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 January

Global equities were mixed in January, with central banks dampening rampant speculation of rate cuts as soon as March. Japanese stocks surged, while eurozone and US shares recorded modest gains. However, emerging market equities declined, dragged down by steep falls in China. At a sector level, Communication Services, Information Technology and Health Care were the strongest sectors, while Materials, Real Estate and Utilities declined the most.

Headline inflation rates reaccelerated modestly in December 2023, and heightened geopolitical tensions in the Red Sea raised concerns over higher shipping costs and extended delivery times. Flash estimates of purchasing managers' indices (PMIs) for January suggested a moderate uptick in economic activity. Central banks in developed markets kept rates on hold, but policymakers stressed that hopes of rate cuts as soon as March were likely to prove premature.

Within Technology, the MSCI ACWI Information Technology Index was higher by 3.2%, thanks primarily to gains in semiconductor, software and information technology (IT) services industries. This was offset by underperformance in technology hardware storage & peripherals, and electronic equipment instruments industries, which each posted modest losses for the month. The ISE Cyber Security Index advanced 2.2% for the month, led by results in communications equipment and aerospace & defence stocks, while IT services were lower in January.

JANUARY 2024

Performance Analysis

The Fund posted a low single-digit advance, slightly outpacing the MSCI ACWI Information Technology Index on a net-of-fees basis, as favourable allocation decisions outpaced short-term stockpicking. For the month, a significant underweight allocation to technology hardware storage & peripherals and the exclusion of electronic equipment instruments, the two worst industry performers for the benchmark, aided results as did a sizable overweight allocation to cyber-related software companies. This was offset primarily by bottom-up selections in IT services, as well as a below-benchmark allocation to semiconductors, the benchmark's top industry performer for the month. On a relative basis, our avoidance of a smartphone and personal computer maker contributed to results, given the company's significant benchmark weight and negative performance for the month. Active exposure to cyber security pure plays CrowdStrike Holdings and Palo Alto Networks Inc. also contributed meaningfully to performance for the month, given their leadership positive, favourable industry tailwinds, and high level of earnings visibility.

Meanwhile, our below-benchmark allocation to a graphics processing and related software maker offset relative results, given the stocks status as the third largest benchmark weight, combined with strong performance to start the year. Our active overweight allocations to global content delivery network provider Cloudflare Inc. and independent identity management platform Okta Inc. also detracted from performance, given their modest declines in January.

Contributors

CrowdStrike Holdings, a provider of cloud-based security solutions built around their endpoint detection and response platform, was the largest contributor to absolute results in January. The stock continues to benefit from their Falcon platform and tailwinds related to web and mobile security, threat protection, cloud application visibility and cloud-enabled networking solutions. The company remains a consensus leader in the segment and shares were incrementally higher amid bullish sell-side recommendations, citing improving demand, platform traction and upcoming artificial intelligence (AI) product cycles. The stock was our largest weight in the portfolio, thanks to a favourable alpha versus risk profile.

Similarly, Palo Alto Networks Inc., a leading player within the next-generation firewall market, delivering multiple network security solutions with improved total cost of ownership and centralised management, also contributed to monthly results amid a favourable industry backdrop combined with the company's leading offering in enterprise-wide network and cloud security solutions. Street analysts are anticipating modest upside to billings results over the next few quarters, which have been offsetting recent deal duration compression. The stock remains our second largest position due to the near-term earnings visibility and reasonably compelling valuation.

The aforementioned graphics processors and related software maker, which offset relative results given its sizable benchmark weight, contributed to absolute performance as shares benefitted from resilient excitement over AI-related demand, where the company has an undisputed chip dominance in the marketplace. We continue the stock given its long-term growth potential, which encompasses cyber security solutions, including digital fingerprinting to detect insider threats and analyse the behaviour of users and machines across a network, to finding and classifying leaked credentials, or detecting phishing emails.

Our positions in security-as-a-service company and cloud-based security platform provider Zscaler Inc., and semiconductor and security provider Broadcom Inc. also contributed to absolute results during the month.

Detractors

Our largest absolute detractor for the month was Okta Inc., a leading provider of cloud identity solutions designed to secure apps, logins and devices. Shares were lower as investors weighed the company's near-term prospects, including the impact from recent security breaches, as well as the sustainability of top-line margin growth. Our belief is that the company is one of the best identity security platforms in the market and new products should drive larger deals and market share gains and management is committed to profitability and free cash flow growth. As such, we added to our position during the month.

The aforementioned Cloudflare Inc., a provider of global content delivery networks aimed at delivering secure, reliable and fast connections, was lower for the month on fairly light news as market participants digested the stock's valuation and near-term growth prospects. Our belief is that their premium valuation is warranted, given the growing pipeline and continued position as a network access, security, and compute disruptors, and market share gains relative to peers.

Shares of a South Korean technology and related conglomerate declined despite an upside earnings surprise, over concerns of moderation in semiconductor demand, which offset a rebound in memory chip results. We exited our position during the month, in favour of companies with a higher level of materiality and better near-term catalysts.

Our exposure to an internet infrastructure software maker and an application software provider also offset results, given our modest exposure combined with their mid-single-digit declines during the month.

Purchases and sales

Turnover was quite low in January and reflective of the portfolio already being well-positioned to start the year from a near-term risk versus reward level. There were no new buys for the month. We added to the aforementioned Okta Inc., given expectations that the market was overly bearish following the impact from recent breaches and the stock is likely to regain its stance as a category-defining platform that enables its customers to securely connect people and technologies.

We also added to our existing position in a customer relationship management software company given a renewed thesis focused on outsized growth and margin expansion, combined with a unique competitive position to transition from a historical high grower to one more focused on mature growth profile emphasising operational efficiency.

These trades were funded in part via the full exit of the previously mentioned South Korean technology and related conglomerate, due to lacklustre near-term growth expectations and in an effort to increase the cyber materiality and alpha versus risk posture in the portfolio.

We also made the decision to incrementally trim exposure in a handful of existing positions, including slightly paring back our weight in CrowdStrike in order to provide a more prudent risk balance in the portfolio, following strong gains in the stock in recent months, which remains the top holding in the portfolio at the end of January.

We also reduced our exposure to Broadcom Inc and another semiconductor maker, following outsized gains in both companies and in an effort to diversify the portfolio.

Market Outlook

2024 is shaping up to be yet another favourable year for cyber security, following strong results in 2023. Our viewpoint is that the cadence of cyber attacks will continue to increase, as has been the case for multiple years, providing a continued favourable backdrop for the segment. In addition, mergers and acquisitions (M&A) activity is likely to progress at a steady pace as the demand for solutions and scale continues to increase. The expectations of a rising threat landscape, including the impact from generative AI tools which is translating to a spike in phishing scams and ransomware demands, as hackers are using increasingly more sophisticated tools to gain access to information. The Security and Exchange Commission (SEC) disclosure rule which went into effect in December requiring publicly traded companies to report "material" cyber security incidents within four business days of the event is also expected to be an incremental driver. This increase, combined with rising global geopolitical headwinds, including Russia/Ukraine, Israel/Hamas, Red Sea attacks, US/China relations, and US presidential election, lay a foundation for potentially greater cyber security events this year. Our positioning remains focused on software and IT services industries (circa 75 to 80% of the portfolio), with semiconductors the third largest industry weight, although at a sizable below-benchmark allocation relative 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 31 January 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.