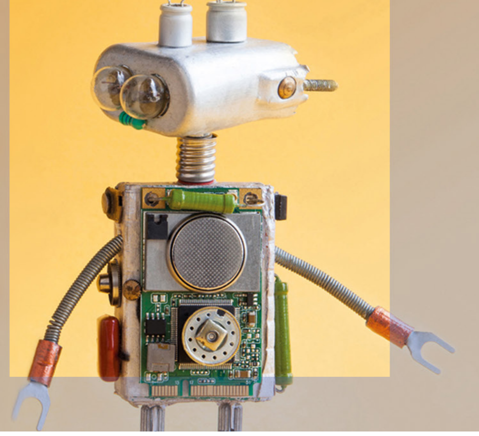

Active is: Investment Insights

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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 dovish Fed

The US Federal Reserve has notably scaled back its ambitions in recent months. It has shown itself responsive to weakening global economic data and taken a pause on interest rate rises for the time being. It is now retaining a watching brief over economic and financial market conditions before undertaking further monetary tightening. This has proved good news for markets in the short-term.

It has become clear that the US has become more sensitive to rate rises. As interest rates moved towards 3%, the US economy started to slow. In particular, housing has proved vulnerable. Whereas in normal circumstances it might have taken interest rates of up to 5-6% to slow down, it has slowed at much lower levels in this cycle. This was conspicuous in high cost areas such as New York, Connecticut and Florida.

This prompted a re-think on the part of the Fed. Previously, it was planning to move back to interest rates in their historic range, but a reappraisal of the economic situation forced a pause. They stopped for a month, looked at housing, at weakening manufacturing orders, plus other leading indicators and decided on a longer-term halt to interest rate rises.

This has important implications for investors. It means those people that were anticipating higher rates on fixed income are likely to be disappointed. The risk-free rate for the 10 year government bond is less than 3%. Pension funds' central assumptions are in the 5-7% range. It is clear they won't meet those assumptions if they simply buy bonds. It also means that private equity cost of capital is lower and they can leverage up companies with more debt. This creates a ready market for those companies with stable revenues and cash flow.

For stocks, it should mean that higher growth companies command a higher premium. The lower discount rate applied means that future earnings are more valuable. As such, the price to earnings on these companies should be higher than it has been historically. To our mind, it is a counterbalance to the view that technology stocks are expensive. If investors can find growth on a sustainable basis – it is worth more.

A looming election

It has come round quickly, but there are just 18 months to go until the next Presidential election. The run-up to an election has traditionally been a good time for technology companies, as advertising spend rises. The question ahead of November 2020 is whether political targeting is going to remain a force, given the various controversies around it.

In our view, and in spite of the controversy, political targeting is still a popular and effective way to raise money and generate crowds for a candidate. Facebook, Twitter and YouTube will still have an important role for targeting. Facebook has spent a lot to improve its news, help users curate content, cut down on bad or incorrect content. Policing ads is a tough business, but it's necessary if political parties and lobbyists are to use this route to reach constituents and raise money. There are currently twenty democratic candidates trying to beat Trump - what will distinguish them is who can raise money and targeting is part of that.

Wearable technology and consumer electronics

Wearable technology had a brief moment in the sun, but has subsequently struggled to make headway. There have been some concerns about the accuracy of the data produced and wearers have been urged not to fill up the emergency rooms with every rogue heart rhythm recorded. Apple is taking more share because its devices can do more – check emails and so on.

The rise and fall of wearable technology raises a broader question on consumer electronics. When there is a product that resonates with a certain group of customers, other companies move in with competing products and the price goes down. If it is also a product that doesn't need to be replaced very often, then the manufacturers have a problem. In the case of wearable devices, they are not like a phone that needs to be replaced because the battery wears out or better functionality becomes available. In this way, the incremental utility of a new device is not particularly high and people don't want to buy it again. Companies don't have recurring revenues. This means their revenues look like a wave – high adoption, but quickly falling away. Some companies making these devices were seeing growth of 50% per year, but are now just trying to stay viable as businesses. In my history of following this type of business, investors need to buy before people realise that the product is going to be popular. After that, the market becomes saturated and the stock doesn't work anymore.

5G

There is a lot of discussion of 5G, the latest generation of mobile technology. 5G-related stocks in Asia have started to do very well as investors have extrapolated future growth trends. However, it may not have as broad a reach as people believe. Initially there was talk about creating a competitor to the cable companies for internet access. That's proved to be difficult to execute at higher frequencies. It may require an antenna on a house, for example, with wires through the wall. If it's raining there can be issues with coverage. As such, it's proving to be a less attractive alternative for many US households. As it stands, it's not as good as cable and people are waiting for the benefits to show.

In China, Japan and Korea, however, it is a different story. They have dense cities and problems with coverage. As such, 5G works much better there and operators are in the process of building up their networks. For them, the promise of handling more traffic with 5G is a reality. However, with these exceptions, 5G may not be the big opportunity that companies have implied. There is investment involved and the return on that investment is not necessarily very high. A number of telecoms companies are rightly taking their time.

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Top 100 Funds 2014 Allianz Technology Trust
Top 100 Funds 2015 Allianz Technology Trust
Top 100 Funds 2016 Allianz Technology Trust (ATT)
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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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