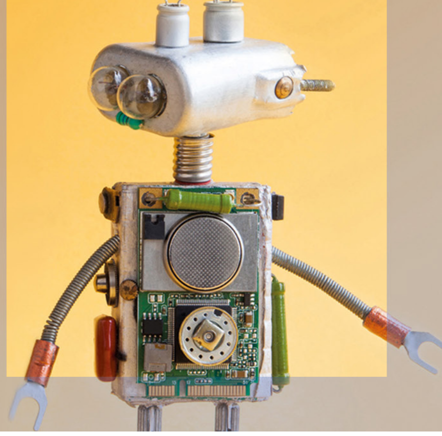

Active is: Investment Insights

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

Earnings season

This year's earnings season was always likely to throw up a few surprises. As it stands, the major surprise has been on technology company margins, which have far exceeded expectations. This has been particularly evident among software companies, largely due to a reduction in business travel. It turns out that not travelling puts a lot of time back in the diary. This has prompted an increase in productivity – and by extension, to profitability and cashflow.

This accounts for some of the share price gains we've seen. Salesforce.com, for example, saw orders come in better than its more dire predictions, but margins at record levels. The share price rose up to 25% in a day. Investors are asking 'is this the new normal?' and if so, what does that mean for free cash flow: could companies generate more cash in future?

Will the 'new normal' endure?

There have been profound changes in the way we live and work as a result of Covid-19, but how many of these changes would endure should a vaccine be found tomorrow? Having seen the potential for productivity improvement, we believe companies won't be in a hurry to resume business travel. In normal circumstances, a sales person can have two meetings a day at best. Replacing face to face meetings with online meetings allows four or five meetings a day. Plus, junior colleagues can be on the call, learning how it's done. This saves on training costs.

We talked to one CEO who said the nature of their meetings had profoundly changed. Instead of 10 people in the room – sales people, specialists, managers and so on - there would now only be two or three people physically in a meeting, with the remainder dialling in or on hand for follow-up enquiries. He said this had proved notably more efficient and their clients liked the new set-up. No-one in the company was in a hurry to resume old working practices.

We are seeing this in unexpected areas, such as research and development. Companies are now working with different research 'pods' around the world, which come together via online collaboration tools. The cost of people in Eastern Europe, for example, is far less than in San Francisco, which helps improve the bottom line. This is becoming the industry standard. It lowers costs and there is less turnover of top people because they have a better work/life balance. If there is something good to come out of the pandemic, it's that productivity of technology companies is far higher. We don't see a return to the (old) normal.

Apple's $2 trillion valuation

Apple hit a symbolic $2 trillion market capitalisation in August. This comes only two years after it was in the headlines as the first $1 trillion company. Even since the middle of last year, Apple shares have moved higher as investors reappraised the group's services business. It's been growing at 15-20% per year and has become more profitable. In particular, Apple Pay has been growing like crazy through the crisis.

Apple has, to some extent, been reinvented as a lifestyle company. It sells a product on which users build their lives. As a result, over the past year, it has moved from 10x earnings to 30x earnings. From here, the valuation improvement is probably at an end and the product cycle will become increasingly important.

Can the group have a product cycle in 2020/21 as 5G hits the market? Existing phones are at a record age, with the average phone over four years old. Apple is hoping that it can encourage people to buy new phones through generous trade-in deals and leasing programmes. The group recognises that it can't simply bring out a more expensive phone each time and sell the same number of units – it needs some natural help.

As it stands, analysts are split on the benefits of 5G. It's not yet clear whether the consumer gets anything out of it. Operators get much lower costs, so there is a question over whether they could subsidise the phones. That's the debate. For the time being, investors are erring on the side of optimism and the stock is rising in anticipation.

China versus US

Boris Johnson's decision to bar China's Huawei from the UK's 5G mobile phone networks may well be the tip of the iceberg in a broader east-west split in the architecture of the internet, according to the head of the UK National Cyber Security Centre, Ciaran Martin. He said it now looked less likely that the open, "Californian" model of the internet would endure.

China has always had a great firewall. It has prevented certain apps being used or downloaded – such as Google or Facebook and barred access to services such as Gmail. At the same time, China has benefited from having all its companies operating in the US. US policymakers are now recognising that this is an unfair playing field and are asking why they are allowing Tik-Tok in the US if Facebook isn't allowed in China.

This is a time when many Chinese companies are depending on export markets to grow because they have run out of market in China. Chinese companies have been accessing US, Dollar-based capital markets to fund their growth and have been able to buy US companies to achieve penetration in new markets. This is likely to come to an end whoever is in the White House in November. We believe that slowly, we may start to see the Internet without Chinese competitors. The era of an open Internet where anyone competes may be at a close – and that has implications for Chinese companies.

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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