

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 September

Global equities mostly rallied over September, buoyed by the US Federal Reserve's (Fed's) larger-than-usual cut in interest rates, its first reduction in four years. The S&P 500 Index closed the month at a fresh record high, while the Nasdaq Composite Index remained below its July peak. With only five weeks to go until the presidential election, Vice President Kamala Harris remains ahead of Donald Trump at a national level, but the race is neck-and-neck in the seven swing states that will decide who wins the most electoral college votes. In late September, a raft of further stimulus measures from the People's Bank of China (PBoC) and the Chinese government further boosted sentiment, particularly towards Chinese stocks which surged over the month.

Headline inflation eased to 2.50% in August, from 2.90% the previous month. At its September meeting, the US central bank cut rates for the first time in more than four years, implementing a bigger-than-usual 50 basis point (bps) reduction, the first cut of this size since the early pandemic days of March 2020. Policymakers indicated rates were likely to be reduced by another 50 bps in total before year-end, with further cuts likely in 2025. The European Central Bank (ECB) also reduced borrowing costs, marking its second cut this year, while the Bank of England (BoE) kept rates on hold, but indicated that borrowing costs were likely to be reduced later this year. While the Bank of Japan (BoJ) also kept rates on hold, the PBoC announced a package of measures aimed at supporting the economy and the property sector, including lowering the reserve requirement ratio for banks and cutting some loan rates.

Oil prices fell, briefly moving back below USD 70 per barrel amid ongoing concerns over the health of the US economy. Saudi Arabia also signalled that it was planning to raise production in December as it seeks to reclaim market share. Elsewhere, industrial metals such as copper surged following China's announcement of massive stimulus measures, while gold, which is often seen to be a safe haven in times of uncertainty, rallied, with the precious metal breaching USD 2,600 an ounce for the first time on record.

From a sector perspective for global equities, as measured by the MSCI All Country World Index, performance was led by the Consumer Discretionary and Materials sectors. Soft-landing optimism and China stimulus news were constructive for these sectors. Energy and Health Care were the top laggards over the period.

Portfolio Review

From a sector perspective, Consumer Discretionary and Communication Services were the largest relative contributors. The Information Technology and Health Care sectors were the largest detractors. Artificial intelligence-enabled (AI-enabled) industries outperformed the blended benchmark from positive stock selection. Both AI Applications and AI Infrastructure generated positive absolute returns but were slightly under the custom benchmark.

Contributors

Our position in electric vehicle (EV) producer Tesla Inc. was the top contributor over the period. The stock rallied amid rising optimism for Q3 delivery numbers and for the upcoming Robotaxi unveiling event in October. 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 progress on each of these agendas in ways that can unlock significant shareholder value in the future.

Shares of a Chinese internet and ecommerce company were higher alongside the rest of China equities, as Beijing launched a multitude of stimulus measures to support its struggling economy. Looking forward, the company is positioned to benefit from a recovery in gross merchandise value as macroeconomic conditions improve, greater penetration into lower-tier cities and new monetisation opportunities on its platform.

Detractors

The top detractor over the period was AstraZeneca Plc., a biopharmaceutical company. Shares underperformed over the period on disappointing data readout from its lung cancer drug. Looking forward, the company possesses a peer-leading oncology pipeline with multiple attractive and underappreciated blockbuster drugs across a wide range of wholly-owned programmes and collaborations that can drive both material mid- and long-term upside. AstraZeneca's incredibly diversified pipeline is unique amongst peers and carries lower patent risk. Also, it is a first mover amongst large pharma peers to implement AI and data analytics in every step of the drug research and development (R&D) process.

Our position in a cloud security company was another top detractor during the period. While the company reported strong quarterly financial results with revenue and earnings exceeding expectations, shares fell as management provided a conservative guidance for fiscal 2025. Big picture, we continue to believe the company remains well positioned on a longer-term basis. It is a first mover in cloud security that has created a new market in the cyber security world with an innovative product suite and strategic focus, which should disrupt the competitive landscape for years to come.

New Buys and Sells

A new purchase for the period was a reinitiation of a leading global financial services provider. The company has made substantial investments in AI to enhance various aspects of its business. The key AI benefits to the company include cost reduction through automation, and improved accuracy in areas like data processing, decision making, projections and fraud detection. From a client experience perspective, AI-driven personalisation and customer service improvements contribute to higher client satisfaction and retention.

Another new buy is a software company that provides a comprehensive customer relationship management (CRM) platform. It recently launched its AI offering, which is an integrated suite of AI tools designed to enhance marketing, sales and customer service functions across its platform. Moreover, management raised the company's intermediate-term profitability goals, demonstrating confidence in its underlying business.

We exited the remaining position in a cell phone, computer and communications equipment giant as early reports suggest more muted demand for the new smartphone release. While the company promoted many new AI features coming to its operating system software later this year, the newest smartphone model has only small physical upgrades and the initial version of the AI software capabilities have been underwhelming to consumers but could improve in time.

Despite having a very financially efficient business model, a software and data company has suffered from weak demand trends in the technology vertical and been a little slow rolling out new innovations. Management has been overly optimistic about improving trends for some time and we have lost confidence in their forecasts and decided to exit the position.

Market Outlook

We continue to have a constructive mid- to long-term outlook for equity markets given the earnings growth potential from continued AI innovation and adoption over the coming years. However, we expect higher market volatility in the near term as markets digest some additional risks.

Investors are paying close attention to the potential for slower US economic growth given later timing of interest rate cuts and recent softer employment numbers and consumer spending trends. A closer race in the upcoming US elections may also add to volatility, especially around geopolitics and global supply chain. An unwind of the Japanese yen carry trade in August introduced additional volatility, although concerns have subsided as most expect the BoJ to be slow with future rate hikes if needed. Overall, corporate earnings have been relatively resilient year-to-date and investors will be closely analysing upcoming Q3 earnings and guidance. Amid the volatility, we are opportunistically looking to upgrade select names and add to our highest conviction ideas to better position the portfolio for improved performance.

Since inflation is now moving towards the Fed's target of 2% and employment conditions have moderated, the central bank is now in a more comfortable spot to normalise policy. From the most recent Federal Open Market Committee (FOMC) meeting in September, the Fed started its cutting campaign by reducing the federal funds rate by 50 bps. Chair Jerome Powell highlighted that the decision reflects a recalibration of policy stance in order to maintain the labour market, which continues to grow albeit at a slower rate, while inflation continues to ease towards the target of 2%. Since the risk of inflation has abated, the Fed has greater latitude to pursue its goal of maximum employment.

An easier monetary backdrop should be constructive for the economy to regain its footing, but it may take time for effects to take hold. While markets may see some volatility in the US elections, we remain optimistic in the resiliency of the US economy, corporate earnings growth and AI innovation in the years ahead.

Separately, a key characteristic of the equity market strength over the past year is that returns have been concentrated among a handful of large technology companies. Coming into 2024, investors were worried over the risk of recession, timing of interest rate cuts and geopolitical tensions, so preferred larger caps, higher quality stocks. Also, the large technology giants were the early beneficiaries of this first phase of AI given their large infrastructure investments and data-driven business models that could quickly capitalise on generative AI. However, we believe some caution is warranted when mega-cap technology earnings begin to slow, compared to other sectors as interest rates moderate and the market broadens out more.

As for what is next in the ongoing generative AI innovation wave, we expect the robust capital investments in “Phase 1” AI infrastructure to continue and the industry to enter the “Phase 2” AI applications wave that leverages this infrastructure to develop new generative AI capabilities in software to drive greater value and automation opportunities. We are also seeing early signs of “Phase 3” AI-enabled industries demonstrating effective use of generative AI. Many companies outside of the Technology sector are increasing investments in generative AI to train one’s own industry-specific model on its proprietary data or knowledge to compete better and innovate in the future. A backdrop of emerging AI beneficiaries underappreciated for their potential creates a significant opportunity for alpha generation in the years ahead.

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. Generative AI appears to be evolving into its next phase with the emergence of AI agents. These applications are customisable and run 24/7 and can mimic human decision making capabilities. This can take a lot of costs out of businesses and dramatically improve productivity. As these AI agents roll out for broader distribution, AI applications companies can open up many new monetisation opportunities and create value for users.

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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