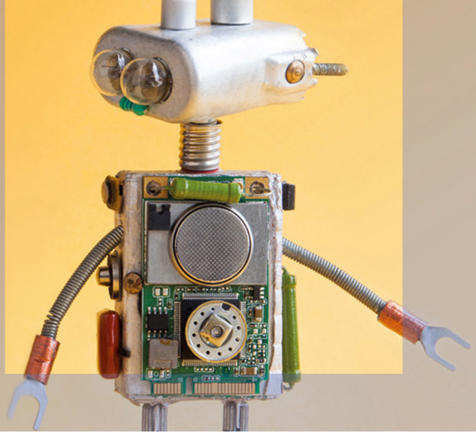

Active is: Investment Insights

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

Optimism versus pessimism

There is a tug of war in financial markets today: there is real concern that the stimulus programme will generate inflation and therefore higher interest rates. The recovery has been notably stronger than many expected, particularly in the US. The market is worried that it is running too hot and, perhaps, this is the top of the cycle with market valuations suggesting high expectations for growth.

This is set against the ongoing backdrop of a virus that continues to evade attempts to suppress it. It is still surging in India and across parts of Europe. Investors are rightly wondering whether another surge in the virus could create real disruption, forcing further lockdowns and economic pain.

The push and pull between these forces explains the shrug that has greeted results from the major technology companies. Many of the technology giants recorded excellent first quarter results: Alphabet, Facebook and Amazon in particular. Apple showed some caution about the next quarter because of the semiconductor shortage, while Microsoft was largely in line with expectations. In spite of encouraging results, share prices have been lacklustre.

We recognise that there are concerns on rate rises and, increasingly, corporate tax changes as well. We moved our portfolio to give it more of a 'value' flavour around six months ago. That said, more recently we've been looking to reinvest selectively in some of the higher growth companies because their valuations look more appealing given their strong results and slipping share prices.

Advertising and ecommerce

Many of the larger technology companies have good operational leverage and should benefit significantly from the recovery – they have relatively high fixed costs, so show a huge increase in earnings when revenues recover. In particular, we expect to see a rebound in advertising, as companies gear up for the year ahead, hoping to attract a share of the stimulus cheques.

Continues overleaf

There is a significant shift in the balance of advertising from TV to ecommerce, which directly benefits technology giants such as Facebook and Alphabet. It is well-established that the pandemic prompted a move to online shopping. Companies are now saying that the rise in ecommerce wasn't simply a COVID phenomenon, but it looks like habits have permanently changed. We believe ecommerce will continue to see good growth throughout 2021 and 2022, even as people go back to stores.

In 2020, around 40% of advertising money was spent on TV with the remainder spent on digital advertising. All areas of digital advertising showed growth in 2020, in spite of an extraordinary year. At the same time, TV advertising saw significant declines.

Partly, TV suffered from a lack of sporting events, but there are longer-term phenomenon at work. Online alternatives are numerous, effective and relatively inexpensive. The advertiser is deserting linear TV because they're getting much better results from Facebook or Google, where they can target their consumers more accurately. This is in contrast to linear TV, where advertisers could be blasting out ads to an indifferent public. This shift is allowing digital advertising companies to push up their prices. We see this phenomenon building momentum in the year ahead.

Semiconductor shortages hit the auto sector

For much of this year, the world has been in the grip of a semiconductor shortage. In the first quarter, semiconductor companies ran through their buffers, using up inventory to meet existing obligations. Now, in the second quarter, they find themselves still limited by production difficulties, plus a fire at a major Japanese supplier to the auto industry and a shortage of water in Taiwan.

The impact of this shortage has been far-reaching, hurting production of everything from hairdryers to laptops. However, it is in the car industry that the biggest impact has been felt. Ford, for example, recently said it would shut down its factories and miss its production targets because of chip shortages.

Modern cars are chip-intensive: any new-build car will use semiconductors for areas such as emissions control and safety. Electric cars use even more. It was always a lean supply chain and now car companies can't get hold of the chips they need. Some of the auto stocks are being hit hard, because they can't make cars.

The shortage should start to resolve in the third and fourth quarters, but it will take until 2022 to normalise. Many of the semiconductor companies have been reporting good earnings as a result. There are lingering concerns that they may add too much capacity and this might be good as it gets, which has prompted some profit-taking. However, our view is that there is a secular trend towards semiconductors in the economy, whether it's autos, cloud computing, more sophisticated cars or high functionality laptops.

Healthcare and the cloud

Big data can legitimately claim a role in the vaccine rollout. Moderna took just two days to come up with the vaccine formula once it had the genetic sequence of the vaccine. The remaining time was focused on testing and approvals. This neatly highlights the power of next generation cloud computing. As we see it, it could be running companies' more mundane operations in the years to come.

The drug industry will be one of the major users of these new data systems. The power of cloud computing, combined with new software, allows healthcare companies to upload swathes of patient data, which in turn allows speedy analysis: are they running trials effectively? Should they change the dosage? What anomalies are emerging? Healthcare is one of the largest sectors for data warehousing group Snowflake. It reports the drug industry transitioning to put more of their data into the system to be able to do analysis on that data.

The healthcare industry is likely to see a revolution post-Covid, with the pandemic exposing not only a worrying lack of resilience, but also the extent of what may be possible in drug development. In our view the cloud has a vital role to play.

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