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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.

Cryptic cryptocurrencies

There can be few technology phenomena that have attracted as many headlines as cryptocurrencies. Although they have been around since 2009, interest has hit fever-pitch in 2017, with around 900 digital currencies now available.

The technology can be used to trade bonds, stocks and other financial assets. Companies in search of early-stage funding believe it may help them circumvent the need for venture capital, potentially allowing management to retain greater control. However, their uses to date have been limited, and the prices extremely volatile. Investors are apparently willing to pay high prices for a technology still in its infancy.

A lot of people have already made a lot of money from cryptocurrencies; the question is what will happen when the party ends? From our analysis of the market, many market participants are buying into cryptocurrencies with the idea that they can trade them, rather than examining what they really own. This is leading to some clear excesses in the market. We are seeing this in the private equity and venture capital areas, where it is helping to drive valuations higher.

Worse, we see that in some cases cryptocurrencies are being used as a way to support criminal activity. Cryptocurrencies can be a way to transact and to make these transactions invisible, moving money to places where it can't be traced.

To our mind, the market looks unstable. For many, dealing in cryptocurrencies is simply gambling – aiming to sell at a higher price than the purchase price. Equally, at the moment pricing seems to be too volatile for it to be of significant use for, say, sending money to relatives in another country. As such, there is not a lot supporting the business models of these cryptocurrencies. The underlying technology of a unique ledger has a place and cryptocurrencies may yet be a way for companies to transfer money at reduced costs. However, for investors, our view is that it looks like a house of cards.

Is robotics changing the outlook for emerging markets?

For some time, it has been commonplace for developed market countries to do their high-end development domestically, and their manufacturing more cheaply in emerging markets. This has generally been good for both sides. It has boosted developed market economies, while improving margins for Western companies. However, there is a danger that the rise of robotics threatens that model. If manufacturing can be done by a robot, what does that mean for emerging market economies?

It is important to differentiate between the types of robot. The first is a physical robot that does a task. What we're seeing is that the low-cost manufacturing countries are installing robots faster than anywhere else. Those groups building the iPhone in China, for example, are making widespread use of robots to reduce their costs. We originally thought it might bring manufacturing back to the US, but that is only likely to happen if the tax laws change and it becomes easier to build factories.

There is another type of robot that looks set to deal with clerical tasks, such as healthcare or insurance claims, changing a plane reservation or a supplier. The popular model has been to work out what is needed and outsource to low cost centres, such as the Philippines or India, where they have language skills. However, increasingly companies are looking at those tasks, applying artificial intelligence and automating them. It could be by voice, or on the web, which it is felt gives better customer service and at a lower cost. This trend could be more problematic for certain emerging markets.

Some of the companies involved in this are familiar names that we hold in the Trust's portfolio - Google, Microsoft and Amazon, for example, who are helping to move voice recognition technology into the cloud. Then we also own Blue Prism, which allows companies to do a lot of this artificial intelligence on their own premises.

Technology companies and the US Senate Tax Bill

It has now been said that the US Senate Tax Bill could be passed with a simple majority in the Senate, making it easier to implement. The constraint is that it can't be too much of a budget-buster, and must not add too much to the deficit. However, this recent development paves the way for the tax bill to be passed faster. Detail is still relatively light. We don't yet know who will be hit, and who will benefit. At the moment, the administration is throwing ideas out and seeing what sticks.

In terms of what technology companies would like to see, the largest companies tend to be very efficient with their taxation anyway, so any tax cuts won't have a significant impact. The medium-sized domestic companies, who are usually full-rate tax payers, are likely to see a greater benefit. However, the biggest impact is on the over-$700 billion 'trapped' overseas by the large potential tax bills were it to be repatriated to the US. The extent to which this 'toll' tax is reduced would allow money to flow back.

The EU tax bills are another major issue. It has been commonplace to put intellectual property in a low tax area, pay royalties on that, but equivalent only to a very low tax rate. This scheme is unlikely to work for much longer and increasingly companies are going to pay tax in the jurisdiction where they are doing business. This may have an impact on the free cash flow of technology companies, but this is largely in their value already.

Apple's product cycle

The way that Apple staggered the introduction of the iPhone 8, 8+ and X has created considerable confusion on orders and prospects. On the positive side, margins are probably going to be better than people had modelled, with people attracted to the larger, more advanced phone. The latest pre-orders are also reasonably robust. This is a two-year cycle and people will continue to upgrade.

The phone is the new platform for Apple's innovation for the next five years. Costs look likely to come down for facial sensors, so Apple is likely to take that technology to their whole line. Our view is that 2018 should be a reasonable year. We are not too negative given the low valuation and extended product cycle.

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