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 March

Global equities moved higher over March, further bolstering already strong year-to-date returns. Sentiment was lifted by signs of improving economic momentum in Europe and China, as well as by central bank indications that rate cuts were likely to start in the summer. US equities advanced, with the S&P 500 Index and Nasdaq Composite Index setting fresh all-time highs. Value stocks outperformed growth-oriented companies as the advance broadened out from the Technology sector.

The Swiss National Bank became the first major central bank to lower rates this cycle. However, in general, central banks stuck with the mantra that rates would be cut this year, but not before summer. In contrast, after months of speculation, the Bank of Japan (BoJ) finally raised rates to 0-0.1% and ended its yield curve control policy. Headline inflation rates slowed in Europe but ticked higher in the US, Japan and China, with the latter exiting deflation for the first time in six months.

Commodity prices rallied. Oil prices moved higher, closing the month around USD 87 per barrel (Brent crude) given the ongoing conflicts in Ukraine and the Gaza strip, as well as the increased attacks in the Red Sea. Gold prices also advanced, touching a fresh high of more than USD 2,200 an ounce. However, iron ore prices slumped to a 10-month low given muted Chinese demand and ample supply.

From a sector perspective for global equities, as measured by the MSCI All Country World Index, the Energy and Materials sectors were the top performers, as commodity prices rallied. Conversely, the Consumer Discretionary and Consumer Staples 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 Information Technology and Consumer Discretionary sectors were the largest detractors to relative performance, while the Health Care and Materials sectors contributed. Artificial intelligence (AI) applications faced headwinds as a few software companies pulled back following their earnings results. AI-enabled industries outperformed with tailwinds from the Health Care and Materials names.

Contributors

Among the top contributors to relative returns was a medical device company that specialises in continuous glucose monitoring (CGM) systems with smart device connectivity. The system provides real-time glucose readings that helps diabetics control blood-sugar levels and improve quality of life. The company delivered better-than-expected earnings with solid results from the US region and strong new patient starts. Its sales momentum should continue. Its strong product pipeline and portfolio of CGM systems position it to capitalise upon a large, underpenetrated patient population. This includes an opportunity to capitalise on the non-insulin type 2 patient market.

Our underweight position in a technology hardware producer was another relative contributor due to its significant weighting in the benchmark. It had an average 10% weight in the benchmark, while the Fund did not have exposure to the name. Shares pulled back on softer smartphone shipments in China and from the European Union (EU) commission issuing a fine on the company.

Detractors

The top relative detractor over the period was a cloud-based data analytics company. Although it delivered solid earnings results, shares pulled back as its cloud revenue grew slightly less than expectations. The company's vector search offering continues to experience strong interest from customers looking to build their own generative AI solutions. This opportunity remains in the early innings and should allow the company to capitalise on the rapid adoption and development of generative AI.

Our position in electric vehicle (EV) maker, Tesla Inc., was also a top detractor. Shares underperformed as EV demand has broadly decelerated and amid uncertainty surrounding Tesla's price cuts. However, it is worth highlighting that Tesla executed on reducing vehicle manufacturing costs, allowing the company to pass cost savings to consumers while increasing automotive gross margins. Further, the scaling of Cybertruck not only yields enhanced revenues, but also should be additive to gross margins and profitability. Tesla continues to have ambitious innovation agendas 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.

New Buys and Sells

A new position for the Fund is a global financial services company with business segments that includes institutional securities, wealth management and investment management. We initiated a position in the company at this time as we believe the relative reward to risk is attractive. We are constructive on the new CEO, who took over leadership in late

2023. Further, we believe the company is well positioned to deliver products and services leveraging AI to enhance its various product offerings. The company invests significantly in AI research and development, and they are a strategic client of a leading AI research lab in the field.

We initiated a position in a provider of cloud-based data warehouse services, which gather data from various sources to a single repository for deeper analysis, as shares corrected post the company's recent earnings report where the management provided conservative guidance and announced a CEO transition. The company leverages advanced AI for multiple applications that enhance data management and extraction of actionable insights. Further, continued development of AI should increase demand for its software. Organisations that run AI training and inference will need to deal with operational demands that include growing data volume and complexity, the need for scalable and secure data management and collaboration among various stakeholders. Its software helps address these challenges. The company remains well positioned as a key enabler as AI technology evolves and broadens across industries.

We exited our positions in a global payments and travel services provider and a cyber security 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 March 2024 Federal Open Market Committee (FOMC) meeting, the US Federal Reserve (Fed) held fed funds rate steady and again 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 infuses 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.

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All data are sourced from Bloomberg and Allianz Global Investors as of 31 March 2024 unless otherwise stated.

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

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.

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