



Active is: Investment Insights

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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.



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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

Shortages across the supply chain

Recent earnings announcements have shown the tough reality of staff shortages for many companies. Amazon, for example, has said labour inflation will add \$2bn to its cost base in the fourth quarter (1.) Companies report that they are having to raise wages not just to recruit new staff, but to keep existing ones. The US Labor Department has released statistics showing wages and benefits rising faster than at any time since 2001.

Parts shortages are also weighing on industrial companies. Initially this was just semiconductors, but this has extended to areas such as plastics or glass. This is intertwined with the labour shortages – ships are stuck in harbours around the globe because the freight companies can't get the workers to offload them. It is a problem of supply and of distribution.

These shortages are affecting all sectors and technology is no exception. The weakness is spreading through the value chain – if there are no cars to sell, automakers won't spend on advertising, for example. Manufacturers can't meet the demand for mobile phones or disc drives because they don't have the relevant pieces to complete the kits. While some companies have accumulated enough inventory – Apple, for example – it is a significant and far-reaching problem.

In the longer-term, however, a shortage of labour should be a tailwind for technology adoption. Companies will try to increase productivity with a smaller number of people. This is already happening – Toast, for example, helps automate all areas of running a restaurant, including order entry, menu management, analytics or online ordering. It IPOed in September at a value of \$20bn (2.) Square, a long-term holding in the portfolio, has also been a beneficiary of this productivity drive.

Deep Mind: a maturing business?

Deep Mind has been the public face of artificial intelligence: a pioneer and an innovator, but has consistently posted losses of hundreds of millions of pounds since its launch in 2010. However, its most recent filing showed a tripling of revenues and the company hitting profitability for the first time.

This feels symbolic. It shows a maturing of the artificial intelligence industry and the increasing number of real world applications for it. Deep Mind, owned by Alphabet since 2014, started out doing academically interesting AI projects, such as teaching a computer to play Atari games from scratch or beating world champions at chess, but without obvious practical application.

That has changed significantly. The group's programs include effective diagnosis of eye disease, energy management of data centres and predicting the complex 3D shape of proteins, which could transform drug development. Another potentially lucrative area is the ability to do short-term weather forecasts. This is valuable for airlines, sports fixtures or travel companies. Artificial intelligence has come of age.

Facebook's tough choices

Facebook has been under fire. A highly critical piece in the New York Times accused it of creating real social harm, from body image problems in young girls, to vaccine misinformation (4). A whistleblower, Frances Haugen, exposed some of the internal working of the company, showing how it has focused ruthlessly on getting more people to spend more time on the app, regardless of the harm that may be causing.

This shows the need for government regulation of social media. This inevitably takes time. Cigarettes showed more obvious and immediate harm, but it took decades for cigarettes to be properly regulated. However, the yawning gap between the responsibilities imposed on conventional media and those that apply to social media is likely to become impossible to ignore and is a real risk for companies operating there.

There are other concerns. Apple has reduced the ability of Facebook to do attribution analysis through cookies, for example. As such, advertisers can't get such granular data. The returns on advertising through Facebook are less obvious and more confusing, YouTube and Google are far clearer.

Facebook has been relatively resilient in the face of these short-term pressures on growth and we believe it should, ultimately, be able to adapt. However, there will be fines and lawsuits and the company needs to show it is serious about addressing the problems.

1. <https://www.ft.com/content/b53a99ec-a835-4a5a-9efc-4d778515237b>
2. <https://www.cnbc.com/2021/09/22/toast-surges-in-nyse-debut-after-ipo-valued-company-at-20-billion.html>
3. <https://www.cnbc.com/2021/10/05/alphabets-deepmind-lab-turns-a-profit-for-the-first-time-ever.html>
4. <https://www.nytimes.com/2021/10/04/technology/facebook-files.html>
5. <https://www.theguardian.com/technology/2021/oct/06/amazon-opens-first-uk-bricks-and-mortar-non-food-store-bluewater-kent>

Hybrid commerce

Amazon has opened its first non-food physical shop in the UK, with books, electronics, toys, games and homeware. The outlet is based at the Bluewater shopping centre in Kent and uses online shopping data to judge which lines to run. This is the latest frontier in retailers experimenting with models of hybrid commerce.

The reasons behind these new openings are sound. Ecommerce is still less than 20% of overall commerce and Amazon is trying to make inroads into the areas it doesn't yet have a presence. This may be its first venture of this kind in the UK, but it has been tried already in the US. Amazon opened a Prime shop in New York City along similar lines.

The problem is that the New York Prime store doesn't seem to have done all that well. While we understand that Amazon is experimenting and seeing what works, to our mind a physical store presence makes far more sense in groceries and convenience stores than for books or toys. There is certainly incremental business to be captured, but it doesn't justify a wider rollout of physical stores.



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