

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 May

Global equities advanced over May. US equities set fresh record highs, although the market came off its best in the closing days of the month. The appreciation was mostly driven by robust gains from the Technology sector. As a result, the tech-heavy Nasdaq Composite Index outperformed the broad-based S&P 500 Index, with growth stocks topping value ones by a sizable margin. In contrast, Japanese and UK shares rose only modestly, while the MSCI Emerging Markets Index was pressured by weak returns from Brazil and Mexico, among others.

On the monetary policy front, US Federal Reserve (Fed) Chair Jerome Powell signalled that investors would need to be "patient and let restrictive policy do its work" in reducing inflation. However, he also confirmed that the likelihood of a further increase in rates was "very small". In the eurozone, the European Central Bank (ECB) gave its strongest hint yet that rates would be cut in June, despite higher-than-expected wage growth. Hopes that the Bank of England (BoE) would also cut rates in June were dashed when UK inflation fell less than forecast and the government unexpectedly called a general election, to be held on 4 July.

In the commodity markets, oil prices eased, touching their lowest level since March on fears of a looming supply glut. Conversely, metals prices moved higher. Gold touched a fresh high of USD 2,450 a troy ounce, while copper topped USD 11,000 a ton for the first time on record as concerns over curtailed supply added to expectations of a pick-up in demand.

From a sector perspective for global equities, as measured by the MSCI All Country World Index, all sectors had positive returns. The Information Technology sector was the top performer, with outperformance from the semiconductors and semiconductor equipment industry group. The Utilities sector was another outperformer. Conversely, the Energy and Consumer Discretionary 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). Market performance was narrowly concentrated among the mega-cap Technology companies, a sharp short-term reversal from the recent market broadening. This backdrop was a headwind for relative returns. From a sector perspective, Information Technology and Consumer Discretionary were the largest detractors to relative performance, while the Industrials and Consumer Staples sectors were offsetting. Although the artificial intelligence (AI) capital investments remain strong, the portfolio's AI infrastructure exposure underperformed the blended index, as a few AI foundational software companies reported earnings results that missed expectations. AI application also underperformed because of a transitory slowdown across the software industry. AI-enabled industries outperformed from strength among our renewable energy names.

Contributors

First Solar Inc. is a vertically integrated solar manufacturer and specialises in the production of high-performance cadmium telluride (thin film) based solar photovoltaic panels. The company is implementing AI across its value chain to drive innovation, enhance efficiency and improve customer service. Shares were higher during the month on news of potential new tariffs for Chinese solar panels, and investor recognition that First Solar is a direct beneficiary of higher power demand from AI and data centres. First Solar remains well positioned to capture the growth potential of US utility scale solar. The company will be the clearest beneficiary of the Inflation Reduction Act (IRA) guidelines for domestic content. Also, First Solar has strong visibility with orders extending through 2027 and margins being set to trend sharply higher, while the announcement of additional manufacturing capacity in the US could provide another catalyst.

Another contributor is a provider of enterprise AI software. Its platform empowers organisations to develop and deploy enterprise-scale AI applications. Shares were higher as the company reported better-than-expected earnings results, as subscription revenues accelerated for the fifth consecutive quarter. The company noted continued success in the government vertical and strong increase in pilot agreements. It is currently benefitting from the developments of large language models and generative AI. Bookings trends have been solid given new products and increased interest from various organisations to leverage AI technologies.

Detractors

Our position in a data developer platform was among the top detractors during the period. Its platform is used to build highly available and scalable cloud applications. Shares fell as it provided disappointing forward guidance, given a slower-than-expected start to the fiscal year for consumption growth and new workload wins. We believe these headwinds to the business are more transitory in nature and that company fundamental factors remain intact. The company continues to strengthen its market position and technological leadership in the growing database-as-a-service market.

Among the largest detractors on a relative basis was Nvidia Corp. Although the stock was a meaningful position in the Fund, we were underweight relative to the benchmark. The benchmark had an average allocation of 9.4% during the quarter versus the Fund's average weight of 3.9%. Shares were higher during the month as the company delivered a

better-than-expected earnings report and as management highlighted that demand continues to out-strip supply, including the current generation Hopper graphics processing unit (GPU) and next generation Blackwell GPU products. For additional context, year-to-date as of 31 May 2024, shares of Nvidia rose 121% and we opportunistically took profits during its rise. We still favour the holding as one piece of a diversified exposure to the AI infrastructure opportunity.

New Buys and Sells

A new addition to the Fund included a technology and computational software company, a leader in the field of Electronic Design Automation (EDA). The company's capabilities are critical for the advancement of AI hardware, enabling engineers to efficiently design next-generation AI-specific semiconductors. Moreover, it integrated AI into its EDA tools. Examples of AI-enhanced tools include capabilities that automates design verification, creates new design through generative AI, and can optimise manufacturing yield.

Another new name included a biotechnology company that is actively leveraging AI across various stages of drug discovery and its business operations. We believe the combination of the company's AI investments blended with pipeline developments creates an attractive entry point to initiate a position.

We also added a provider of technology hardware and services. It developed an AI strategy focused on three pillars: AI in products, AI infrastructure solutions, and AI for its internal operations. By infusing AI across its business, the company can drive operational efficiencies, gain competitive advantages and offer AI-optimised products, which include AI server racks and AI edge devices, to customers.

We exited positions in a subscription streaming service and production company, and a manufacturer of semiconductors and wireless telecommunications products as the positions became small and shares had appreciated to a point where we did not believe the reward-to-risk ratios were as attractive as other opportunities.

Market Outlook

We continue to believe that the equity market recovery can extend from 2023 into 2024. Inflation has trended lower over the trailing 12 months but has moved sideways so far this year. As a result, the Fed likely maintains the restrictive stance by holding policy interest rates at current levels. Despite tight monetary conditions, the US economy remains healthy, as labour markets, corporate earnings and consumer spending have been resilient.

Expectations for Fed rate cuts have been lowered from six to under two over the year-to-date period. Amid this backdrop, equity markets have demonstrated resilience, especially for AI and cloud infrastructure companies. From the most recent Federal Open Market Committee (FOMC) meeting, Fed Chair Jerome Powell indicated that rates likely stay elevated for the time being. 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 growth to broaden. We are starting to see a broader recovery in earnings 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 longer-term investors. Lower rates should eventually ease financial conditions and help broaden the recovery as we head into 2025. These conditions should translate to better demand across various industries, 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. 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 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 31 May 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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