

Could It Be Time for a Turnaround in Cloud Computing?

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Key Takeaways

- In 2024, the cloud computing sector, especially Software-as-a-Service (SaaS) companies, faced significant challenges due to the U.S. Federal Reserve's interest rate policies, resulting in negative returns for many more speculative companies.
- The [WisdomTree Cloud Computing Fund \(WCLD\)](#) experienced both positive and negative catalysts from 2020 to 2024, including the COVID-19 pandemic, inflation and the rise of AI, which influenced the Fund's returns.
- Despite disappointing actual returns for software companies in 2024, AI could be a catalyst for cloud companies. The BVP Cloud 100 list highlighted strong potential in the AI, fintech and productivity sectors.

Do you remember the last time you put a disc into your computer to install new software? My laptop hasn't had a disc drive going back several years.

Software has shifted from being a physical thing purchased from a store to being a subscription run completely over the internet.

Software business models are attractive due to their scalability and resulting high profit margins. The next copy of software available to the marginal user is not cost-intensive, and there is no physical manufacturing involved. Of course, the economics could change if we think of scaling to the next 100 million users with the need for data centers and servers.

In 2019, WisdomTree launched the [WisdomTree Cloud Computing Fund \(WCLD\)](#) to focus predominantly on the specific, relatively high-growth companies within the Software-as-a-Service (SaaS) space.¹ This strategy focuses on those SaaS companies that are seeking to deliver their software to enterprise customers.

Demonstrating the attractive economics of this business, we compare the gross margin of [WCLD](#) to a major benchmark, in this case, the S&P 500 Index, and can see the dramatic differential and high margins in [WCLD](#).

Figure 1: Gross Margin of WCLD (Software Companies) vs. the S&P 500 Index (500)



Source: WisdomTree's Fund Compare software tool from within its PATH suite of tools, as of 7/31/24. **Past performance is not indicative of future results.**

Yet, the actual returns for software companies in 2024 have disappointed. In evaluating where we are, let's recap the experience of recent years within [WCLD](#), which tells us how SaaS companies have been doing, returns-wise, in different environments:

- 2020:** This year was characterized by the COVID-19 pandemic and the “work-from-home” trend kicking off. Companies like Zoom Video Communications saw incredible increases in revenues due to the sudden value being placed on the ability to do high-quality virtual meetings and presentations. Many cloud companies ensure that certain tasks can be performed as long as there is an internet connection, and the pandemic created an instant one-time boost in demand for this sort of thing.
- 2021:** 2021 was a year of “liquidity,” and the impacts of printing money and lowering interest rates to zero really coalesced during this year. As the year progressed, higher inflation became more and more visible, and higher interest rates and contractionary monetary policy began to be anticipated. This extreme, juxtaposed with the prior year's extreme of greater-than-100% returns, contributed to a very rough 2021 full year for [WCLD's](#) returns.
- 2022:** This was a year when U.S. equities² and bonds³ both delivered negative returns—historic for asset allocators in the negative sense since history has not seen many times when this occurred. There are a lot of speculative companies in [WCLD](#) that are not yet carrying their revenues through their income statements to indicate positive profits at the bottom line—many are continuing to make various growth-oriented investments. As interest rates sharply rose, these speculative stocks did not do well.

- **2023:** The primary topic of this year was AI, and the primary companies that delivered returns connected to that story were some of the world's largest—the so-called “Magnificent 7.”⁴ [WCLD](#) rallied into the end of 2023 due to expectations that the U.S. Federal Reserve had contained inflation successfully and would have to start lowering interest rates quickly to start 2024.
- **2024:** The market, and the world, has been waiting on the U.S. Federal Reserve for basically the first eight months of the year. The misplaced expectation of a quick series of interest rate cuts had to be “corrected” with negative returns from more speculative companies—like those within [WCLD](#). If interest rate cuts do come, it's possible that these companies could see their share prices respond.

If one takes the full figure 2b into account, starting at the end of 2019 and carrying through to the end of July 2024, one will see an annualized return of 4.7% for [WCLD](#) as compared to 14.2% for the S&P 500 Index. Even with the greater-than-100% return, being cut in half in 2022 was by far the critical driver of this result.

AI could be a significant catalyst for these businesses. The pandemic was a catalyst for a massive amount of software adoption—adoption that might have naturally played out over years played out over months. If AI increases or improves what software providers can do, maybe this is a future growth catalyst that could contribute to further equity returns.

Figure 2a: Standardized Performance

Fund/Index Name	Fund Ticker	Fund Inception Date	Fund Expense Ratio	Year-to-Date	1-Year	3-Year	5-Year	10-Year	Since Fund Inception
WisdomTree Cloud Computing Fund (NAV)	WCLD	9/6/2019	0.45%	-9.61%	-0.38%	-17.30%	N/A	N/A	4.94%
WisdomTree Cloud Computing Fund (MP)	WCLD	9/6/2019	0.45%	-9.64%	-0.41%	-17.36%	N/A	N/A	4.93%
S&P 500 Index				15.29%	24.56%	10.01%	15.05%	12.86%	N/A

Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, as of 6/30/24. NAV denotes total return performance at net asset value. MP denotes market price performance. **Past performance is not indicative of future results.** Investment returns and the principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance and to download the respective Fund prospectuses, click [here](#).

Figure 2b: WCLD’s Journey through the Calendar Years



Source: WisdomTree, specifically data from the Fund Comparison Tool in the PATH suite of tools, for the period 12/31/19–7/31/24. NAV

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The BVP Cloud 100 List Is Out!

The BVP Cloud 100 list is something we have been following in earnest since 2019—[WCLD](#) was launched during the 2019 event.⁵

[WCLD](#) comprises a basket of publicly listed equity investments, and the BVP Cloud 100 comprises the 100 most significant private cloud companies—but the largest and most impactful private companies may foreshadow what we see over the coming years in the public equity space.

There have been nine versions so far of the Cloud 100 list. Figure 3 indicates summary information of this journey back to 2016:

- The list value at C100 (Cloud 100)—we have seen that go from \$99 billion to \$820 billion in 2024. This is the total value across all 100 companies, so we have seen this figure getting to a point where we are thinking about that 10x type of increase.
- Possibly the starkest statistic in the figure regards the number of exits. Eighty in 2016. Three in 2023. We don't have indications that 2024 will be a big year on this front—but it is only about eight months in.

Figure 3: The BVP Cloud 100 List Highlights across Time (2016 to 2024)

	2016	2017	2018	2019	2020	2021	2022	2023	2024
CLOUD #1	slack	stripe	stripe	stripe	snowflake	stripe	stripe	OpenAI	OpenAI
CLOUD #100	Skyhigh	Canva	pendo	DASHLANE	LaunchDarkly	AXONIUS	Front	DeepL	ABRIDGE
LIST VALUE AT C100	\$99B	\$116B	\$138B	\$166B	\$267B	\$518B	\$738B	\$654B	\$820B
TODAY'S VALUE	\$582B 5.9x	\$794B 6.8x	\$741B 5.4x	\$674B 4.1x	\$714B 2.7x	\$681B 1.3x	\$698B 0.9x	\$784B 1.2x	\$820B 1.0x
# EXITS	80	75	63	48	35	20	4	3	-
EXIT VALUE	\$279B	\$320B	\$320B	\$282B	\$252B	\$113B	\$14.8B	\$14.8B	-
AVERAGE EXIT VALUE	\$4.0B	\$4.8B	\$5.6B	\$6.4B	\$7.4B	\$7.0B	\$7.4B	\$7.4B	-

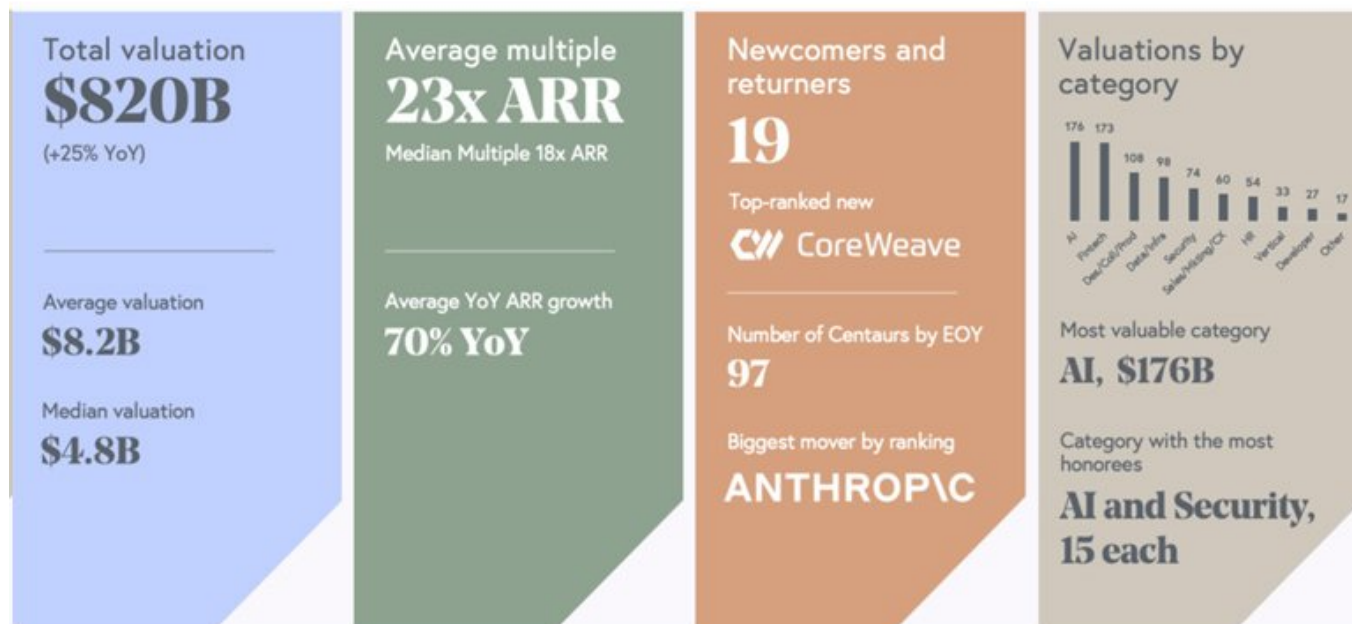
Note: Exits with undisclosed valuations have been excluded from exit value calculations; 2023 had one exit with an undisclosed price; 2022 had two exits with undisclosed prices

Source: Bessemer Venture Partners.

We saw in figure 3 that OpenAI has attained the top position now for two years in a row (2023 and 2024). There is some time yet to compete with Stripe's five out of nine years in the top spot, but we see in figure 4 that as a category—AI—we have a massive overall valuation of \$176 billion.

What's more interesting about this "AI" category is that it only started being included in 2023, so in 2022, it was not even being tracked or on the radar of the Cloud 100.

Figure 4: Summary of Highlights from 2024's BVP Cloud 100 List

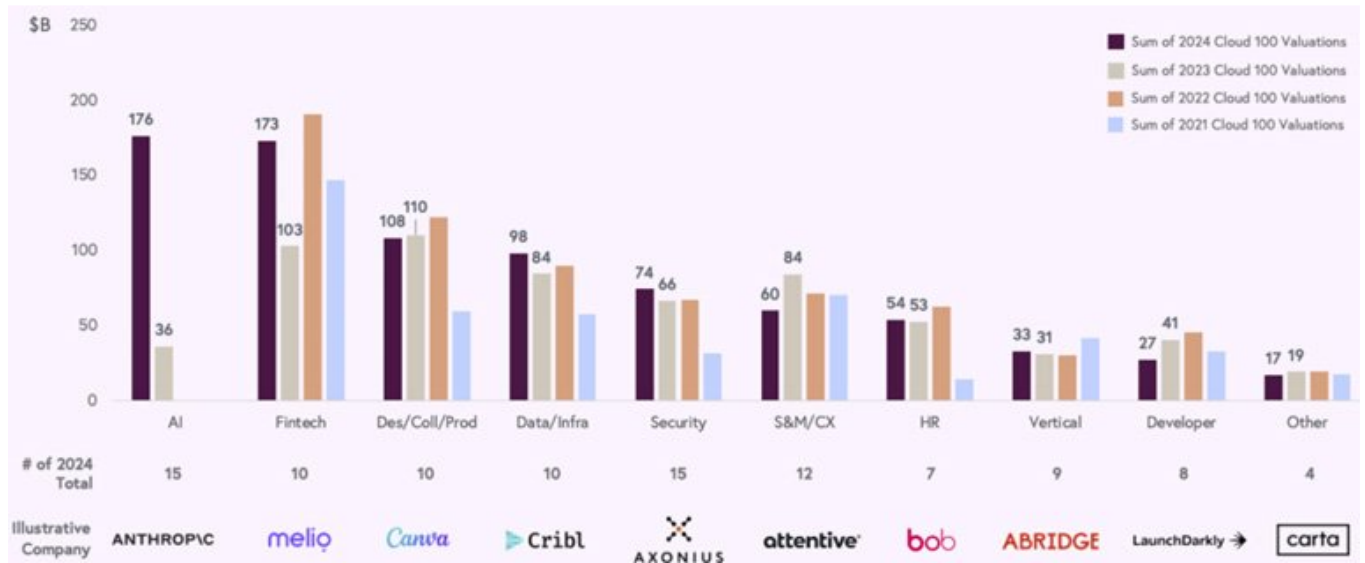


Source: Bessemer Venture Partners.

In figure 5, we see that three overall functional groups of companies in the Cloud 100 achieved an aggregate value greater than \$100 billion.

- AI: \$176 billion
- Fintech: \$173 billion
- Design/Collaboration/Productivity: \$108 billion

Figure 5: It's Useful to Know Where We See the Biggest Private Software Companies



Source: Bessemer Venture Partners.

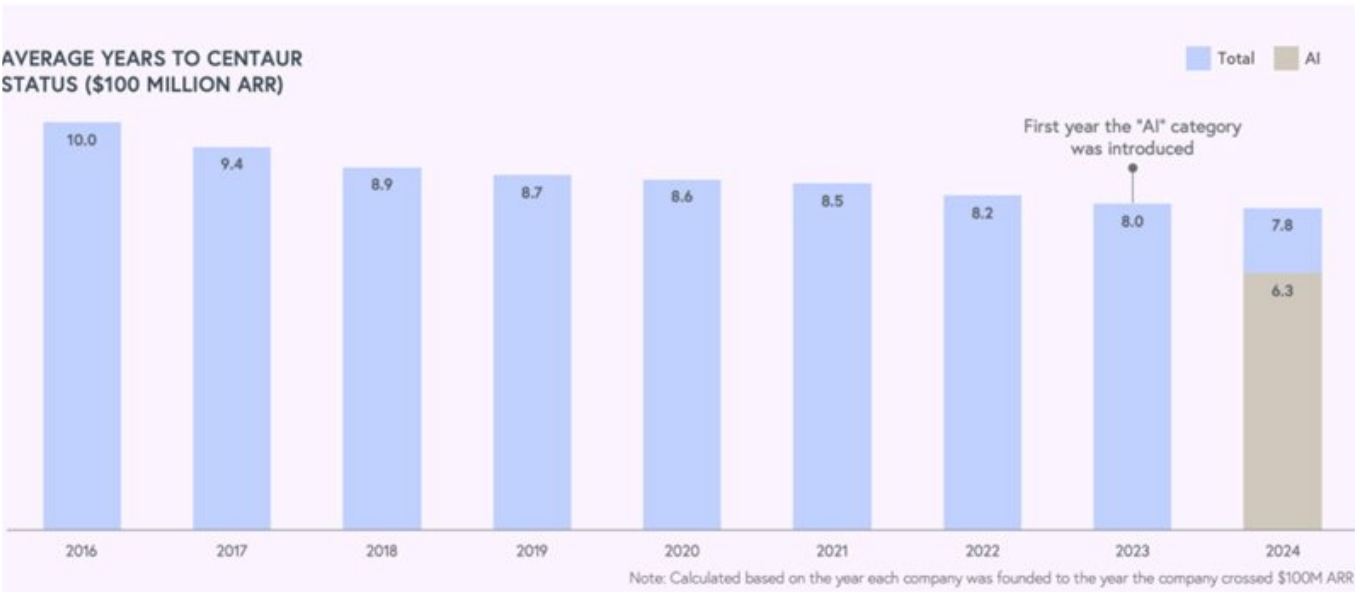
It's funny to take a step back and consider, as someone following developments in technology markets, the last time I heard the term "unicorn." This was the term used for a company in the private market that achieved a valuation of \$1 billion or more. A "decacorn" would be a company in the private market that achieved a valuation of \$10 billion or more.

The Cloud 100 companies have a value of \$820 billion, an average value of \$8.2 billion per company.

BVP, a few years ago, shifted the thinking from the idea of the "unicorn" valuation to the "centaur"—companies that are able to achieve \$100 million or more in annual recurring revenues (ARR). This means that they are convincing customers to sign up and pay them this amount on an ongoing basis—far more impressive than simply raising money.

What's interesting—and figure 6 only allows us to look at one year—is that AI companies are taking an average of 6.3 years to hit centaur status. The general company in the Cloud 100 is taking 7.8 years. With cloud companies, speeding up the trajectory to get to major revenue milestones is significant.

Figure 6: How Long Until "Centaur" Status?

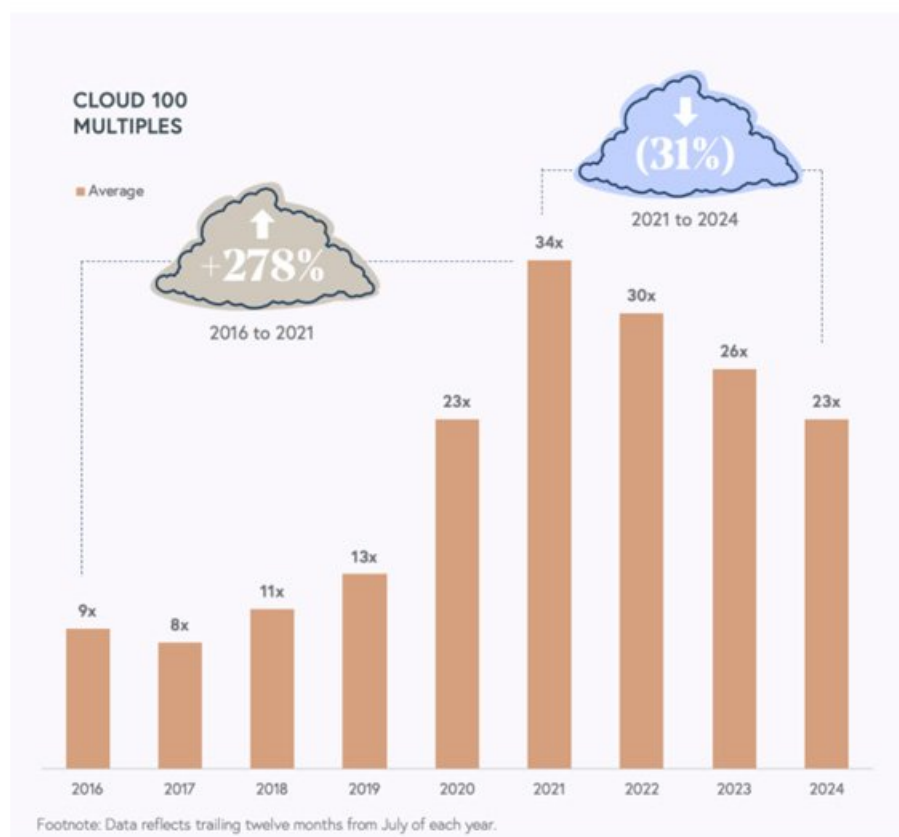


Source: Bessemer Venture Partners.

Finally, within software, it does make sense to think about “valuation, valuation, valuation.” It’s a good measure of inherent risk. When interest rates were zero, valuations peaked at a 34x ARR multiple within the Cloud 100.

In 2024, even with the increase in aggregate value to \$820 billion—it was \$113 billion in 2021—the valuation has gone down to 23x, which is a drop of 31% relative to 2021’s figure.

Figure 7: Evolution of Cloud 100 Multiples



Source: Bessemer Venture Partners.

Conclusion: Software Is Here to Stay

Especially if we consider the “application economy” in our smartphones, there are few things that we use as much as software. BVP has also pointed out in its 2024 State of the Cloud report that we must all remember that the large language models that feel as though they are in almost every AI headline in 2024 are very expensive to develop, train and maintain. Companies that build software on top of these models, using them as a foundation, could have a much more compelling economic proposition—similar to how companies building data centers have different economic profiles than those using the compute resources.

For those with a longer time horizon, software could be quite interesting.

1 [WCLD](#) is designed to track the total return performance of the BVP Nasdaq Emerging Cloud Index, before fees and expenses. This Index has as its main criteria for inclusion the generation of more than 50% of revenues from cloud activities focused on enterprise customers and at least 15% year-over-year revenue growth.

2 Refers to the S&P 500 Index.

3 Refers to the Bloomberg U.S. Aggregate Index.

4 Refers to Alphabet, Amazon, Apple, Microsoft, Meta Platforms, Nvidia and Tesla.

5 Source: D'Onofrio, Mary, et al. "The Cloud 100 Benchmarks Report 2024." Bessemer Venture Partners, 8/6/24, www.bvp.com/atlas/the-cloud-100-benchmarks-report.

Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. The Fund invests in cloud computing companies, which are heavily dependent on the internet and utilizing a distributed network of servers over the internet. Cloud computing companies may have limited product lines, markets, financial resources or personnel and are subject to the risks of changes in business cycles, world economic growth, technological progress and government regulation. These companies typically face intense competition and potentially rapid product obsolescence. Additionally, many cloud computing companies store sensitive consumer information and could be the target of cybersecurity attacks and other types of theft, which could have a negative impact on these companies and the Fund. Securities of cloud computing companies tend to be more volatile than securities of companies that rely less heavily on technology and, specifically, on the internet. Cloud computing companies can typically engage in significant amounts of spending on research and development, and rapid changes to the field could have a material adverse effect on a company's operating results. The composition of the Index is heavily dependent on quantitative and qualitative information and data from one or more third parties, and the Index may not perform as intended. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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