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Investment Insights from Silicon Valley

www.allianztechnologytrust.com

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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\$4.5billion* in assets.

*Source: Allianz Global Investors GmbH as at September 2015.

The state of e-commerce

It seems pertinent to discuss e-commerce as the holiday season is here. Online retailing has long been a growing trend, but the rate of growth continues to surprise. The third quarter retail sales statistics from the US Department of Commerce showed e-commerce sales up 15.7% quarter on quarter and momentum appears to be building.

This isn't confined to the US or UK. China's 'Singles Day' defied all expectations. The 11th November proved true to its billing as the 'World's biggest shopping day' with Chinese shoppers spending \$17.8bn (£14.2bn) in 24 hours. Chinese e-commerce giant Alibaba, which we hold in the Allianz Technology Trust portfolio, owns the trademark for Singles Day and is its prime beneficiary. This year, KPMG believes its online sales on the day may have reached over \$20bn.

US rival Amazon, one of the Trust's top ten holdings, has not been a major winner in China; it misread the local market, believing that consumers would want quality goods. Instead they proved particularly price sensitive. Amazon has learnt its lesson and in places such as India has delegated its build-out to local experts.

However, it does look likely to have a better year domestically. Last year was disappointing for many Amazon customers with some not getting their goods until after Christmas. This year, it has spent a great deal on logistics to avoid the same mistake. Customers should have a good chance of getting their goods by Christmas, and Amazon of having a profitable season.

Amazon Echo

Amazon also looks as if it will have one of the top-selling consumer products this year: Amazon Echo. It is building globally on the success of the product in the US, where – according to a new report from Consumer Intelligence Research Partners – 5.1 million of the 'smart speakers' have been sold since its launch two years ago.

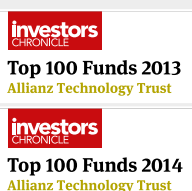
For many consumers, it will be their first significant exposure to artificial intelligence, though we believe it will be increasingly in evidence throughout 2017 and beyond. Amazon Echo is the just the start of a fully voice-controlled home. Amazon has made a significant investment in voice-based technologies with a \$100 million fund, designed to invest in those companies making breakthroughs in the sector. Amazon Echo may have some challengers, however, with Google Home now in the mix.

We believe that we will see other commercial uses for artificial intelligence. In particular, steps will be made towards autonomous driving. Although the full autonomous car is probably a decade away, within the next two years we are likely to see technology taking over the 'boring' bits of driving such as when you are stuck in traffic.

The Trump effect

The immediate impact of the victory of Donald Trump in the Presidential election on the technology sector has been negative. The outlook for a number of sectors has improved under Trump: for industrials, for example, because of the potential

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for infrastructure spending, or for healthcare, because the looming threat of Democrat reform has been removed. Investors have rotated out of technology into these sectors where prospects have improved.

There are also concerns for technology in the longer-term: If Donald Trump manages to push through significant fiscal stimulus, technology stocks may – to some extent – lose their advantage. In an environment where growth is easy, why buy a secular growth sector? Then there is the threat of greater protectionism. Technology companies have huge, international supply chains and could lose out if Trump seeks to impose trade tariffs or otherwise damage relations with China.

Having said that, technology is usually seen as a beneficiary of stronger economic growth and there is no reason this should be any different. Equally, we believe that it will be a long time before iPhones are made in the US. Certainly, there is a trend to move manufacturing closer to where goods are consumed, but this is not likely to take the form of lots of expensive labourers in rural America. It is almost certain to take the form of greater automation and this will be good for segments of the technology industry. We are already looking to invest in those companies likely to benefit from this drive to automation, taking money from some of the higher growth companies in the portfolio.

Value versus growth

Although the impact of President Trump remains to be seen, the prevailing market mood has prompted us to adopt more of a value tilt in the portfolio. Technology is often seen as a growth investment, but had broadened in recent years and now includes high growth companies, such as Facebook, or more 'annuity' style businesses, such as Apple. We hold both in our portfolio but we'll always aim to have a blend, endeavouring to tilt the portfolio to reflect relative valuations and market conditions.

There can be little doubt that some of the higher growth stocks became very expensive. In a low-growth world, the ability to achieve high earnings growth was considered valuable and shares were bid higher. Most have achieved the expectations set for them. Facebook and Amazon, for example, continue to meet and even surpass earnings expectations.

However, the mood has changed. Investors have become more sensitive to valuation and there has been a steady decline in the ratings for these higher growth companies. These companies need sustained high growth rates to justify their ratings and for the stock to work as an investment. They tend to be punished at any sign that growth is slowing.

As economic growth picks up, earnings growth will be easier to come by. As such, the growth generated by these companies is

less valued by the market. Although we still have faith in the long-term growth outlook for many of these companies, we believe it is the right time to shift the portfolio.

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