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Investment Insights from Silicon Valley

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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 billion* in assets.

*Source: Allianz Global Investors GmbH.

The online advertising boycott

Recent weeks have seen considerable controversy around online advertising. Google's European boss was forced to apologise after adverts from companies and government agencies appeared next to extremist content on YouTube. Major international businesses have withdrawn advertising from the site and there were calls for the group to pay back advertising revenue.

This is an important issue and could act as a real brake on the growth of certain social media sites. YouTube has been billed as a significant growth engine of the future for Google (which we hold in the portfolio), because search advertising is not growing very fast. However, this problem needs to be addressed, and swiftly, to preserve the group's reputation.

At the moment, YouTube can specify the type of person that is watching certain content – how old they are, where they live, their video preferences. However, it doesn't have a quality screen for content. As a result, advertisers may be getting a targeted group of people, but they may not be getting the right brand associations.

YouTube is taking steps to address the problem, using artificial intelligence for better categorisation of its content. We believe this will ultimately come to Google's rescue.

In the meantime, Facebook (which we own) is further ahead in terms of curating content. Admittedly, it doesn't have as many videos on its site, but it has been hiring people in India and Brazil to help identify rogue content in different languages. It is being a lot more proactive than Google and we see this as a positive solution.

This is indeed a menace for all social media.

Providers need to get a grip on rogue content, from extremist material to trolling. The more it happens, the less people want to engage with the site and that is of course the biggest problem of all.

The decline of tablets: does it matter?

It seems like only yesterday when tablets were the new kid on the block, but they have already started to lose share relative to PCs and mobiles. Reports from the International Data Corporation showed tablet sales down 15.6% for 2016 over 2015. This is after many years when tablet growth significantly outpaced that of PCs in particular.

The decline has been attributed to the vogue for detachable devices and lap-top/tablet hybrids. People often bought tablets to replace PCs, but PCs have got a lot better – providers have built better keyboards and better storage. Consumers can now buy a neat, detachable PC that is touch-sensitive. This weakens the case for a separate tablet.

The market for PCs and tablets is mature. PCs are advancing while tablets are little changed. The iPad doesn't need frequent replacement: it is for email, kids games, or to watch movies. As such, they don't need to be replaced as often as mobile – they don't break as often, or get dropped, or lost. There is also competition from mobile phones, which are getting bigger. As a result, the replacement cycle on a tablet is significantly longer than on a mobile phone - up to 4-5 years.

Is it a threat to Apple or Samsung (both holdings in the portfolio)? The lengthening replacement cycle on mobiles is a greater concern because it is a far

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higher proportion of the business. iPads are around 10-15% of Apple's business. This is why Apple is working so hard on the iPhone 8. This will have a new screen and improved functionality, and is due to be released in the Autumn. If Apple can push the replacement cycle from 3 years to 2.5 years, it could be a significant source of revenue growth.

Amazon's move into grocery

Amazon (which we own) has set its sights on the \$800bn grocery market. In some ways, this is not surprising; grocery is a huge market and something for which consumers regularly shop. As a result, it is very attractive for frequent upselling. Amazon has been experimenting with this market for some time however, and it remains very competitive. Can it make it work financially?

Amazon is not alone in moving into this market: groups such as Alibaba are also trying to crack it. The rewards for those who exploit it successfully are promising: online sales are set to be around 20% of the overall grocery market by 2020. Amazon's goal is to become a Top 5 grocery retailer by 2025.

There are plenty of experimental models. Amazon is trying the convenience store model through its Amazon Go stores. These use cameras and artificial intelligence to deliver a check-out free experience. Elsewhere, they are delivering food from warehouses or encouraging customers to pick up food on their route home. They are diversifying their strategy by trying different models in different countries. Slowly, it is starting to work.

Amazon has been building out its own delivery force with drivers that it pays by the hour, or pays per delivery. The group is hiring over 100,000 people and most will be within this new infrastructure. Having built up its delivery system, it is now trying to ensure it works for them as efficiently as possible. As it finds the method that works, it should be an important development.

Gaming: the new superbowl?

The gaming industry has had its ups and downs, but eSports may yet move the dial for gaming groups. eSports turn gaming into a spectator sport and while comparisons with the Superbowl may be overblown, eSports attract a loyal and dedicated following and is an important reason why we own groups such as Activision.

The latest predictions put eSports global revenues at £1bn by 2020, with an audience of around 600m people. Already, it is big news, with large audiences, strong franchising opportunities and plenty of ancillary products. It has even attracted interest from major sports teams - French football club Paris St-Germain has created an eSports team, while some of the major UK clubs also employ professional gamers.

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