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 February

Equities rallied over February, with China, Japan and the US among the strongest markets, buoyed by hopes of further stimulus measures in China, ongoing resilience in the US economy and solid corporate earnings. At a sector level, growth stocks in the Consumer Discretionary, Industrials and Information Technology sectors were the top performers in the MSCI All Countries World Index, while Utilities, Consumer Staples, Real Estate and Energy lagged.

Global central banks indicated that they were in no rush to reduce borrowing costs but suggested that rate cuts would likely be possible later this year. Headline inflation rates slowed modestly, but policymakers continue to be vigilant for signs that inflationary pressures, such as wage growth, may be accelerating again. While economic activity appeared to improve in Europe during February, it deteriorated slightly in the US and Japan.

Within Technology, the MSCI ACWI Information Technology Index was higher by 6.2% for the month. Gains were led primarily by outperformance in semiconductors, followed by more modest advances in software, electronic equipment instruments, and information technology (IT) services industries. Meanwhile, communications equipment was flat and technology hardware stocks were slightly lower for the month. The ISE Cyber Security Index advanced a more modest 0.7% in February as double-digit gains in professional services and semiconductors led results to the upside, while IT services and communications equipment stocks were laggards for the month.

FEBRUARY 2024

Performance Analysis

The Fund (class AT USD) posted 2.05% in February, underperforming the MSCI ACWI Information Technology Index. A sizable active underweight allocation to technology hardware stocks contributed to results as did strong bottom-up stockpicking in IT services. Alternatively, our active underweight allocation to semiconductors, given the overall lower level of cyber materiality and sizable benchmark weight offset results, as did an above-benchmark allocation to software stocks.

On a relative basis, our avoidance of a smartphone and personal computer maker contributed to results again this month, due to the company's significant benchmark weight and modestly lower return in February. Active exposure to cyber security pure plays Okta Inc. and Cloudflare Inc. also contributed meaningfully to relative performance for the month, thanks to favourable earnings results and increasingly bullish guidance from management.

Alternatively, our below-benchmark allocation to a graphics processing and related software maker was a significant headwind relative to the broad technology benchmark, as the stock advanced meaningfully for the month and commands a double-digit benchmark weight. Our position in a cyber security leader Palo Alto Networks was lower following a moderation in near-term deal recognition in an effort to increase their long-term competitiveness, while a provider of cloud computing, security and content delivery services posted slightly positive earnings results alongside lacklustre near-term growth catalysts.

Contributors

Shares of Okta Inc., a leading provider of cloud identity solutions designed to secure apps, logins and devices, rallied following an upside earnings surprise, and improved guidance across all metrics suggests management has higher visibility into the year. Results have been driven by upselling existing customers and the company's recent shift to a hunter-framer model, which separates sales and client service functions, may be a positive to help incremental growth. Valuations are not demanding on electric vehicle (EV) to sales basis, and we are seeing potential upside and could add further particularly if new product demand increases. We have been adding to our position in the stock, thanks to a favourable backdrop and expectations of continued execution.

Cloudflare Inc., a provider of global content delivery networks aimed at delivering secure, reliable and fast connections, was also the beneficiary of upside earnings results, particularly as the company's salesforce restructuring is leading to better top-line growth. We are seeing a nice turnaround in demand, capped by a constructive management call for a team which is typically more cautious in terms of guidance. The stock has an opportunity to be a next-generation winner, via a high degree of investor excitement, competitive advantage, with a long runway and new sales chief has a history of success in building a salesforce.

The aforementioned graphics processors and related software maker, which offset relative results for the second month in a row given its performance and sizable benchmark weight, also continued to contribute to absolute performance as shares benefitted from resilient excitement over artificial intelligence-related (AI-related) demand, where the company has an undisputed chip dominance in the marketplace.

Our exposures to cloud-based security solutions leader CrowdStrike Holdings, and semiconductors and enterprise security provider Broadcom Inc. also aided results on an absolute basis for the month.

Detractors

Our largest absolute detractor for the month was Palo Alto Networks Inc., a cyber security pure play with capabilities to deliver multiple network security solutions with improved total cost of ownership, centralised management, and low latency in a distributed framework. Shares declined following earnings results which highlighted spending fatigue due in part to the high competitiveness in the space. We had a call with the company's CEO who suggested long-term results were unchanged and this was simply the case of discounting on select deals in the near term to support their long-term growth aspirations. Our conviction level increased following this discussion and the company's growth potential and leadership position remain resilient due to secular demand trends and the necessity of applications and tailwind from generative AI and enterprise growth.

Shares of a software application provider which enables developers to build, scale, and operate real-time communications, within applications, was lower despite posting a strong upside earnings surprise, as the sell-side anticipated higher future guidance and suggested the company's new CEO may need more time to drive sales and profit growth by adding additional AI features to the product line. We trimmed our exposure given a lack of material near-term drivers to warrant a larger position size.

The previously mentioned provider of cloud computing, security and content delivery services declined on mixed guidance with solid trends in security which were offset by its delivery segment. We are seeing evidence of growth within the company's edge platform, but will take more time to kickstart and make the decision to trim our exposure in favour of opportunities with better near-term catalysts.

Our exposure to an enterprise cloud and software intelligence platform, and a diversified software and generative AI leader also offset results for the month, given their modest weights in the portfolio and overall performance decline compared to the monthly advance for the benchmark.

Purchases and sales

Turnover was higher than average in February, reflective of earnings results and a news-driven environment. We newly purchased shares of an online retailer and cloud security provider following an upbeat earnings call and expectations that the company would see an acceleration in margins. There were no other new buys for the month. We added to several existing positions, including a cyber security software company, and the aforementioned Palo Alto following the pullback in the company's share price which presented an opportunity to add to our position given our long-term conviction level. We also added to our existing positions in the independent identity platform Okta Inc mentioned above, as well as an IT services provider, and a semiconductor maker, based upon attractive near-term alpha opportunities. These changes were funded in part by the exit of a search engine, advertising and enterprise solutions giant due to lacklustre ad revenue growth and inline cloud results, as well as a domain name registry services and an internet infrastructure provider, following expectations the stock was appropriately valued, seeking to redeploy capital into other higher conviction opportunities.

We also trimmed exposure to several positions, including a previously highlighted software maker, and infrastructure software provider amid moderation near-term momentum, with weights in a data centre networking solutions equipment maker, and a semiconductor device manufacturer, each notching lower in order to align the alpha versus risk profile of the cyber portfolio.

Market Outlook

2024 is off to a solid start from both an absolute and relative return perspective. Cyber pure plays had noticeably outpaced the broad-based technology benchmark through the first half of February, with short-term volatility picking up post the Palo Alto earnings results. Many of these stocks rebounded towards the end of the month as the market realised this had more to do with company-specific and short-term impact, rather than any changes to the broader asset class or long-term outlook. We view this recovery as a sign of confidence, highlighting the resiliency of cyber security and related companies. The backdrop for normalising monetary policy should be conducive for an economic recovery and for growth to reaccelerate during the calendar year, as lower rates and easier financial conditions should translate to better demand, easier access to capital, and increased investment in high return-on-investment projects. There are likely bumps along the way and the market might be due for a short-term breather after the recent strength, but there are multiple reasons to be optimistic. Our positioning remains focused on software and IT services industries (~75 to 80% of the portfolio), with semiconductors the third largest industry weight at a double-digit absolute level, although at a sizable below-benchmark relative exposure to the broad benchmark.

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 29 February 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.