Allianz Global Investors

Allianz Cyber Security

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth by investing in the global equity markets with a focus on companies whose business will benefit from or is currently related to cyber security.

What Happened in April

Global equities generally sold off over April, undermined by fears that the conflict in the Middle East may be spreading and concerns that the US Federal Reserve (Fed) may keep interest rates higher for longer to bring inflation back to target. The retreat was led by US shares, with eurozone and Japanese stocks also falling over the month. In contrast, UK and emerging market equities advanced. At a sector level, Real Estate and Information Technology suffered the largest falls, while Utilities and Energy were the only sectors to advance.

Hopes of a summer rate cut from the Fed were dashed given stronger-than-expected jobs growth and stickier-than-forecasted inflation. Financial markets are now starting to consider that the Fed may not cut rates before the end of the year. While the European Central Bank (ECB) is widely expected to reduce borrowing costs in June, investors are expecting this to be followed by a pause as policymakers wait to see how inflation evolves. In contrast, the weakness of the Japanese yen led to speculation that the Bank of Japan (BoJ) may increase rates once again.

Within Technology, the MSCI ACWI Information Technology Index declined 5.5% for the month as performance was broadly lower. Each of the industries within the benchmark declined in April, with technology hardware posting a modest decline, while information technology (IT) services and software providers were down close to double digits.

Performance Analysis

The Fund posted a decline in April, due primarily to short-term industry allocation impacts. For the month, outperformance in professional services contributed to results, followed by slight relative gains in software and semiconductors industries, thanks to bottom-up stockpicking. Meanwhile, an above-benchmark weight in IT services and below-benchmark exposure to technology hardware storage, due primarily to our focus on maintaining a high level of cyber materiality within the portfolio, offset results for the month.

On a relative basis, our position in cyber security pureplay Palo Alto Networks, Inc. contributed to performance given its modest gain in April, following declines in the prior two months amid uncertainty around customer spending growth. Our avoidance of a legacy semiconductor maker and a below-benchmark allocation to enterprise software, cloud and cyber security giant Microsoft Corporation also aided relative returns.

Meanwhile, our avoidance of a smartphone and personal computer maker, which had been advantageous to relative performance for the last several months, offset results as investor sentiment surrounding the company's artificial intelligence (AI) aspirations improved. Our above-benchmark allocations to Okta Inc., a leading independent identity management platform, and Cloudflare Inc., a global content delivery network, also detracted from relative returns in April.

The following summaries below include key contributors and detractors to absolute performance:

Contributors

Our exposure to a UK-based application software provider which leverages AI and machine learning to detect cyber threats, contributed to results for the month. The stock was recently purchased, thanks to its attractive market positioning and favourable fundamentals. The stock price surged following news that the company was being taken private in an all-cash deal, which represented a healthy premium to the prior close.

Shares of a provider of computer, data centre and software solutions contributed to results due to improving momentum following the company's recent report of better-than-expected sales and profits. In particular, investor sentiment was led high by AI-driven demand for equipment, given a need for high-powered servers to run AI workloads, with digital transformation and cyber security growth among the key drivers. We continue to hold the stock given the exposure to cyber security and its attractive growth versus valuation mix.

Shares of the afore-mentioned Palo Alto Networks, Inc., a leading network security provider, rebounded following short-term headwinds in February and March, as investors increasingly looked past the potential near-term impact of shorter contract durations and changes to its market strategy and focused on their ability to provide a bundled approach as part of their broader platformisation strategy.

Our positions in a data storage devices and solutions provider, and a cloud-based data monitoring and analytics platform also aided absolute returns in April.

Detractors

Our largest absolute detractor for the month was CrowdStrike Holdings Inc., a provider of cloud-based security solutions built around the company's endpoint detection and response platform, as the street grappled with the potential for IT budget growth uncertainty. We witnessed a similar demand pattern around the same time last year and look for sentiment to likely ratchet higher in the coming months. The robust demand for cyber security solutions, combined with greater regulatory scrutiny, incremental growth related to AI and the company's strong leadership position, translate to our continued confidence in CrowdStrike as one of the largest positions in the portfolio.

Shares of Okta Inc., a category-defining platform that enables its customers to securely connect the right people to the right technologies at the right time, were lower given the short-term overhang in cyber-related software names and concerns of a moderation in new customer growth. Our viewpoint is that the stock remains attractive, thanks to its leadership position in identity management, and we are encouraged by its potential for sales productivity and margin expansion, particularly given the company's focus on moving up market to drive growth opportunities.

Cloudflare, a global content delivery network provider designed to make everything you connect to the internet secure, private, fast, and reliable, was lower for the month amid sell-side concerns of a more challenging business environment and sensitivity to the macroeconomic outlook. We continue to have a favourable viewpoint over the medium-term as the company may take share from rivals with cloud-based offerings delivered off of its content-delivery network, alongside a sales restructuring which appears to be gaining traction and improving business momentum.

Cyber security pure plays Zscaler Inc. and CyberArk Software Ltd also offset absolute returns for the month, given the overall headwinds in software stocks.

Purchases and Sales

Turnover was lower than typical in April, reflecting our viewpoint that the portfolio was already well-positioned from a stock-specific and materiality standpoint. We recently added a security platform which helps enterprises achieve resilience against cyber-attacks, malicious insiders, operational disruptions, cloud mobility, and regulatory compliance, which completed its initial public offering (IPO) at the end of the month.

We also bought shares of a designer, manufacturer and marketer of electrical, electronic and fibre optic connectors and interconnect systems for cyber network security.

There were no other new buys or meaningful increases to existing positions. These additions were funded in part by a reduction in a provider of cloud networking solutions for data centres and computer environments, due to a slightly more muted near-term outlook. There were no complete sells in the portfolio during the month.

Market Outlook

Technology-related stocks slumped in April as investor expectations about near-term rate cuts were met with stickier-than-expected inflation results, translating to a greater likelihood that dovish central bank expectations may not materialise as early as originally anticipated. Our confidence in cyber-related companies remains robust and our viewpoint is that the recent patch of underperformance is likely to subside as market expectations about interest rates have been somewhat reset, with valuations trending lower and long-term demand for cyber solutions remaining high. Despite tighter-than-anticipated monetary conditions, the economy remains resilient, as labour markets remained healthy, corporate earnings trended higher, and consumer spending has been robust. As the Fed gets comfortable that inflation is moving towards its 2% target, we should see rate cuts, which are looking likely to happen closer to the latter end of 2024.

We remain optimistic that continued enterprise investment into cyber security may yield double-digit growth and AI adoption is likely to fuel further investment as companies look to defend against improving capabilities from adversaries. In addition, companies are looking to create efficiencies from use of AI with cyber products, including threat detection and to automate mundane tasks, which also helps address the understaffing globally. Our expectation is that the mergers and acquisitions (M&A) environment, as evident by the takeout of the aforementioned UK-based application software provider, is likely to accelerate for both public and private companies. Valuations remain reasonable and we believe there is ample room for estimates to increase which should be the primary driver of performance over the course of the year.

We are seeing a broader recovery of earning growth, including for mid and small market capitalisation stocks. Even if there is more volatility ahead, we believe companies further down the cap spectrum have discounted more uncertainties, offering attractive risk rewards for companies that are well positioned for a recovery. The upcoming quarterly earnings results are likely to dictate the performance trend over the next few months, particularly as we enter a seasonally slower summer trading period.

Despite short-term periods of higher volatility among technology stocks, earnings growth ultimately drives stock prices over the long term, and in our view, we are still early in the spending trend supporting this dynamic segment. We are excited about the investment opportunities presented, and believe our research-driven, bottom-up process is the most effective means to capture the value generated by this theme.

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All data are sourced from Bloomberg and Allianz Global Investors as of 30 April 2024 unless otherwise stated.

Allianz Global Investors and Voya Investment Management (Voya IM) have entered into a long-term strategic partnership, and as such, as of 25 July 2022, the investment team transferred to Voya IM and Voya IM became the delegated manager for this fund. AllianzGI continues to provide information and services to Voya IM for this investment through a transitional service agreement.