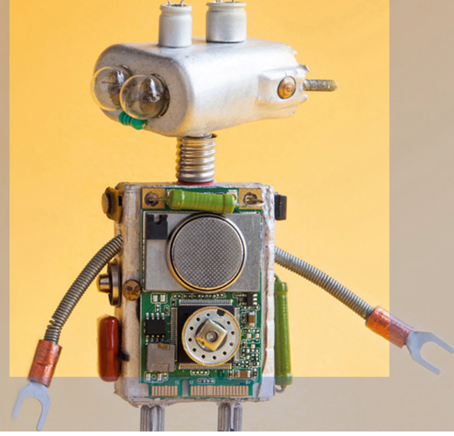

Active is: Investment Insights

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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.

Investment Insights from Silicon Valley

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$4 billion* in assets.

*Source: Allianz Global Investors GmbH.

A new reality for tech?

This has been a tough time in the technology sector (among others). Global equities sold off sharply in October, the worst month for technology stocks in a decade.

The market was capricious in the stocks it chose to punish. Those companies that have been the strongest over the past nine months were hit hardest. This is perhaps not surprising. Many of these stocks had high expectations built into their share prices and were ripe for a fall. The slightest hint that they were not going to meet their growth targets was enough to send share prices tumbling. Some even sold off with no hint of weakness. Netflix, for example, beat earnings expectations, adding nearly 7 million new subscribers over its third quarter (a new record for Netflix) and said it would add another 9 million in the last quarter of the year. Netflix ended the quarter with 137 million streaming members worldwide, but this has not protected it from the recent rout

What is going on? In general, we believe, investors are worried about a recession in 2019. This would be triggered by the Federal Reserve raising interest rates, which would in turn slow the economy. This risk can't be dismissed. Tariffs can be inflationary and the Federal Reserve may feel forced to act. That said, there is the counterbalancing force of the President, who has said he considers the Federal Reserve to have 'gone crazy' over interest rate rises. "To me the Fed is the biggest risk, because I think interest rates are being raised too quickly" he said at the end of October.

There are signs that the global economy is slowing and shifting into a lower gear. Confidence is much lower. A second order effect of tariffs is that companies are not buying machinery from the US. With this in mind, the Fed is under pressure from the US administration to respond to any weakness it sees. The US tax rate reform has added 10% to earnings growth, but it won't be there in 2019. We believe it is more likely that the Federal Reserve will moderate its tax increases as the effect of the tax cuts wears off and the markets will take any indication of lower rates favourably.

The prospects for technology in a slower growth world

Technology has historically been seen as a cyclical sector. However, there are many reasons why this is no longer the case. This is perhaps most evident in the enterprise software sector: from our research, companies across many sectors are determined to continue their digital transformation projects. For software-as-a-service companies,

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there doesn't have to be strong growth to justify the current valuations, it just has to tick over. When we listen to companies talking about their plans, CEOs continue to be focused on transforming their businesses and making them more efficient. This is a necessity in many cases to stay responsive to their customers.

This transformation is still in its early stages and is unlikely to be derailed. In many cases, companies are transitioning from decades-old software and the new software they are adopting will be embedded in their technology infrastructure for decades to come. For investors, this means that the return from these companies is less cyclical and more like a long-term annuity. Even if economic growth slows, there are technology companies that can thrive.

Slowing China?

There are understandable fears of a slowdown in China. After years of eye-watering annual growth, the most recent growth figures show the economy expanding at its slowest rate since the global financial crisis of 2008-9, albeit still a formidable 6.5%. The US-China trade war has been an important factor in this slowdown. Revenues are falling and companies are increasingly choosing not to build manufacturing plants in China because it is such a clear target for the Trump administration.

While the Chinese economy is seeing a shift from its old manufacturing base to a more consumer-led economy, manufacturing is still important and these problems will be a major headache for the Chinese economy. Over time, the country's manufacturing base has been the major stimulus for the country's growth. If that is over, is there any reason why it would grow faster than the rest of the world? In a recent visit, we saw real uncertainty among manufacturing companies. They were worried about the actions of the US government and the decisions global companies would take.

The key question is whether Chinese companies can adapt. Many Japanese companies faced a similar problem in the 1980s when the US launched a trade war. Some companies adapted, building plants in the US. They thrived and became more valuable as a result; those that didn't saw their business deteriorate. It is difficult to see the Chinese government giving in on trade tariffs so it is important companies find a way to adjust to a new reality.

As for those non-Chinese technology companies that could be influenced by this weakness, Apple has good penetration in China with a meaningful share of the high end mobile market. It is its second most important market globally. As such, it could face problems. In contrast, Facebook has only just gained a licence to operate in China. Amazon has also never managed to penetrate significantly with domestic giant Alibaba dominating the market.

The virtues of diversification

There has been a raft of specialist technology funds launched in recent months – from robotics to artificial intelligence to future trends. These are all worthy themes and ones that we play to a greater or lesser extent, through Allianz Technology Trust.

However, we would still argue that a diversified technology fund has its advantages. Robotics, for example, has had a very difficult year for some of the reasons we mention above. Robotics groups were building new products to meet the demand in Chinese manufacturing and orders have fallen through the floor. If this is a fund's only area of focus, where do you go in the meantime? Having a broader technology fund allows rotation between different sectors and we believe having that flexibility as industries change is really important.

This is no recommendation or solicitation to buy or sell any particular security. A ranking, a rating or an award provides no indicator of future performance and is not constant over time.

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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