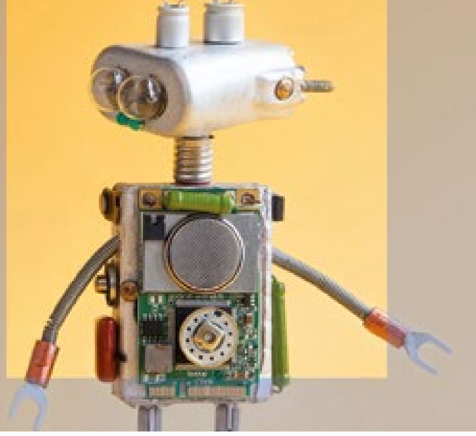

Active is: Investment Insights

www.allianztechnologytrust.com

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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.

How millennials change the game

Millennials are the biggest demographic cohort since the influential baby boomers. They are 'digital natives', adept with social media and digital technologies. Companies in our portfolio, whose longevity relies on staying relevant to new generations of users, are taking time and effort to understand what makes them tick.

We see millennials setting a new bar for time spent on the internet. Millennials are happy to multi-task – watching a television programme on their computer, while gaming or communicating with their friends on their phone. This means on-demand subscription TV services, for example, are vastly more popular with millennials than with other segments of the population because it is a more efficient way to consume these services – they only pay for the content they want. It is also far easier to curate on-demand services. They will have playlists and favourites, which help them navigate quickly and easily.

There is also a notable preference for consuming information visually rather than by text among millennials. They are as likely to search for a solution on YouTube as on Google. Often, it is seen as a far more effective way to find out how to make a recipe or fix a phone. This also explains the growth of Instagram; they prefer to compose a picture with a filter than use text to show what they're doing.

Technology companies are aware of this shift, and most are adapting to it. However, in the excitement over millennials, it is worth remembering that there are other demographic cohorts that will be around for a few years yet. Boomers are heavy users of Facebook (to look at their grand-children), while Generation X is in its prime earning years and also worthy of attention.

The technology sweet spot

Some old faces have come back to the market in recent months and investors would be forgiven for being surprised at their apparent reinvention. As public markets have got healthier – or, as some might argue, frothier – it has become increasingly easy to achieve a good price at Initial Public Offering (IPO). There's been a lot of IPO activity this year and plenty more are planned. This isn't just in the US, but across the globe – 27 billionaires emerged in Asia in the first half of 2018 and about a third of these did so through IPOs in Hong Kong and Shenzen[1].

We also see something else at work: this is a honeymoon phase for the technology market. Companies are

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moving to the Cloud. Part of that process means they have to upgrade their existing applications and improve their infrastructure to prepare for the new changes.

However, the move doesn't happen overnight, and in the interim businesses are in a situation where they are still spending on existing infrastructure, while also spending on their move to the Cloud. Of course, ultimately they are moving to the Cloud to become more agile and efficient, and spend less money.

In this honeymoon period, many of the old technology companies are doing well. However, once the move has happened, companies will likely spend less and less on their on-premise infrastructure, dwindling to nothing. At this point growth for these companies may disappoint. As such, many of these companies know that if they want to go public, they need to do it quickly.

Global trade wars: time to worry?

Technology is, to some extent, the final frontier for the global trade war. When it hits the technology sector, we will know that it has escalated. It is an important sector for both China and the US. However, we are not there yet.

It is worth looking at the background to the trade war: China has run a huge trade surplus with the US, which is not good for either party. For China, it is dependent on its ability to be a low cost manufacturing hub. This has had social and environmental consequences and, given the pollution problems, it is clear that the country is not absorbing the social cost. Chinese policymakers have recognised that they need to start moving to a consumption economy. For the US, a huge trade deficit is a clear source of vulnerability.

As such, while we are worried about the near-term impact of tariffs, there also needs to be action to address the main problem of the trade surplus. It will create additional costs for companies, who need to look for other places to put their factories. It increases uncertainty.

In some ways, this is nothing new. Countries have often sought to manipulate markets to manufacture domestically. There is a constant trade-off between free trade and a balanced trading position. There is a third way, where Chinese companies build factories in the US, bringing their expertise. This has been used before, notably by Japanese companies such as Toyota or Nissan. To our mind, this could be a stronger long-term path for China.

Paying for news

Social media benefits from the fact that they don't pay for much of the media they have on their platform. Instead they are gathering information on what a person is doing. Social media companies are very adept at building databases on individuals. Having gathered this, they can market far more effectively for advertising. The trade-off is that users get the service and pay for it via advertising.

A lot of Google search activity is based on accessing snippets of media for those who want to see the news. The media companies are struggling with how to get paid when social media users can get the information for free.

In our opinion, there is going to be constant tension between the view that users shouldn't be able to see the news unless they consume the advertising, or the millennial who wants to consume free news with no paywall. That will be a battle between those who want to get paid for content and those who want it for free.

In this battle between the old media and new media model, new media's notable advantage is that they are dominated by a few companies. Old media is trying to stay alive in that new world. Regulations are trying to help with this balance – supporting the existing model and making it a fairer fight.

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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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[1]Source: Bloomberg Billionaires Index.