# 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 March

Global equities moved higher over March, further bolstering already strong year-to-date returns. Sentiment was lifted by signs of improving economic momentum in Europe and China, as well as by central bank indications that rate cuts were likely to start in the summer. At a sector level, Energy companies advanced the most, followed by Materials stocks, while Consumer Discretionary was the weakest.

The Swiss National Bank became the first major central bank to lower rates this cycle. However, in general, central banks stuck with the mantra that rates would be cut this year, but not before summer. In contrast, after months of speculation, the Bank of Japan (BoJ) finally raised rates to 0 - 0.1% and ended its yield curve control policy. Headline inflation rates slowed in Europe but ticked higher in the US, Japan and China, with the latter exiting deflation for the first time in six months.

Within Technology, the MSCI ACWI Information Technology Index was higher by 2.3% for the month. Outperformance was led by high-single-digit gains in semiconductors, followed by more modest advances in electrical equipment instruments and communications equipment. Software stocks were overall flat for the month, while information technology (IT) services and technology hardware industries each posted losses. The ISE Cyber Security Index was lower by 0.2% in March, as outperformance in aerospace and defence and semiconductor industries was offset by headwinds in interactive media and IT services stocks.

**MARCH 2024**

## Performance Analysis

The Fund posted a decline in March, compared to the advance of MSCI ACWI Information Technology Index. The relative return differential was primarily related to the short-term divergence between cyber and non-cyber industries. Our performance was aided by a below-benchmark allocation and positive stockpicking in technology hardware, followed by exposure to communications equipment. Alternatively, selections in software offset results as did our below-benchmark allocation to semiconductors and above-benchmark allocation to IT services. We continue to have a high degree of confidence in the cyber security and the thematic purity offered by our approach, and view results this month as simply a short-term anomaly which is likely to be adjusted in the near future.

On a relative basis, our avoidance of a smartphone and personal computer maker contributed to results yet again this month, due to the company's significant benchmark weight, poor execution and relatively weak investor sentiment. Our active exposure to a computer hardware and storage provider, and below-benchmark allocation to a digital marketing and creative software developer also contributed to relative performance for the month.

Meanwhile, our above-benchmark weight in cloud-based security software provider Zscaler Inc. detracted from relative results, due to weaker-than-expected billings and a lower forward guidance. A below-benchmark allocation to a graphics processing and related software maker offset results due to the continued surge in shares, combined with a sizable benchmark weight, while our exposure to an infrastructure security software provider declined amid a lower-than-expected revenue forecast.

**Contributors**

The aforementioned 3D graphics processors and related software maker, which offset relative results for the third month in a row given its performance and sizable benchmark weight, also continued to contribute to absolute performance as shares benefitted from resiliency over chip and artificial intelligence-related (AI-related) demand, where the company has an undisputed chip dominance in the marketplace. We continue to hold the stock, although we reduced our position and will remain at a structural underweight given its double-digit benchmark weight and moderate cyber purity level.

Shares of the afore-mentioned developer, manufacturer and provider of data storage security and solutions devices advanced, thanks to robust investor sentiment related to the company's broad-based storage portfolio, expectations of strong growth in enterprise and data centre markets, coupled with the recent spinoff of its flash business. We added to our position during the month, thanks to a favourable alpha versus risk profile.

A leading provider of memory and related chips primarily sold to equipment makers rallied, thanks to upside revenue and earnings results combined with strong sales forecast which was buoyed by demand for AI hardware. We trimmed exposure in order to lock in profits and increase the thematic purity of the portfolio.

Our exposures to semiconductors and enterprise security provider Broadcom Inc., and a data centre cloud networking solutions provider also aided results on an absolute basis for the month.

**Detractors**

Our largest absolute detractor for the month was Zscaler Inc., a security-as-a-service company, offering a cloud-based security platform. The stock posted upside earnings results yet was impacted by lofty expectations as the market was anticipating higher billings guidance to sustain recent performance. We view this as simply a case of where expectations got ahead of the stock and there is no change to our thesis or reasons to be concerned based upon the earnings update.

Shares of the aforementioned cyber security platform were lower despite healthy demand trends and exceeding guidance for the second consecutive quarter, as the market anticipated an even stronger beat and weighed the potential decelerating trends in net new business growth. The company has established itself as a best-of-breed next generation endpoint detection and response platform, and we took advantage of the pullback in share price to add to our position due to the potential to deliver strong growth alongside improving fundamental factors.

Security platform leader Palo Alto Networks Inc. was modestly lower for the month, as the prior month's decline due to concerns of spending fatigue continued to impact the near-term stock price. Our expectation is that barring any new updates, the stock is likely to trade along with the overall market until the next quarter results. Our long-term outlook on the stock is unchanged, thanks to its leadership position and secular demand trends which highlight the necessity of cyber security applications.

Our exposure to a modern general purpose database developer, and to an application and search-powered software solutions provider also detracted from absolute results in March.

**Purchases and Sales**

Turnover was slightly higher than average in March, reflective of the continuation of earnings results and the overall market choppiness. We newly purchased shares of an AI-supported cyber security solutions platform to identify and respond to the threats, thanks to its potential to deliver double-digit growth and its unique product suite which is less likely to be plagued by competitive pressures. We newly bought shares of a provider of computers, monitors and technology solutions, thanks in part to expectations of growth in AI-optimised servers, and a semiconductor equipment manufacturer amid resilient demand for semiconductor capital equipment. In addition to these new buys, we increased exposure to a handful of existing companies in the portfolio, namely an electronic design automation software and services provider; the aforementioned developer, manufacturer and provider of data storage security and solutions devices; a network security solutions provider; and AI-enabled endpoint detection and response platform CrowdStrike Holdings, Inc., due to their favourable near-term alpha versus risk profiles.

These buys were funded in part by the exit of the previously mentioned digital marketing and creative software developer, due to expectations that the stock price fully reflected fundamental factors and the competition for similar generative AI tools may translate to weaker-than-expected forward guidance. We also completely exited a provider of real-time communications within software applications, amid expectations that there were better opportunities with more favourable upside versus downside and near-term catalysts. We also sold our position in a designer and developer of software solutions, following earnings results which highlighted a weaker-than-expected outlook and changes in leadership.

We also trimmed exposure to several existing positions, including two infrastructure software solutions providers, two semiconductor companies, a communications equipment provider, as well as two software companies, in an effort to increase the thematic purity of the portfolio and adjust the alpha versus risk profile of the portfolio.

## Market Outlook

We witnessed a divergence in the broader technology market during March, with software and IT services, key industries within the cyber security universe, declining, while semiconductors and electronic equipment instruments, industries with generally less direct cyber exposure, advancing. We view this as a short-term variance and continue to have a high degree of conviction in cyber security due to the thematic tailwinds and bottom-up stock selection potential. 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. Recent earnings reports from cyber security were uniformly positive and we anticipate outsized growth from cloud security, identity, access management, data backup, recovery, governance and security operations. Our expectation is that the merger and acquisition environment is likely to accelerate for both public and private companies. Valuations remain reasonable, particularly following a strong finish to the calendar year 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 31 March 2024 unless otherwise stated.