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# Investment Insights from Silicon Valley

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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\$4.4billion\* in assets.

\*Source: Allianz Global Investors GmbH as at Nov 2014. This is no recommendation or solicitation to buy or sell any particular security.

## What makes a valuable brand?

Forbes has released its annual list of the most valuable brands. It is striking how many technology names feature on the list - six of the top 10 brands are technology groups. Apple is, perhaps unsurprisingly, top, with Microsoft, Facebook and Google also appearing. Brand strength should be a long-term contributor to returns, but in our view some types of technology brand are more valuable than others.

We would argue that there are two types of brand strength in technology: Google has become a strong brand because people use it every day and it works. It is ubiquitous across the globe. This is very powerful. Its brand is based on its value to individual people and its use in their everyday lives. As a result, it does relatively little to build its brand recognition, with only occasional television advertising.

Apple, on the other hand, relies on heavy brand advertising. Only 20% of mobile phone users currently use Apple products and the brand is far more vulnerable to consumer sentiment. If Samsung introduced a stronger range of products, Apple's position would be at risk. As a result, we believe Google's brand is stronger, because it is much more difficult to usurp.

Technology is growing as a part of the market because it is growing as a part of all our lives. Companies that become part of our lives become valuable companies. Brand is important, but it has to be valuable for the right reasons.

## Tax clampdown

There has been an increasing focus on the taxation of 'virtual' companies. Amazon's relatively small UK tax bill, for example, has drawn the attention of columnists and politicians alike. But it is not just in the UK and it is not just Amazon: Pressure is being brought on governments to address the issue and ensure that domestic retailers do not face an unfair competitive threat from these global giants.

Certainly, we consider this a risk for some groups, potentially denting sales growth for online retailers and reducing their ability to grow at the pace seen to this point. They now have to pay cash out to the government rather than reinvesting it for growth.

Price differences, however small, changes consumer behaviour. The Amazon experience shows that products bought through third parties – where there is no state tax – rather than through 'Prime' are more popular when there are no other variables.

That said, this is not a new problem for many companies. They have been through it already in a number of countries and negotiated. Amazon has already gone through this in the US. There is usually a compromise and it is not generally a company killer.

However, it does show the importance for internet retailers to have a value proposition that extends beyond price. Amazon can also claim good availability and delivery skill. Free shipping, for example, can be a huge factor as can good logistics. Consumers will factor this into their decision-making.

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## Reflections on the earnings season

With the earnings season almost at an end, some clear trends have emerged. Perhaps the biggest surprise has been the weakness in the hardware and PC markets. Most companies in this market had a bad quarter. We attribute this firmly to the rise of cloud computing. It is finally becoming established, as companies recognise its merits.

Another notable feature of the earnings season was the strength of the security companies. There had been fears that the strong dollar might dent momentum, but they proved unfounded. In spite of the currency issues, most security companies had outstanding quarters.

The semiconductor industry also had an active quarter, with a number of big deals: Singapore-based Avago Technologies announced in May that it would buy Broadcom, a major supplier of integrated circuits for the mobile-phone industry, for \$37 billion in a cash and stock deal. The growth of the Internet of Things is boosting the market for semiconductor groups and mergers can help develop a company's technology.

There was also merger activity among the 'value' technology players. There are plenty of profitable businesses, throwing off a lot of cash with good dividend yields. Low interest rates make acquisitions more appealing and they can be transformative. We believe that this is likely to continue.

## New innovation

To date, the headset revolution has had limited appeal. It was of interest to a few gamers, but difficult to see its wider application. Facebook bought headset maker Oculus US\$2bn in 2014, which at the time seemed a high price to pay for its technology.

However, anecdotally, we are seeing more and more people embrace this technology, largely because they see that its use extends beyond gaming. People can use it for work, for example: They can work on a spreadsheet on their living room wall, manipulating it and making changes. The technology is about becoming more productive, rather than just looking at pictures.

The rise of these headset technologies is occupying a lot of development time and energy. For example, many are working on the creation of 3D images with a view to making compelling 3D adverts. In the gaming market, both Sony and Samsung are currently building headset technology to integrate with their gaming technology. We could see virtual reality rolling out to consumers in a meaningful way over the next twelve months.

One new, and potentially terrifying, new use of headsets is in mind control technology. This remains at its early stages, but the BBC recently rolled out new technology that allows people to control its on-demand service iPlayer using just their mind. Users with the right headset can now turn on iPlayer and select their

desired programme. The prototype reads brainwaves using a sensor that rests on the forehead and attaches to the ear using a clip.

Mind control technology is some way from having real world utility, but it is part of the development of these 'immersive' technologies. We expect more from this part of the market in the next twelve months.

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