

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 June

Global stocks advanced over June, driven by a further rally in technology companies. The tech-heavy US equity market was among the strongest performers. Japanese stocks also rose slightly, while European and Chinese shares fell. Political risk re-emerged in Europe after France called a surprise election. At a sector level, Information Technology was the standout sector, while Utilities and Materials stocks declined the most.

Economic news was mixed. Surveys of economic activity suggested that growth was stagnating in Europe and Japan and slowing in China, but US economic momentum picked up. Inflation eased in the US and UK, but central banks in these markets kept rates on hold. In contrast, Canada became the first G7 nation to cut rates, swiftly followed by the European Central Bank (ECB). The Bank of Japan (BoJ) maintained rates at 0-0.1% but suggested it would soon start to reduce its monthly bond purchase programme.

Within Technology, the MSCI ACWI Information Technology Index advanced 9.2% for the month amid gains in all industries. Results were led by continued momentum within semiconductors, followed closely by outsized gains in software stocks which rebounded meaningfully from relative headwinds in prior months, while electronic equipment and communications equipment advanced more modestly. The ISE Cyber Security Index was higher by 3.0% in June, as semiconductor and dedicated enterprise cyber defence platform Broadcom Inc. contributed to performance amid favourable industry tailwinds and strong earnings results, while a Japanese anti-virus and internet security provider offset results due in part to cost and workforce pressures.

Performance Analysis

The Fund posted an advance in June, topping the broad-based MSCI ACWI Information Technology Index gain, thanks to favourable stockpicking. For the month, strong bottom-up stock selection within the software industry led to relative gains, followed by favourable stockpicking in semiconductor and information technology (IT) services stocks. This was offset in part by more conservative stock selection in the technology hardware industry.

On a relative basis, our above-benchmark exposures to cyber security pure plays CrowdStrike Holdings, Cloudflare Inc. and CyberArk Software Ltd led to relative gains, thanks to improved investor sentiment and favourable industry tailwinds.

Meanwhile, our active underweight allocation to a graphics processing and related software maker offset results due to the continued advance in share price amid strong investor sentiment and durable demand drivers, thanks to secular growth expectations for artificial intelligence-related (AI-related) applications. Our avoidance of a Taiwanese semiconductor company, in favour of other cyber-related chip stocks, detracted from the broader benchmark performance, as shares benefitted from improving price visibility and a rebound in the supply chain providers of a computer hardware and consumer electronics manufacturer. Our above-benchmark allocation to a data storage and solutions provider also impacted relative results as the company's share price was flat for the month following gains in the prior seven months.

Contributors

CrowdStrike Holdings was the top absolute contributor to the performance, thanks in part to strong company execution. The stock has been a key beneficiary of AI-related demand built around its endpoint detection and response platform, with robust deal flow momentum, including larger clients and diversification across cloud, identify and log translating to resilient earnings growth. Even as valuations are generally higher than peers, the company's long runway for growth and industry-leading product suite warrant a premium. Although we incrementally took profits in the stock during the month, it remains one of the largest holdings in the portfolio, thanks to its favourable risk/reward profile and high level of thematic purity.

Shares of Broadcom Inc., a supplier of semiconductor, infrastructure and cyber security solutions, were higher due to the continued strength in chip stocks, combined with the rebound in cyber pure plays. The company's stock price accelerated following outsized earnings results and an upbeat forecast, buoyed by demand for AI-related solutions. We slightly reduced our exposure to the stock on profit taking and it remains a top holding due to its proven track record and diversified exposure across key technology themes, including cyber security.

Cloudflare Inc., a global content delivery network, which to speed up websites by placing cloud servers closer to customers and designed to provide more secure, private, fast, and reliable connections, rebounded significantly following declines in the prior three months, due in part to the announcement of their Private Cloud Compute alongside the AI product of the aforementioned computer hardware and consumer electronics manufacturer. The latter is likely to drive incremental growth in the coming quarters, particularly as the AI penetration within its base grows. We added to the stock during the month due to its attractive near-term alpha profile.

Our positions in leading network security provider Palo Alto Networks, Inc. and identity management platform CyberArk Software, Ltd also contributed to absolute performance in June.

Detractors

Our largest absolute detractor for the month was a software intelligence platform. Shares were lower despite the company affirming guidance on revenue growth, customer budget prioritisation for their observability solutions, and retention in sales representatives, following its recent change in strategy which may impact near-term bookings. We continue to hold the stock given its favourable growth potential related to robust enterprise demand, product initiatives and potential market share gains.

Shares of a Japanese anti-virus and internet security software maker offset results as the company's share price was lower despite little in the way of new news. Investor apprehension drove the share price lower due in part to ongoing cost concerns and workforce pressures, combined with the foreign exchange impact from a weakened Japanese yen. The stock remains at a very modest weight due to more favourable investment opportunities from other stocks in the portfolio.

A semiconductor solutions provider was modestly lower for the month amid industry competition and uncertainty around a cyberattack, with the company citing that hackers stole a limited amount of information and the infiltration unlikely to have a significant impact on its operations. The stock remains at a modest weight in the portfolio given its secular growth potential.

Our exposure to a computer and data centre supplier, and an infrastructure security, content delivery and computer provider offset absolute results more modestly for the month.

Purchases and Sales

Turnover was taken at a measured pace and lower than typical in June amid expectations that the portfolio was already well-positioned from a fundamental and materiality standpoint. There were no new buys in the portfolio during June and we made incremental additions to three existing positions, namely Cloudflare Inc.; as well as an application and search-powered software solutions provider; and a semiconductor equipment producer, due to their favourable risk versus reward profiles. These additions were funded in part via the exit of a UK-based application software provider which leverages AI and machine learning to detect cyber threats that was essentially trading for cash following a takeover announcement in late April. We modestly reduced our exposure to CrowdStrike Holdings in an effort to lock in profits and diversify proceeds into other stocks within the portfolio. We also incrementally reduced our weight in the graphics processing and related software maker mentioned earlier amid expectations that there were potentially better near-term alpha opportunities elsewhere in the space.

Market Outlook

We were pleased to see the prior headwinds for software and related cyber security stocks sharply reverse course during the month as investors have appeared to incrementally discount the somewhat clouded near-term outlook for the long-term runway and opportunities these companies provide. Our belief is the cyber security space may be set up for a continuation of the performance, thanks to robust earnings growth potential, healthy valuation levels relative to history and expectations that H2 will provide a tailwind for sentiment, mirroring the realised results in 2023. Uncertainty in terms of the US presidential elections alongside the timing and the level of the US Federal Reserve (Fed) interest rate cuts may translate to near-term volatility, which is likely to be increasingly discounted by the market in the coming months.

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 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.

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 June 2024 unless otherwise stated.

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