



April 2018

# Investment Insights from Silicon Valley

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## 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.

## Facebook and technology troubles

Facebook has become embroiled in an ugly row over the collection, storage and use of individuals' personal data. The immediate catalyst has been the row over Cambridge Analytica, with Facebook accused of being insufficiently clear with its users as to how the research group had collected and stored their information.

Last month, we considered 'Big Tech' and how its use of technology needs to be balanced by a responsibility to wider society. Although we didn't foresee Facebook's particular use of personal data issue, it seems clear that the new General Data Protection Regulation (GDPR) legislation in Europe may have broader implications than the market had been expecting.

Under the terms of the new legislation, effective from 25 May 2018, companies must ask for permission to share data with any advertiser. This must be specific each time, rather than part of a general one-off request. This, to our mind, could represent a real inhibitor to advertising on a platform in the European Union. It also looks like the EU will enforce the rules to the letter. Our research suggests that this will change the make-up of the Facebook news feed, and as a result, people are likely to be less engaged and could spend less time on the site.

The new GDPR law makes Facebook's business more complicated. While it is still doing well, there are clouds on the horizon. We believe that when it is forced to give users the option to opt out, many will choose not to share.

A final point, however, is that Facebook's shares are down significantly. Markets are aware of the problems and, as such, it may be increasingly reflected in the price.

## Is anyone else affected?

There is a certain irony that many of the clarion calls to remove the Facebook app are being sounded on other social media platforms that gather data in much the same way. This problem will affect everyone who is building a database and tracking users. GDPR says companies need explicit permission and that is what is different. However, Europe does not constitute all their business and the US has been more laissez-faire on the issue.

It is worth saying that the largest Silicon Valley companies rely on brainpower. They have been able to recruit the smartest and most talented graduates with high and attractive starting salaries. However, as much as half of that remuneration will come from share options – valuable if the share price is rising, but of less value if it is falling. To keep these talented people, they need support for their shares. As such, the Facebook fall-out may have wider implications.

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## Our recent China trip

The sensitivity over data is not as present in China. In fact, the Chinese government co-operates with the major technology names of Alibaba and TenCent to gather data on people's shopping habits and social media preferences. WeChat - the closest Chinese equivalent of Facebook - shares its information with the Government.

This means that China is compiling a lot of data. It has been suggested that this enables China to steal a march on artificial intelligence. After all, they have far more data with which to find patterns and develop algorithms. However, we see no evidence that China is obviously more advanced in its technology. The technology within the US 'Big Tech' digital giants is just as sophisticated.

That said, there were plenty of interesting insights from our recent trip. Particularly notable was the amount of time spent on social networking sites in China. The major platform is WeChat, but there are plenty of others, each of which has found a niche in the market. For example, there are entertainment sites, where people will upload videos of themselves and others pay to watch. The sites might put people in contact with talent agencies, who will tell them how to improve their ratings. It's an amazing niche economy that has grown up.

We see people spending 4-5 hours a day on different social media sites. It made us consider – potentially – a stronger future for Instagram or Twitter. The Chinese engage with a broad variety of social media sites. They have their life and their online life. We saw a lot of Western social media ideas being taken and developed differently.

## The tariff problem

It has been a difficult time for markets, prompted by the 'tit for tat' trade tariffs between China and the US. We have to consider how this affects the technology sector. Certainly, many PCs, printers and servers are manufactured in China and the tariffs will hike costs. The longer-term goal of the Trump administration is to ensure that these products are manufactured in the US, but it takes time to get to that point. New supply does not come on stream instantly, and in the meantime, demand may slide.

Tariffs are inherently inflationary. An increase in inflation and rising cost pressures on hardware products in technology will, in our view, encourage companies to reduce rather than replace technology products. We hope it will blow over reasonably quickly, rather than developing into a full-blown trade war.

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