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Investment Insights from Silicon Valley

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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$4 billion* in assets.

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*Source: Allianz Global Investors GmbH.

Messaging apps

The world of messaging is more exciting than it initially appears: although messaging apps are ostensibly just a means to communicate with friends, they offer advertisers a means to target an otherwise elusive younger demographic. This is a group that watches relatively little television, doesn't read newspapers and isn't swayed by other forms of advertising, so they are valuable.

Some messaging apps leave it there, but TenCent's WeChat is taking it one step further: users can chat, but they can also shop, order taxis, make payments and share photos, all without ever leaving WeChat. Estimates from August 2016 (published in The Economist) suggest that as much as a third of all time spent on mobile internet in China's mainland is spent on WeChat.

This month saw the group introduce paid content. This company will now allow official, public-facing accounts to charge readers for access to content, an option previously only available to a limited number of accounts. This is important – active users are one thing, making money from them is quite another. TenCent barely makes a profit from its 800 million active users. Revenue streams are currently limited to running advertisements or sponsored posts and this diversification is welcome.

The change is testament to the innovation emerging from the Chinese tech sector. In February 2017, the Financial Times called it a transition from 'imitator to innovator', adding that China is seeing exciting new companies in areas as broad as robotics and artificial intelligence to medical devices and fintech. Not all have come to market, and some are still early-stage, but there are opportunities nonetheless.

A January 2017 report from Citigroup into the Fintech sector estimated that venture capital investment into China doubled in 2016. It fell 38% in the US over the same period. This is narrowing the gap between the two countries - Chinese companies now account 46% of global venture capital investment in Fintech.

That is not to diminish the innovation coming out of Silicon Valley, but it now has real competition from Asia. This is likely to create better technology businesses in the long-term.

A game of catch-up

Car manufacturers and software companies seem unlikely bedfellows. However, a number of companies have joined forces to tap into the growing revolution in the automobile sector, which looks set to see strong technology becoming as important to car manufacturers as strong engineering.

However, Tesla remains dominant in this field. Being a first mover does not always confer advantages, but in this area it has allowed Tesla (held by the Trust)to steal a march on its rivals. At a time when most groups are at the foothills of introducing technology into cars, Tesla's latest model has multiple electric sensors and a radar on every car shipped. We've tested it, and it is a much more capable system, in our view; the previous model was good for driver-assisted use but the functionality on changing lanes, for example, was a

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little sketchy. However, the new system rectifies some of these problems and puts Tesla significantly ahead of everyone else. In our 20-minute ride, the engineer didn't touch the steering wheel once.

Part of Tesla's skill is a 'Silicon Valley' approach to innovation. Rather than endlessly testing in a lab, it rolls out a good first effort and learns on the job. Recognising there is only so much that can be tested under controlled conditions and that computers need real-world input for different scenarios. Every car participates in the training process and they are gaining insight all the time.

For Tesla, the goal is a medium-sized car, the Model 3 – it already has a 400,000-strong waiting list for this model, which is due out in July. This opens up a new front in driverless cars. We can see a future scenario where driver-led driving is outlawed in cities as the safety data improves. These driverless cars are usually safer, with computers not getting distracted, talking on their mobiles, or eating sandwiches. In Singapore, they are equipping the traffic cameras with tracking devices so they can communicate with the cars. Driving is going to change in ways we can barely imagine.

Fake news and the role of social media

'Fake news' has been blamed for everything from the election of Donald Trump, to a gunman incident in a Washington pizza restaurant. This is an issue for politicians and lawmakers, but it is also an issue for social media. 'Fake news' has increasingly been disseminated through social media sites – spread among friends and contacts giving it a veil of legitimacy.

The question is whether this is encouraged by the algorithms inherent in these sites. This is also a problem because fake news articles, erroneous 'teaser' links and other problems destroy the value social media sites are trying to create.

Companies are acting: increasingly groups have moved to try and curate the news that appears on their sites. One company encourages users to remove incidents of apparent fake news, so that it can check its validity and then take off news if it proves to be wrong. Initially, this is being done as a manual process, but the group is developing algorithms to check facts. It is a welcome move to stem the problems of the darker side of the Internet.

Finally, a word on Apple

The ongoing strength of Apple shares in spite of a relatively weak quarter has been notable. There has been a huge change in sentiment as investors anticipate the next iPhone and reappraise its services business. We continue to hold Apple in the portfolio; it has long looked to be a solid reliable, annuity-style business, but investors are starting to recognise that its services business – including iTunes, games and storage - should provide a higher secondary growth rate.

All of its services are growing as a percentage of its installed base, which has seen its services business deliver growth in excess of 20%. Apple management has been clear that investors are not giving them enough credit for the strength of the services business, and it appears that these investors are now starting to believe them.

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