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 July

Global equities were modestly positive in July. There was a strong rotation away from technology companies in favour of value stocks, as artificial intelligence-related (AI-related) and semiconductor stocks were particularly impacted by a shift in sentiment. There were various factors behind the technology sell-off. US inflation was slower than expected in June, boosting hopes that US rates would soon be cut – an outcome that could weigh on mega-cap companies' cash piles; an electric vehicle (EV) manufacturer and a technology conglomerate delivered disappointing earnings; Donald Trump said Taiwan, a global chipmaking industry leader, should pay for its own defence; and the Biden administration threatened severe export curbs if non-US companies continued to provide China with access to advanced chips.

As expected, central banks in the US and eurozone kept rates on hold. However, expectations of a September cut grew after US Federal Reserve (Fed) Chair Jerome Powell signalled that rates could be cut in September if inflation continues to moderate. European Central Bank (ECB) President Christine Lagarde said the decision on a possible rate cut in September was "wide open", but downplayed fears of sticky price pressures. In contrast, the Bank of Japan (BoJ) tightened monetary policy, raising rates to 0.25% and setting out plans to halve its monthly bond purchases.

Within Technology, the MSCI ACWI Information Technology Index declined 2.15% in July amid a rotation away from AI-related segments of the market. IT services, technology hardware and communications equipment industries each rallied for the month, while semiconductors and software were under pressure due to a combination of stock-specific and macroeconomic headwinds. The ISE Cyber Security Index was higher by 1.85% in July, led by gains in a Japanese anti-virus and internet security provider, while a cyber security pure play declined following a global outage which impacted investor sentiment and muddied near-term sales expectations.

Performance Analysis

The Fund posted a decline in July, trailing the broad-based MSCI ACWI Information Technology Index, due primarily to short-term stockpicking. For the month, a below-benchmark weight in semiconductors, the benchmark's worst industry performer, aided results. This was offset by an active underweight allocation to technology hardware, and above-benchmark exposure and relative performance in the software industry.

On a relative basis, below-benchmark weights to Microsoft Corp. and a graphics processing units manufacturer contributed to results, given their mid-single-digit declines and sizable benchmark weights. Our active exposure to cyber security provider SentinelOne Inc. also aided results for the month.

Meanwhile, our meaningful overweight allocation to a cyber security leader offset results, given the impact from an update to their sensor that resulted in a widespread outage of Microsoft systems globally. Our avoidance of a computer hardware and consumer electronics manufacturer, given its low cyber security materiality and lacklustre growth expectations, offset results given the stock's significant benchmark weight and mid-single-digit advance, while our active exposure to a provider of computer, data centre and software solutions detracted from performance amid headwinds in AI and data centre-related providers.

Contributors

SentinelOne Inc., a security developer platform seeking to protect organisations against advanced threats and nation state malware, was the top absolute contributor for the month. Shares were higher following a continuation of the performance rebound in June, as the sell-side became increasingly bullish that the company was poised for faster growth via rapid customer adoption, and that shares were attractive given the valuation discount to peers. This sentiment increased towards the end of the month as the stock was widely cited as a potential incremental beneficiary from the headwinds in the cyber security leader mentioned earlier, given SentinelOne's leading endpoint protection platform. We added to our existing position given the stock's attractive alpha potential.

Shares of a data security and analytics company rallied following positive earnings results which highlighted strong execution and better-than-expected revenue, profitability and free cash flow results. We continue to hold the stock given its improved visibility amid a combination of new client growth and upgrades from existing customers.

Similarly, shares of a security software and appliances for corporate networks and service provider also advanced, thanks to an acceleration in billings. In addition, the company announced the long-awaited appointment of a new CEO who is slated to start in December, which helped drive incremental positive momentum in the stock. We increased our stake in the company amid its attractive growth versus valuation mix.

Our positions in application and cloud-based security solutions Tenable Holdings Inc., and a cloud data management and data security platform also contributed to absolute performance in July.

Detractors

Our largest absolute detractor for the month was the aforementioned cyber security leader. The stock had been a strong performer with outsized gains prior months, thanks to their leading security platform built around the company's endpoint detection and response solutions. On 19 July, a software update from the company caused Microsoft Windows operating systems to crash, translating to severe outages globally, one of the largest IT mishaps in recent history. While we are thankful this was not a security incident or cyber attack, the outcome is likely a reset in the company's near-term sentiment, and we concede this event is likely to translate to an elongation in the near term as the sales cycle and an earnings impact which is being digested by the market. We continue to believe that it is one of the most compelling stories in the cyber security space, and the most likely path forward is for the company to implement improved testing and security controls internally to ensure there is not another incident. In the meantime, we cut our exposure to the company in light of near-term uncertainty and in an effort to manage the risk profile of the portfolio.

Shares of a provider of computer, data centre and software solutions mentioned earlier, which is a diversified global provider focused on mobility products, desktop personal computers and software, networking and storage solutions, were lower due to the overall rotation within select technology companies. In particular, it was impacted by expectations that sales outlooks may be tempered due to production issues, translating to fewer-than-expected next generation graphics processing units, resulting in moderating growth in AI servers. We continue to hold the stock at a moderate portfolio weight given its attractive growth versus valuation mix and leadership position.

A cloud-based data monitoring and analytics platform declined amid rumours of a potential interest in acquiring an application software provider, alongside the overall pressures in select cyber-related providers. We maintained our exposure to the stock which is likely to benefit from acceleration in their core business, as well as sustained gains among generative AI customers and use cases.

Our exposure to global content delivery network provider Cloudflare Inc. and security-as-a-service platform Zscaler Inc. also offset results given the overall moderation in select cyber software providers in the back half of the month.

Purchases and Sales

Turnover in July was in line with historical levels, as we choose not to overreact to the short-term flurry of news and market rotation during the month. We newly purchased shares of a leading data solutions support provider, thanks in part to their potential for outsized growth as the company is seen as a go-to vendor for implementing AI in an enterprise environment, particularly given their broad platform which allows for integration across multiple software stacks. We also bought a provider of digital platform engineering and software development services, which is benefitting from their comprehensive suite of cyber security offerings, from zero trust, managed detection and response, and ransomware protection, as the stock may be poised for a turnaround following headwinds in prior months. We purchased a leading search engine, services, infrastructure and data analytics platform, as the company looks to become more involved in delivering cyber security offerings, including a rumoured acquisition of a cybersecurity startup which can augment existing growth in their cloud security business.

We also added to a handful of existing positions based upon near-term alpha potential, including the aforementioned security software and appliances for corporate networks and service provider, as well as enterprise information technology management software provider ServiceNow, Inc., and a semiconductor products and devices maker. We also increased our stake in a communications equipment maker, given their exposure across enterprise network security, software development and data collaboration, combined with the company's attractive value profile with optionality for incremental growth.

We made the decision to fully exit our position in the previously mentioned graphics processing units manufacturer, in an effort to move towards higher cyber materiality names and amid expectations that the market may be broadening out from the narrowness experience in H1. There were no other complete sells in the portfolio. We cut our stake in the cyber security leader mentioned above in light of the near-term uncertainty in the stock and in an effort to reduce the overall risk of the portfolio. We trimmed our exposure to a handful of other stocks, most notably a data storage devices and solutions provider; and a developer database platform; and Broadcom Inc in an effort to incrementally tilt the portfolio towards stocks with better near-term catalysts.

Market Outlook

We continue to have a constructive mid-to-long-term outlook for equity markets, particularly cyber security given its outsized growth potential, resilient balance sheets, positive cash flows and improving profitability. However, we expect higher market volatility in the near term as the markets digest additional risks. Investors are increasingly fearful of a deeper economic slowdown and late timing of interest rate cuts, given recent softer employment numbers, economic indicators, and consumer spending trends. Also, a closer race in the upcoming US elections is adding to volatility, especially potential uncertainty surrounding geopolitics and the global supply value chain. The equity market is now seeing a modest pullback following a strong rally in H1.

Although the volatility may continue as investors look to reduce risk, this is a normal and healthy event in bull markets, as long as fundamental factors remain solid. The overall corporate earnings appear relatively fairly resilient as most companies which have reported are citing better-than-expected earnings for the quarter.

Since inflation is moving towards the Fed's target of 2%, the central bank is now in a more comfortable spot to normalise monetary conditions. Given that monetary conditions have been tight for some time, there are many tools at central banks' disposal to ease conditions. From the most recent Federal Open Market Committee (FOMC) meeting in July, Fed Chair Jerome Powell indicated a rate cut in September is probable.

The overall outlook for cyber security remains constructive and may incrementally outpace broader technology peers, which also occurred in the back half last calendar year. In particular, spending remains durable in comparison to other areas of technology, and we expect that to continue through year-end. We are encouraged with recent earnings results and believe the cyber group's relative valuation remains compelling. We have started to see a mergers and acquisitions (M&A) pick-up and believe this will serve as a tailwind for the remainder of the year.

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 July 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.