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 January

Global equities were mixed in January, with central banks dampening rampant speculation of rate cuts as soon as March. Japanese stocks surged, while eurozone shares recorded modest gains. US stocks rose, with the S&P 500 Index hitting a fresh record high towards month-end, buoyed by continued gains from the Magnificent Seven. However, emerging market equities declined, dragged down by steep falls in China.

Headline inflation rates reaccelerated modestly in December 2023, and heightened geopolitical tensions in the Red Sea raised concerns over higher shipping costs and extended delivery times. Flash estimates of purchasing managers' indices (PMIs) for January suggested a moderate uptick in economic activity. Central banks in developed markets kept rates on hold, but policymakers stressed that hopes of rate cuts as soon as March were likely to prove premature.

Escalating geopolitical tensions in the Middle East sent oil prices higher amid fears of supply disruptions. Companies increasingly avoided using the Red Sea and the Suez Canal, choosing the longer route around Africa given the heightened chance of attack from Houthi rebels. There were also fears that the Israel and Hamas conflict would spill over into other flashpoints in the region. Brent crude reached a peak of USD 84 per barrel and gold eased slightly over the month.

From a sector perspective for global equities, as measured by the MSCI All Country World Index, the Information Technology sector was the top performer and was supported by strong performance in the semiconductors and semiconductor equipment industry group. The Communication Services 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). During the month, the benchmark returns were positive, but this was driven by strong returns within a subset of growth-oriented technology stocks. The concentrated nature of the market backdrop represented a challenge for the Fund. Artificial intelligence-enabled (AI-enabled) industries were a detractor for returns, given company-specific challenges within the Consumer Discretionary sector. AI application performed in-line with the index. AI infrastructure outperformed with tailwinds from the exposure to data centre-related semiconductor companies.

Contributors

A fabless semiconductor company that provides networking and custom design solutions is a top contributor over the period. Shares were higher from positive investor sentiment surrounding AI infrastructure investments. The company continues to see new demand for custom AI chips as cloud service providers scale out AI infrastructure. It is well situated to garner design wins for next generation custom AI chips, including the 3nm process nodes and potentially 2nm process nodes in the future. Additionally, the company's other product segments are positioned for a cyclical rebound, providing an additional tailwind for revenue and margin expansion.

Our underweight position in a technology hardware producer was another relative contributor due to its significant weighting in the benchmark. The company had an average 12.7% 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 electric vehicle (EV) producer Tesla Inc. was the top detractor over the period. Shares fell on near-term demand uncertainty and on the future direction of price cuts. Despite cutting vehicle prices, the company was able to drive a quarter-on-quarter increase in automotive gross margins this past quarter, even with the drags associated with the Cybertruck production ramp. Looking forward, Tesla has an ambitious innovation agenda spanning EV, energy transition, AI and advanced robotics. We believe the company is making strong progress on each of these fronts in ways that can unlock significant shareholder value in the future.

Our position in ON Semiconductor Corp., a power semiconductor provider with presence across various end-markets, was another detractor over the period. Shares were lower on soft near-term demand trends for silicon carbide. The company's growth trajectory remains robust given the company's focus on being a value-added semiconductor supplier to high-growth opportunities in EV, data centres and silicon carbide.

New Buys and Sells

During the period, new purchases in the Fund included a technology-driven online brokerage provider for both individuals and institutional clients. The company is actively integrating AI into various aspects of the business that includes AI-driven order routing system for best execution of trades, customer service chatbots, and AI-powered market research tools.

An oil and gas technology and services provider that drives energy innovation was another addition during the period. The company provides a wide range of technology solutions and services across the energy value chain. It utilises AI across various aspects of its products and business operations, aiming to enhance efficiency, optimise processes and provide innovative solutions for traditional and alternative energy clients.

As for complete sales, we exited a lithium producer, given lithium oversupply conditions and an ongoing industry rationalisation. Additionally, the Fund sold the position in a network products and services company, as it is being acquired by a manufacturer of software and computer services. Given the limited upside potential, we redeployed proceeds for other ideas.

Also, we exited stub positions of a cyber security provider, a financial services software company, a semiconductor provider, a software provider, a semiconductor equipment producer, and the aforementioned technology hardware producer**.** These names appreciated significantly and approached our price target.

Market Outlook

We believe the equity market recovery in 2023 can extend into 2024. Over the last few months of 2023, the US equity market has shown signs of broadening out beyond the Magnificent Seven 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 2023 and 2024 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 Seven 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 can't 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.

Connect with Us | sg.allianzgi.com | +65 6438 0828 | Search more Allianz Global Investors

Like us on Facebook **Allianz Global Investors Singapore**

Connect on LinkedIn **Allianz Global Investors**

Subscribe to YouTube channel **Allianz Global Investors**

All data are sourced from Bloomberg and Allianz Global Investors as of 31 January 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.