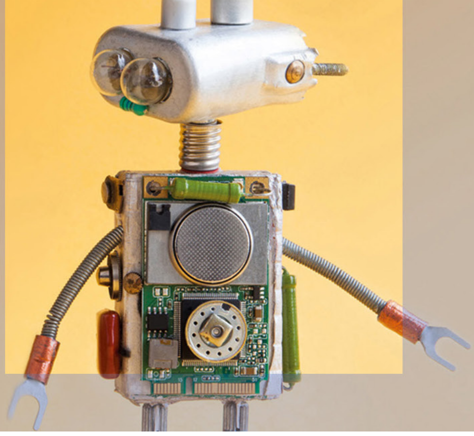

Active is: Investment Insights

www.allianztechnologytrust.com

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Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors may not get back the full amount invested.

Walter Price
Lead Manager
Allianz Technology Trust

With over 40 years of experience of investing in technology companies, Walter Price has witnessed the evolution of the technology sector from the birth of the personal computer to the arrival of the internet and now the shift to cloud computing. Based in San Francisco, giving him close proximity to many of the world's most innovative companies, he heads up the Global Technology Team which manages US$11 billion* in assets.

*Source: Allianz Global Investors GmbH.

Investment Insights from Silicon Valley

Experimental innovation

Technology leaders are paid to be visionaries. It is often their ability to innovate that propelled them to greatness in the first place. 2021 has been a fertile period for big ideas, from SPACs to space travel to the metaverse. How can investors distinguish between a flight of fancy and a genuinely great idea?

We are always looking for new sub-sectors in technology that are exciting and have potential for high growth. There is no shortage of those ideas: the growing 'SPACs' market – where companies seek to raise money for a 'blue sky' idea – is full of optimistic CEOs with big plans. Established companies tend to have innovation hubs, focused on exploration and innovation.

However, there are a number of problems. CEOs have to be optimistic to get funding, which can often make it difficult to judge the real potential of an idea. Equally, very few entrepreneurs have a second act. They have a great idea and build a great company, but often struggle to build on it. This makes for 'shooting star' performance – a good idea is adopted, the stock rises, but then the company disappears into irrelevance.

This is even a problem for great companies with deep pockets. Alphabet, for example, promised to find more businesses as successful as Google with the aim of generating everlasting high growth. However, it has proved very difficult to find those businesses, even with all the resources the company has at its disposal. Waymo perhaps came closest, but results are still mixed.

Innovation is difficult. Our key criteria is whether a new idea brings a benefit to the user that wasn't there before, whether that is cost, efficiency or entertainment. This tends to be easier in medium and larger companies, where we can talk to the users of the product or try it ourselves. For this, we often refer to our Grassroots team, a global network of journalists, field investigators and industry contacts who gather research, talk to companies and industry experts to help us identify new stock ideas and sector trends.

Living in the metaverse

The concept of the 'metaverse' isn't new. It first appeared in Neal Stephenson's 1992 sci-fi novel 'Snow Crash', which imagined a world where avatars would meet, work and socialise in a virtual reality world. Mark Zuckerberg is betting that this becomes mainstream within 5-10 years, renaming Facebook 'Meta' and suggesting it could replace the internet as we know it.

Continues overleaf

Given his track record, Zuckerberg's ideas may be worth considering. He envisages a world where people have digital avatars, which connect for work, travel or entertainment using virtual reality headsets. If he's right, it could be revolutionary, changing the way people live. Facebook/Meta has already made significant investments in artificial intelligence and is unquestionably serious about the change. It has hired an experienced team and is undertaking high quality, real world research.

However, we question the broader adoption of the 'metaverse'. There are undoubtedly a lot of active gamers – the gaming industry is bigger than the film and music industries combined (1.) – but only around 15% of people play immersive games. To suggest this will broaden out to the wider population could be a stretch. It is a trend we think can't be forced.

Payments war

The payments industry has been subject to considerable disruption: new FinTech players have started to encroach on traditional financial institutions and card providers. At times, this has brought the unwelcome attention of governments. The Chinese authorities, for example, were initially keen on electronic wallets, such as those provided by Alipay, but started to get nervous when they realised wallets could disintermediate the banking system. They sought to regulate, which put the brakes on the Ant initial public offering (IPO) last year (it has now been abandoned).

Now we see merchants flexing their muscles. Amazon has recently said it will no longer allow its customers to use Visa on its UK platform. Its complaint is Visa's fees: the retail group is irritated that Visa has increased fees from 0.3% to 1.5% on UK credit card purchases in the EU (2). Its view is that card companies taking too much profit for themselves at a time when higher inflation is putting real pressure on retailers.

There is a bigger threat looming – Amazon says is it considering ending its co-branded cards in the US. The US is the largest consumer market and its loss could be significant. The credit card groups also face new entrants. From next year, Amazon users in the US will be able to use PayPal-owned Venmo.

Merchants have tried to fight back on credit card fees before. Some have tried to pass costs on to the consumer, saying they'll have to pay extra use credit cards – with mixed success. However, Amazon has a far greater power and global reach than other retail groups.

Merchants and card providers are at an impasse. Either way, it seems likely that there will have to be compromise. While the merchants may not like higher fees, it is not in their interest to constrain customer choice. Equally, the card issuers need to maintain as high a usage base as possible.

The influence of cryptocurrency

The other potential complexity for players in the payments network is cryptocurrency. Traditional payment groups face a challenge from their growing popularity. While we remain unconvinced on the investment case, it is unquestionably disrupting the way people think about wallets and managing money. Brokers are making these wallets increasingly attractive.

Governments don't like cryptocurrencies – perhaps understandably. They no longer have control and it may represent a real risk to consumers. Wallets get hacked with surprising regularity. Electronic records are relatively easy to steal and move; it becomes difficult to trace and the money is gone. China has already outlawed Bitcoin and other cryptocurrencies and other countries may follow suit in the next few years. Unquestionably, the sector needs regulation.

The payments industry is in the midst of a significant shake out. There are emerging winners, and some of the incumbents face significant challenges. We are watching closely.

1. https://eu.usatoday.com/videos/tech/2021/06/10/e-3-2021-video-games-big-business-topping-film-and-music-combined/7637695002/

2. https://www.ft.com/content/af1fdbb6-bf89-4c6a-9c70-08a08648d958

Please note that we can only offer information and are unable to provide investment advice. You should contact your financial adviser before making any investment decision.

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