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Walter Price
Lead Manager
Allianz Technology Trust

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Technology shake-out

It has been a tough start to the year for the technology sector. The Nasdaq has seen double digit falls, with a significant sell-off in some high profile technology names such as Tesla and Netflix. Only a handful of large companies have bucked the trend. Apple, for example, has been relatively steady, while Microsoft has also seen solid growth. At a time of significant uncertainty investors have continued to gravitate to companies offering stable earnings.

The sell-off has been hardest for some of the highest growth companies. These may be in fast growth areas, such as software companies geared into the digitalisation trend. They may be growing revenues at 50%+ per year, but their share prices had become quite extended. They needed to grow into their valuations, even if the underlying businesses were still very strong.

The biggest problem has been the change in the monetary policy environment. The Federal Reserve is making the right move on raising rates. Inflation can be a significant problem and central banks need to get hold of it in time. It is better to do this when the economy is strong and robust. This gives flexibility when the economy slows. Today, the economy is reopening and recovery is increasingly well-established. This seems like a good time for the Fed to act.

However, it changes the metrics by which the highest growth companies are valued and has pushed share prices lower. While we have pared back our holdings in this area, we believe it is still worth holding 15-20% of our portfolio here. Eventually, investors will start looking for growth again.

Plus, the fundamentals are strong for many of these companies. Digitalisation projects tend to last three years or more and have only just started, so companies may have two or more years of strong growth ahead. It is a similar picture with cyber security. Governments and businesses have started to realise that they are very exposed, giving these companies a strong pipeline of growth. As the situation in Ukraine shows, the world is becoming more dangerous and cyberspace is a key battleground.

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$11 billion* in assets.

*Source:
Allianz Global Investors GmbH

Against this backdrop, we continue to see the merit in holding high growth companies. However, we have rotated selectively into 'reopening' companies as a reflection that the environment has changed. This means areas such as card processing or travel companies with strong business models

Shifting advertising

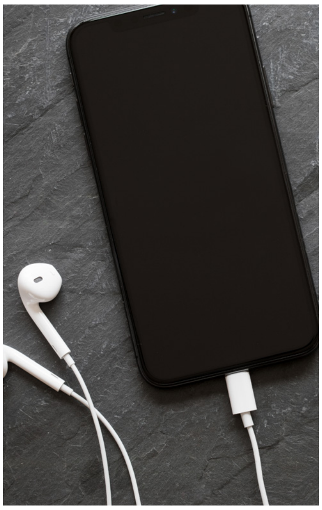
Alphabet's most recent results surprised Wall Street with a strong surge in search advertising revenue. It is part of a redistribution of advertising revenue in response to a shifting privacy environment. The group said a number of Artificial Intelligence (AI) improvements had boosted the efficacy of its ads, but perhaps more importantly, it has also been able to sidestep the effect of Apple's privacy changes that have dented its rivals.

In 2021, Apple said that iPhone users could choose whether advertisers could track them. With most people opting out, it has reduced the efficacy of advertising for companies such as Meta. More recently Google said it would limit the distribution of its user data with third parties. This also impacts apps such as Facebook or Roblox.

Advertising agencies will tend to gravitate to the most effective tool. Search engines don't need an identifier (such as a cookie) to know a user's interests – the user has told them. As such, they are the least impacted by the privacy rule changes. They also tend to be cheaper than ads on other apps. Google knows if a user has been looking for holidays, they may need a backpack, so it shows a backpack. Facebook does it by profiling and following people round the internet when they're not on Facebook. This model is under threat.

Users increasingly want targeted ads, relevant to their interests. In this context, search engine advertising is performing really well. However, it is not completely immune to privacy considerations. Alphabet was recently forced to scrap a proposed system it had planned to adopt in place of advertising cookies. The world of online ads is reconfiguring and all participants need to adapt.

Amplifying minority viewpoints can be good for the platform, but bad for society.

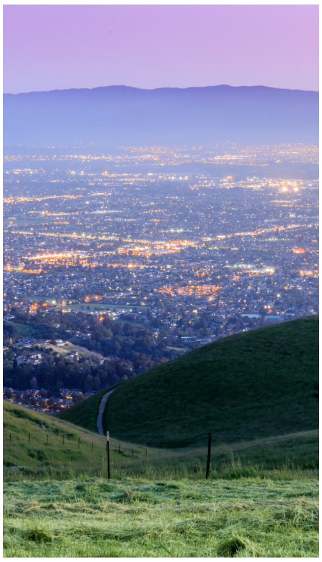


Social wars

Spotify is the latest company to get caught in the crossfire of a culture war. A number of key artists, including Neil Young and Joni Mitchell, have withdrawn their music from the platform over its hosting of the Joe Rogan podcast. The popular podcast has featured prominent antivaxxers and other controversial minority viewpoints.

Securing Rogan's podcast (for a reported $200m) was a major coup for Spotify and caused a jump in the share price. It is an important part of its competitive position against other platforms such as Apple and Google. It has taken a number of Rogan's podcasts off the platform, but is unlikely to back away from the star altogether.

This illustrates the problem for a lot of social media platforms today. Amplifying minority viewpoints can be good for the platform, but bad for society. It may also accelerate regulatory moves to bring platforms in line with other media outlets. Newspapers, for example, are subject to libel suits. This can focus the mind of platform owners – it makes it economically powerful not to surface difficult ideas. This may be coming for social media platforms.



The future of Silicon Valley

For thirty years, a narrow strip of California has been the beating heart of the world's technology industry. However, more recently its pre-eminence has come under threat. It has, to some extent, been a victim of its own success. There has been increasing competition for real estate and offices, at the same time as state taxes have been rising.

This means some groups have moved out of Silicon Valley – Tesla's headquarters are now in Texas, Cisco is in Colorado, Palantir is in Denver. Other states have put incentives in place to lure chief executives dissatisfied with the Bay Area.

Is this a problem? We've always travelled and will continue to do so, but Silicon Valley is still a fertile source of ideas. The start-up infrastructure is still very good and it remains the best place for growing technology companies to find people and raise capital. However, we recognise there Is a trend for companies to become more 'virtual'. It is a slow-bleed rather than an exodus, but we are making sure we are alert to the new technology hubs that are emerging.

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 an 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.

Contact Details:

Telephone:
0800 389 4696

E-mail:
investment-trusts@allianzgi.com