# Allianz Global Artificial Intelligence

## Monthly commentary

### Investment Objective

The Fund aims at long-term capital growth by investing in the global equity markets with a focus on the evolution of artificial intelligence in accordance with the Sustainability Key Performance Indicator Strategy (Relative). In this context, the aim is to outperform the Sub-Fund's Sustainability KPI compared to Sub-Fund's benchmark to achieve the investment objective.

### What Happened in April

Global equities generally sold off over April, undermined by fears that the conflict in the Middle East may be spreading and concerns that the US Federal Reserve (Fed) may keep interest rates higher for longer to bring inflation back to target. The retreat was led by US shares, with eurozone and Japanese stocks also falling over the month. In contrast, UK and emerging market equities advanced. More on the US, sentiment was undermined by fears that the Fed would keep rates higher for longer and concerns over the forthcoming Q1 earnings season. While there was little difference in the performance of growth versus value, smaller companies trailed larger ones by a sizable margin.

Hopes of a summer rate cut from the Fed were dashed given stronger-than-expected jobs growth and stickier-than-forecast inflation. Financial markets are now starting to consider that the Fed may not cut rates before the end of the year. While the European Central Bank (ECB) is widely expected to reduce borrowing costs in June, investors are expecting this to be followed by a pause as policymakers wait to see how inflation evolves. In contrast, the weakness of the Japanese yen led to speculation that the Bank of Japan (BoJ) may increase rates once again.

In the commodity markets, oil prices initially moved higher as Iran sent hundreds of rockets into Israel in retaliation for an alleged Israeli attack on Iran's embassy in Syria. Nevertheless, after the brief tit-for-tat exchange, tensions between the two countries appeared to calm a little, helping Brent crude to close the month slightly lower at just under USD 85 per barrel. Industrial metals surged on signs of improvement in China's manufacturing activity, with copper prices rising to a two-year high.

From a sector perspective for global equities, as measured by the MSCI All Country World Index, the Utilities and Energy sectors were the top performers and the only sectors with positive returns. Conversely, the Real Estate and Information Technology sectors lagged broader markets.

## Portfolio Review

During the period, the Fund outperformed the custom benchmark (50% MSCI ACWI Index/50% MSCI World Information Technology Index). The Information Technology and Health Care sectors were the largest contributors to relative performance, while the Energy and Industrials sectors detracted. Artificial intelligence (AI) infrastructure and AI-enabled industries outperformed the blended index on security selection and strong earnings results. AI application underperformed as investors were cautious on the near-term demand trends for several software companies.

**Contributors**

The top contributor over the period was Alphabet Inc., which provided a wide range of internet products and services that include search, advertising and cloud infrastructure. Shares of Alphabet rallied as the company reported better-than-expected earnings results with strength from its advertising and cloud businesses. Alphabet's results alleviated many investors' fears that competition from generative AI would take share from Google's search business. Instead, the print proved that generative AI was a growth driver for Google and that competitor generative AI apps did not have a meaningful impact. We continue to have a constructive view on Google's growth trajectory, as trends are positive within Alphabet's advertising, YouTube and Google Could Platform (GCP) businesses. AI remains a key driver going forward for Alphabet. The GCP should be a beneficiary from greater AI research and development. Generative AI should be a complementary feature for the Google search business and could improve monetisation for mobile search.

Our position in electric vehicle (EV) producer Tesla Inc. was among the top contributors over the period. The stock rallied strongly after reporting earnings results, as management announced an accelerated timeline for a mass market vehicle and guided to a recovery in production for the rest of the year. Shares were also helped by Tesla receiving approval for its full self-driving software in China. Looking forward, Tesla has some of the most ambitious innovation agendas of most any public company, spanning EV, energy transition, AI and advanced robotics. We believe the company is making strong progress on each of these agendas in ways that can unlock significant shareholder value in the future.

**Detractors**

A project management software company is a detractor for the month. The company provides a no-code and low-code cloud-based platform that allows users to easily build application and work management tools that fits their needs. Shares underperformed as investors were cautious on near-term demand trends. We remain constructive on the company's growth trajectory, as it is well positioned to help customers centralise and digitalise their workflows. Its platform has incorporated AI through a collection of AI-powered automation applications.

Our underweight position in a technology hardware producer was also among the top detractors due to its significant weighting in the benchmark. The company had an average 10% weight in the benchmark, while the Fund had an average exposure of 0.8%. Shares outperformed broader markets on media reports of the company nearing production of its next generation AI processors.

**New Buys and Sells**

We re-initiated a position in the aforementioned technology hardware producer as the company is now taking a greater focus on bringing AI features to its smartphone platform. We believe investor focus will begin to shift as the company begins to make progress on its AI initiatives. The smartphone will likely be one of the primary devices that consumers will use to interact with AI. The company's large installed base could see an upgrade cycle, improving its earnings trajectory.

We had previously reduced shares of a software company that supplies computer-aided design and visualisation software at higher prices as the stock had relatively outperformed. This month, the company failed to file its annual 10-k with the Securities and Exchange Commission (SEC), given an ongoing investigation to ensure that cash flows are properly stated. With little visibility on the timing of this investigation, we sold the remaining small position.

We exited the position in a cybersecurity solutions company after shares recovered from weaker results in 2023. We believe the company continues to make efforts towards re-accelerating its business, but that the current valuation reflects higher expectations of near-term success.

While we like a health insurance and services provider in the longer term, we have become concerned regarding the recent antitrust case being brought against the company by the Department of Justice. Given the risks, we chose to exit the remaining position in the company at this time.

We exited a minor position in an electronic component manufacturer, a communications infrastructure solutions company, and a video game company as we do not anticipate adding to the names in near term . We wanted to free up the cash represented by these positions to potentially redeploy into higher conviction ideas.

## Market Outlook

We continue to believe that the equity market recovery can extend from 2023 into 2024. Although inflation has trended lower over the trailing 12 months, inflation has moved sideways this year. The Fed will likely maintain the restrictive stance by holding policy interest rates at current levels. Despite tight monetary conditions, the US economy remains resilient, as labour markets remained healthy, corporate earnings trended higher, and consumer spending has been robust. As the Fed gets comfortable that inflation is moving towards its 2% target, we should see rate cuts, which are looking likely to happen closer to the latter end of 2024.

A normalised monetary policy backdrop should be conducive for economic strength to broaden. We are already seeing a broader recovery of earning growth that encompasses sectors outside of Technology and for mid-and small market capitalisation stocks. Even if there is more volatility ahead, we believe smaller companies have discounted more uncertainties, offering attractive risk rewards for companies that are well positioned for a recovery. Further, lower rates and easier financial conditions should help extend the broadening recovery. These conditions should translate to better demand across customer segments, easier access to capital and increased investment in high return-on-investment (ROI) projects like generative AI. There are likely bumps along the way, but we remain optimistic for the rest of 2024.

AI's impact on every industry is starting to take hold, and we see a growing opportunity set beyond just the Magnificent 7* and the Technology sector. ChatGPT and early use cases of generative AI have proven that these breakthroughs can greatly improve efficiency and drive a new wave of automation. We are likely at the dawn of a long-term AI investment cycle that will have significant growth implications across the value chain and in every sector of the economy.

**AI infrastructure:** The developments around generative AI and large language models further demonstrate that the demand backdrop for AI infrastructure companies should remain strong given the computing requirements for training complex AI models and subsequent inference needed for edge intelligence. More companies are now motivated to build out their own domain-specific generative AI capabilities through continuous training and refinement. As these launch for broad-based use, demand should also expand to networking and storage infrastructure to support the explosive growth in new AI workloads. Investment also appears to be expanding to smaller cloud providers, governments and corporations in more countries around the world, which should be supportive of the ongoing build-out of critical AI infrastructure in the coming years.

**AI applications:** A new wave of AI applications is emerging that infuse generative AI capabilities into their software to drive greater value and create more monetisation opportunities. Today's general purpose AI models were trained on the internet, and they cannot respond to questions based on proprietary knowledge or data housed privately within an organisation. Many internet and software companies have a wealth of proprietary data sets and workflows to train AI models that can result in a new era of more intelligent applications and systems, opening up many new opportunities for monetisation and value.

**AI-enabled industries:** AI is helping to reinvent digital transformation, introducing new generative AI possibilities that can significantly boost productivity and reduce costs. As more processes go digital, the opportunity for AI to react to new information or unexpected changes can revolutionise every industry. Many companies in AI-enabled industries are increasing investments in generative AI to train one's own industry-specific model on its proprietary content or knowledge to compete better and innovate in the future. We are witnessing an increasing number of companies across Automotive, Consumer, Health Care and Finance sectors leveraging proprietary datasets that could yield differentiated AI models and applications that are difficult to replicate and can handle tasks better than general purpose AI. We believe this is just the tip of the iceberg as companies become more comfortable with AI's potential to drive greater efficiencies and automation across every part of their business.

Overall, we continue to believe we are at the very early stages of massive disruptive change brought about by advances in – and the deployment of – AI. We believe these changes will drive meaningful growth for companies that can take advantage and drive disruption within their respective industries. Our view is that the compounding effect from AI disruption will create massive opportunities for innovative companies across every sector. Stock picking will be essential to capturing the benefits of this opportunity, especially in an environment characterised by disruption and change. As we have done since the launch of the Fund, we remain focused on identifying the companies that leverage AI to deliver the most shareholder value creation over the long term. Compared to the technology innovation ahead of us, humanity is still on day one of our journey through the AI revolution.

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All data are sourced from Bloomberg and Allianz Global Investors as of 30 April 2024 unless otherwise stated.

* Magnificent 7 refers to a group of US stocks which includes Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla.





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