Allianz Global Investors

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 February

Global equities rallied over February, with China, Japan and the US among the strongest markets, buoyed by hopes of further stimulus measures in China, ongoing resilience in the US economy and solid corporate earnings. A resilient US economy and a further surge in artificial intelligence (AI)-related stocks all drove the US market higher, with growth stocks outperforming value over the month.

Global central banks indicated that they were in no rush to reduce borrowing costs but suggested that rate cuts would likely be possible later this year. Headline inflation rates slowed modestly, but policymakers continue to be vigilant for signs that inflationary pressures, such as wage growth, may be accelerating again. While economic activity appeared to improve in Europe during February, it deteriorated slightly in the US and Japan.

Oil prices traded just above USD 80 per barrel for much of the month (Brent crude), as investors weighed hopes for a ceasefire in the Israel and Hamas conflict against the forthcoming Organisation of Petroleum Exporting Countries plus (OPEC+) decision as to whether to extend production cuts. European gas prices fell to their lowest level since May 2021 as a warm winter coincided with abundant inventories. Gold briefly dipped below USD 2,000 a troy ounce but later regained its earlier losses to close the month relatively unchanged.

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From a sector perspective for global equities, as measured by the MSCI All Country World Index, the Consumer Discretionary sector was the top performer and supported by large growth-oriented names. The Information Technology sector was another outperformer. Conversely, stocks in the Materials and Real Estate sectors lagged broader markets.

Portfolio Review

During the period, the Fund underperformed on both a gross- and net-of-fees basis versus the custom benchmark (50% MSCI ACWI Index/50% MSCI World Information Technology Index). The Health Care and Materials sectors detracted from performance, while the Information Technology and Communication Services sectors were offsetting. AI applications underperformed the custom benchmark because of softer earnings results from a few software companies. AI infrastructure was a relative contributor with tailwinds from the exposure to data centre-related semiconductor companies. AI-enabled industries performed mostly in line with the custom benchmark.

Contributors

Social media operator Meta Platforms Inc. was among the top contributors. Shares were higher as the company delivered strong earnings results. Revenue upside came from strength in the retail, gaming and entertainment verticals. Meta's "year of efficiency" continues as expenses remain controlled, translating to operating margin expansion and higher overall net income. The company is working on new ways that generative AI can improve experiences across Facebook, Instagram, Messenger and WhatsApp – spanning search, social discovery, advertisements, messaging and more. This includes a generative AI personal assistant with robust functionality that rivals other co-pilot AI applications. We believe these new innovations can help drive greater user engagement and stickiness, as well as improvements with ad targeting and monetisation.

Our underweight position in a technology hardware producer was another relative contributor due to its significant weighting in the benchmark. It had an average 11.8% weight in the benchmark, while the Fund did not have exposure to the name. Shares pulled back on speculation of softer smartphone shipments for calendar year 2024.

Detractors

Our position in cloud-based communication platform Twilio Inc. was among the largest detractors of relative returns. Shares were lower following mixed earnings results, as guidance came in lighter than expected because of headwinds from the cryptocurrency industry vertical and the wind-down of a legacy software business. Twilio continues to make operational improvements and is set up to capture a potential demand recovery. It continues to have a compelling cloud communications platform that enables developers to build and manage applications without the complexity of maintaining the underlying infrastructure.

Another detractor was a streaming television platform provider. Although the company reported solid earnings results, the stock fell as guidance missed investors' lofty expectations. Looking forward, it is well positioned to benefit from an ongoing shift of television viewing to streaming. Its streaming platform has a large and growing user base with significant engagement. The company's earnings growth runway appears healthy as advertising dollars shift from traditional TV to connective TV, and as it introduces new advertising formats to spur demand.

New Buys and Sells

During the period, new purchases in the Fund included the world's second-largest home improvement retailer. Although negative sentiment has weighed on companies tied to residential construction, investors may be underappreciating the various growth and AI initiatives that the company has been implementing over the last several years. We believe there is a growing pent-up demand for home improvement that could drive additional upside.

The Fund also purchased a global industrial automation leader. The company sees AI as a key driver of industrial transformation and is actively incorporating it into various products and business operations. We believe its AI initiatives have the potential to be additive to a range of factory processes that includes preventative maintenance, quality inspection, supply chain optimisation and autonomous guided vehicles for material handling.

A company which specialises in a wide range of networking hardware, telecommunications equipment, software, and other high-technology services and products was another new addition. We believe it stands to benefit across its product portfolio as companies invest in their AI infrastructure, given the company's growing pipeline of orders for AI networking solutions.

We re-initiated a position in a cyber security provider, as the risk reward became more attractive. Over the past several quarters, the company has made strong progress on enhancing its cost structure and product portfolio through AI, while also leveraging AI to streamline its operations, including task automation.

Lastly, we exited our position in a cloud services platform provider, as shares appreciated significantly and approached our price target.

Market Outlook

We believe the equity market recovery in 2023 can extend into 2024. Over the last couple of months, the US equity market has shown signs of broadening out beyond the Magnificent 7 as interest rates appear to be on a path lower with an economic soft landing more likely. At the December 2023 Federal Open Market Committee (FOMC) meeting, the US Federal Reserve (Fed) held fed funds rate steady and signalled multiple rate cuts could come in 2024 and 2025 as rates are either at or near peak levels with promising inflation and moderating jobs data.

The backdrop for normalising monetary policy should be conducive for an economic recovery and for growth to reaccelerate as 2024 progresses. The recent soft economic backdrop due to higher interest rates has weighed on some sectors and industries more than others. Lower rates and easier financial conditions should translate to better demand, easier access to capital and increased investment in high return-on-investment projects like AI.

We also think small- and mid-cap stocks have the potential to outperform large caps in 2024, given historical outperformance during a recovery phase and the relatively muted returns over the past few years. Even if there is more market volatility ahead, smaller stocks might be further along towards a recovery as estimates already discounted more of the uncertainties ahead, in our opinion. Earnings growth looks poised to reaccelerate in 2024 across more sectors, which should be supportive of a continued broadening of the market. There are likely bumps along the way and the market might be due for a short-term breather after the recent strength, but there are reasons to be optimistic for 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. Stockpicking 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 strategy, 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.

All data are sourced from Bloomberg and Allianz Global Investors as of 29 February 2024 unless otherwise stated.

Allianz Global Investors and Voya Investment Management (Voya IM) have entered into a long-term strategic partnership, and as such, as of 25 July 2022, the investment team transferred to Voya IM and Voya IM became the delegated manager for this fund. AllianzGI continues to provide information and services to Voya IM for this investment through a transitional service agreement.