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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 September

Global equities mostly rallied over September, buoyed by the US Federal Reserve's (Fed's) larger-than-usual cut in interest rates, its first reduction in four years. In late September, a raft of further stimulus measures from the People's Bank of China (PBoC) and the Chinese government further boosted sentiment, particularly towards Chinese stocks which surged over the month. Sectoral performance was mixed, with Consumer Discretionary, Utilities, Real Estate and Communication Services rising the most, while Health Care and Energy were the weakest.

Concerns over the health of the labour market finally persuaded the Fed to start cutting rates. The Fed's larger-than-usual 50-basis point (50-bps) cut was accompanied by forecasts of further cuts this year and in 2025. The European Central Bank (ECB) also reduced borrowing costs, marking its second cut this year, while the Bank of England (BoE) kept rates on hold but indicated that borrowing costs were likely to be reduced later this year. While the Bank of Japan (BoJ) also kept rates on hold, the PBoC announced a package of measures aimed at supporting the economy and the property sector, including lowering the reserve requirement ratio for banks and cutting some loan rates.

Within Technology, the MSCI ACWI Information Technology Index advanced 1.92%, thanks to monthly gains in all industries. Results were led by mid-single-digit gains in communications equipment, information technology (IT) services and software stocks, while technology hardware and electronic equipment managed only modest gains. The ISE Cyber Security Index was higher by 1.60%, thanks in part to a rebound in an infrastructure software and security provider, while cyber security pure play Palo Alto Networks Inc. offset results in September, following a double-digit advance in August.

Performance Analysis

The Fund posted a low single-digit advance in September, trailing the broad-based MSCI ACWI Information Technology Index on gross- and net-of-fees basis, due to short-term stock selection. For the month, relative performance was aided by a below-benchmark exposure and positive bottom-up selections in semiconductors, as well as the avoidance of the technology hardware industry. Meanwhile, more conservative stock selection in software and IT services offset performance for the month, countering the positive tailwinds from above-benchmark allocations within each industry.

On a relative basis, our active allocation to a leading data solutions support provider contributed to results following favourable momentum and news that it would be added to the S&P 500 Index, while the avoidance of a South Korean technology and related conglomerate and a semiconductor manufacturing equipment supplier also aided results given their sizeable benchmark weights and negative monthly performance.

Conversely, our above-benchmark positions in cyber security leaders Zscaler Inc. and Palo Alto Networks Inc. offset relative performance as did the avoidance of an enterprise information management software provider, which rallied following upside earnings results and favourable guidance.

Contributors

The afore-mentioned data solutions support provider was our largest contributor to performance for the month. The global leader in the field of data analytics, with a range of products and services, rallied on the continued momentum for artificial intelligence-related (AI-related) applications as well as news that it would be added to the S&P 500 Index, which is likely to increase liquidity in the stock. The company is optimistic that acceleration in their products and services, including via its partnership with a suite of AI services and increased use of hyperscale cloud infrastructure for AI training and inferencing workloads, will drive growth in the near term. We continue to hold the stock given the incremental shift in IT spending towards AI, aimed at improving data visualisation and piloting its AI platform product for better analytics, is likely to drive secular growth in the future.

Shares of Broadcom Inc., a leading semiconductor and infrastructure software solutions provider, rallied despite headwinds from a weaker-than-expected earnings guidance at the beginning of September, as investors focused on the company's strong core market positioning in networking and AI-related growth. We continue to hold the stock given its strong management team, growth in chip demand related to data centres for both AI and traditional applications, as well as non-semiconductor and security solutions business coming off cyclical bottoms.

ServiceNow Inc., provider of enterprise information technology management software, was higher despite little in the way of new news, as the company's near-term outlook was positive and shares are likely to benefit from Fed rate cuts, particularly as software providers tend to be more sensitive to lower rates. In the longer term, the company is a clear beneficiary of increased demand for workflow automation, a critical piece of any digital transformation.

Our positions in a cloud-based customer relationship management software provider and an information technology and networking services leader also contributed to absolute performance in September.

Detractors

Our largest absolute detractor for the month was Zscaler Inc., a cloud-based provider of web and mobile security, threat protection, cloud application visibility and networking solutions. Shares were lower following weaker-than-expected guidance which elicited concerns of moderating growth, a potential increase in competition and slower upsell opportunities. We viewed this more conservative stance as an opportunity for the company to potentially reset market expectations, in light of a less certain macroeconomic environment and seasonal software trends, which is likely to allow for future revenue and earnings beats. The stock remains well-positioned as a cyber security pure play which is likely to benefit from secular growth in the segment, greater cloud adoption and its strong product offering.

Similarly, cyber security pure play Palo Alto Networks Inc. saw its share price moderate following upside earnings results and a double-digit gain in August, as there was little in the way of new news to drive momentum which has been building over prior months. We continue to have a favourable outlook on the stock given its platformisation strategy and leadership position in next-generation firewalls, expansion into cloud and security operations, as well as generative AI positioning via its co-pilot offering, which is likely to drive free cash flow generation.

Shares of an independent enterprise identity management platform were lower following earnings results at the end of August, indicating saturation in larger accounts and moderating new customer accounts, which continued to impact the stock during the month. We trimmed our position in the stock in favour of companies with better near-term catalysts.

Our exposure to a cloud data management and data security provider and Cloudflare Inc (a web infrastructure and security services provider) also offset absolute performance for the month.

Purchases and Sales

Turnover in September was at a moderate level, as the portfolio was already well-positioned from a bottom-up and thematic perspective. We newly purchased shares of an AI-hardware and software solutions provider for vehicle telematics, fleet management, asset security and related applications platform, due to expectations of outsized growth as the company offers leading technologies and helps companies improve the safety, efficiency and sustainability of their operations.

We also added to a handful of existing positions, including network security solutions provider Fortinet Inc.; a technology consulting and professional services leader; and the afore-mentioned cloud data management and data security provider, based upon their bottom-up investment attributes. We funded these trades in part through the sale of a software technology, design and consulting services provider, which was sold amid concerns of semiconductor capital expenditure (capex) pressures and to increase the overall materiality of the portfolio.

We also trimmed exposure to a handful of names to better position the portfolio from an alpha versus risk and near-term catalyst standpoint, reducing our stakes in a software development provider, a cloud networking solutions provider, and the aforementioned independent enterprise identity management platform**.**

Market Outlook

The near-term outlook for cyber security-related companies has improved in light of the Fed rate cuts, which is likely to have an incrementally positive impact on software and IT services providers given their greater sensitivity to lower rates. There has been a notable relative rotation out of semiconductor and technology hardware-related stocks in recent weeks, which has helped alleviate some of the shorter-term performance comparisons relative to the broad-based technology benchmark. Quarterly earnings results for the majority of cyber security stocks were positive and points to the potential for incremental asset class momentum relative to a broader technology mandate. We look for continued strength in the upcoming quarter, particularly as we enter a period of seasonal tailwinds which are also likely to benefit software and IT services segments of the market, where many of our cyber security holdings reside.

Our expectation is that mergers and acquisitions (M&A) activity may rise as capital markets continue to show signs of strength, and there is potentially a broad cross-section of acquirers for cyber assets given their durability and strategic positioning. Additionally, valuations remain attractive with cyber companies broadly trading at pre-COVID levels on an enterprise value-to-sales ratio and cyber remains one of the more insulated areas within Technology which is less likely to be impacted by any boom/bust spending which has been impacting AI-related opportunities in recent months. Investors are paying attention to a closer race in the upcoming US elections which may also add to volatility, especially around geopolitics and global supply chain. Amid any potential volatility, we are opportunistically looking to upgrade select names and add to our highest conviction ideas to better position the portfolio for improved performance. We continue to have a constructive mid- to long-term outlook for equity markets, particularly cyber security stocks given their secular growth expectations.

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 September 2024 unless otherwise stated.

Allianz Global Investors and Voya Investment Management have entered into a long-term strategic partnership, and as such, as of 25 July 2022, the investment team transferred to Voya Investment Management. This did not materially change the composition of the team, the investment philosophy nor the investment process. Management Company: Allianz Global Investors GmbH. Delegated Manager: Voya Investment Management Co. LLC ("Voya IM").