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Allianz Global Investors Insights

The Disruption Issue

Global View

Assessing President Trump's First 100 Days

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President Donald Trump came into office amid high expectations that were set by his own forceful campaign pledges. The financial markets expressed their high hopes in the form of higher share prices, buoyed by the prospect of tax cuts and other business-friendly measures from the new president.

Soon enough, however, Mr Trump began facing significant challenges, starting with a combative Congress that couldn't muster the votes for his proposed repeal of Obamacare. With its defeat, Mr Trump had discovered what many leaders before him had already learned: Progress can be slow when political reality sets in.

Still, Mr Trump continues to promote his key policy priorities as he tries to muster Congressional support. His approval ratings will be increasingly important as the 2018 mid-term elections approach, since they will affect how much support he gets from Congress.

Mr Trump's 3-4 per cent sustainable growth pledge is ambitious, and it could be hard to attain. Long-run economic growth helps determine future corporate earnings, inflation and bond yields, but much depends on labour-force and productivity growth. With tighter borders threatening to reduce the labour pool, raise wages and cramp earnings, raising productivity is key.

If Mr Trump is successful in slashing red tape, it could provide a boost to financial services but would have less of an impact on energy. More broadly, the link between regulation and productivity growth isn't very strong, and many tough regulations exist at state and local levels.

Overall, business leaders are optimistic about Trumponomics and are closely watching the outlook for stimulus and growth. If their optimism translates into action, we could see greater investment – perhaps in research & development – that boosts productivity.

Clearly, President Trump has an ambitious agenda, and it is unrealistic to expect him to have succeeded on every aspect in just over three months. Nevertheless, he has also passed the 100-day mark of his presidency, which has long been a milestone for assessing a president's progress. With that in mind, our scorecard on the next page provides our best assessment of Mr Trump's complishments during his brief time in office.

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Allianz Global Investors

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Global View

President Trump's 100-Day Scorecard

Mr Trump came into office with a bold vision and scored at least one quick win, but many of his proposed policies have made only incremental progress since then. Congressional support seems to hold the key to success for many of Mr Trump's initiatives; without it, his ability to advance his agenda may be limited.

		No Progress In Progress Complete	Commentary
Make America Great Again	Build a Wall		Executive action signed; supplementary border barriers are likely
	Restrict Immigration		Policy affected by US judiciary
	Increase Infrastructure		Congress unlikely to commit to major spending program
	Increase Defence		Proposition to swell defence budget by USD 52 billion
	"Drain the Swamp" and Reduce Political Influencers		Congress and Republicans gridlocked
Trade	Withdraw from TPP		Executive action signed
	Renegotiate NAFTA		Mr Trump recently softened his position on NAFTA, agreeing to negotiate instead of terminate
	China "Fair Trade"		Awaiting assessment report from the US Department of Commerce
	BAT or other Tax-Increase idea		Congress cooling on BAT
Trumponomics	Reduce Personal tax		New proposal cuts tax rates but also limits some popular deductions
	Reduce Corporate tax		Big cuts in business-income tax should boost corporate earnings
	Repatriate cash		Unlikely to stimulate the economy
Deregulation	Dodd-Frank Simplification		Expectations of deregulation too high
	Return of Glass-Steagall?		Reinstatement called for by both Democratic and Republican parties
	FDA Improvements		Scott Gottlieb picked for commissioner
	Obamacare Improvements		Prioritizing Obamacare now a policy mistake
Financials	Change Composition of FOMC		To come in 2018
	Deliver New 2017 – 2018 Budget		Preliminary budget delivered, covering only discretionary spending
	Unfunded "Tax Cuts"?		Unlikely from a conservative Congress

Investment implications

- The markets' expectations for "Trumpflation" should be lower
- Mr Trump's 3-4 per cent sustainable growth pledge may be tough to attain; much depends on labour force growth and productivity growth
- If Mr Trump successfully reduces regulations, financial services could benefit; less so the energy sector
- Overall, progress will be slower and take longer than many anticipate

Perspective on the US

How Innovation Creates Opportunities Late in the Cycle

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Senior Portfolio Manager

It is hard to ignore the fact that the US equity market is trading near record highs, with the S&P 500 Index more than tripling in value since its 2009 lows and price-to-earnings multiples near all-time peaks.

While some investors are still enjoying this run-up, others worry they might hold on too long. There is of course no way to identify the best time to buy or sell, but it is important to point out that some of the largest gains in an investment cycle are left to the end. Exiting too early can mean a sizable loss of opportunity.

> Some of the largest gains in an investment cycle are left to the end; exiting too early can mean a sizable loss of opportunity

In addition to maintaining one's positions, there is another approach for investors to consider late in an economic cycle such as this one: Investing in companies that thrive off disruption and create significant value for their customers. Many of these firms are highly valued precisely because they have vital products and services that consumers consider essential, which could bode well in a downturn.

Innovation drives value

Consider for a moment the productivity-enhancing high-tech innovations that powered the growth of social media, cloud computing and ecommerce. These disruptive technologies triggered an interesting inflection point that is very different from the one seen during the tech bubble, which was fueled by red ink. Today's most innovative companies have growing levels of free cash flows and the ability to drive their own profitability expansion, which makes them that much more valuable to customers and shareholders alike.

> Today's most innovative companies have good cash flows and can drive their own profitability expansion

For example, the largest social media advertiser in the world continues to add value for its customers by improving the visibility of returns for every ad dollar spent. As advertising budgets become tighter in a downturn, their clients are more likely to invest their last ad dollars in a channel that can target engaged consumers and generate sales.

Also consider the largest providers of cloud computing, who offer the opportunity to reduce costs and increase productivity without requiring their customers to invest big capital budgets behind massive data centers and enterprise integrations. This flexibility is exactly what their customers need as economic tailwinds subside, when they look to optimize costs.

> Big cloud computing firms help clients cut costs and boost productivity without massive investment – just what clients need as economic tailwinds subside

Finally, the largest ecommerce company in the world continues to invest in new services to improve the value of their annual membership: music, media, free delivery, books and digital storage. So when they raised subscription prices by 25 per cent in a single year, after many years of adding content to their service, there was very little pushback from their customers even as the company enjoyed a significant boost to its revenues.

The importance of active stock selection

Clearly, there are many options for managing portfolios in the later stages of an economic cycle. Shifting portfolios to more defensive sectors or cash is one traditional option, as is investing across a broad basket of securities to improve diversification.

However, given that a rapidly falling market has the ability to drag down entire asset classes, an active, focused approach may be beneficial during the late stages of a bull market. While no investment strategy can guarantee a profit or protect against a loss, investing in companies that offer differentiated consumer services and measurable returns could add the diversification investors need as the debate over market tops intensifies.

> Investing in companies with differentiated services and measurable returns could add valuable diversification

Notes from Silicon Valley

Artificial Intelligence: New Opportunities for Investors

Sebastian Thomas, CFA
Portfolio Manager

Today's artificial-intelligence (AI) technology might not yet be the stuff of science-fiction fantasies, but it is already changing the world in which we live. In fact, promising new AI developments are set to drive the next wave of innovation and automation for decades to come. Like the personal computer and the internet, it is a truly transformational force that has the potential to create new industries and dramatically change the business models of existing businesses. That is why understanding the impact of AI is critical to active investing – and not just in the high-tech space.

AI is a truly disruptive force that can create and destroy entire industries, which makes understanding AI critical to active investing

Why AI is reaching an inflection point

AI has a long history. While the principles behind it first emerged in the 1950s, it was only with the unprecedented convergence of today's powerful cloud-based computing, mobile technology and "big data" resources that genuine AI became a real possibility. Better chips are gathering and processing more information at an exponential rate, which helps make AI deeper and more powerful than ever before. Moreover, the ubiquity of smartphones – to communicate over social media, make purchases and more – is resulting in enormous amounts of data that are stored, analysed and interpreted in real time. All the while, machines continue to learn with each interaction.

It is important to understand that much of what today's AI is already achieving is behind the scenes or merely the start of the journey. Here are just a handful of practical applications that already show the potential for AI to transform our daily lives:

- Route-planning algorithms adapt to changing traffic conditions, and smart sensors enable self-parking and other advanced safety features.
- Consumers routinely communicate using virtual assistants like Amazon's Alexa, Apple's Siri and Google Assistant – devices that get smarter with each question asked.
- AI is starting to be used to identify breast cancer and diagnose pulmonary hypertension – in some cases with greater accuracy than human specialists.

These changes to our world will have a dramatic impact on the companies in which we invest, both directly and indirectly. For example, the work being done on driverless cars by companies like Google, Tesla and Uber threatens not only established auto giants, but the businesses that support them. Cars guided by AI will not only move differently, but they may be owned, repaired and, with the elimination of "human" error, insured differently too. Such is the wide reach of a truly disruptive technology.

AI-guided cars will not only move differently, but they may be owned, repaired and insured differently too

The AI era is just beginning

Artificial intelligence is likely to be the largest driver of innovation and disruption across every industry group for decades to come. In fact, the accelerating pace of innovation in AI means that companies will need to identify and deploy new business strategies infused with AI or find themselves at a competitive disadvantage. We believe that companies that are able to effectively embrace this innovation are likely to capture a large portion of their industries' profits. As a result, vulnerability to disruption is something we have actively chosen to include in our broader company analysis here at Allianz Global Investors.

Is AI the next industrial revolution?

The potential benefits from AI have led some to compare its advancement to the next industrial revolution. In much the same way that steam-powered machines changed the face of rural economies and the labour force, AI has the potential to transform entire industries. For our part, we believe AI could have a bigger and more profound impact on people's lives and society than even the internet. And for our clients, this inflection point represents an exciting opportunity to access future sources of innovation and growth potential across the market.

This AI inflection point gives investors an exciting opportunity to access future sources of innovation and growth potential

As active investors, it is our job to recognize the companies that will drive and benefit from those changes, and to help our clients take advantage of them. Embracing and adapting to those challenges will be a large part of what will make being an investor in the coming decades so exciting.

Grassroots℠ Research

Robo-Advisors: Early Disruptors in Private Wealth Management

Kelly Reuba
Global Head of Grassroots℠ Research

Is the future of wealth management digital, or is this trend overplayed? While it may be too soon to tell, it's clear that "robo-advisors" – automated, online wealth-management services that provide algorithm-based portfolio-management advice – are continuing to attract attention from investors. Moreover, increasing numbers of financial advisors are beginning to use "systematic" or "robotic" investment strategies in their own practices.

To learn more about this trend in the private wealth-management industry, Grassroots℠ Research conducted two surveys in February 2017. The first targeted individual investors, while the second focused on independent and corporate financial advisors.

Investors like low fees but appreciate personal advice

The findings from our first survey indicated that, as expected, the lower costs associated with robo-advice are a key factor in the growth of these services. Slightly more than half of the individual investors we surveyed cited the lack of fees, or low annual fees, as the biggest appeal of robo-advisors. However, this didn't prevent investors who use financial advisors for private wealth management from also appreciating the tailored services their advisors offer.

Only 36 per cent of respondents said they were somewhat to highly willing to try a robo-advisor in 2017 – a decrease when compared with our February 2016 survey results (44 per cent). Among those investors who use a financial advisor, slightly more than half said they are highly unlikely to switch their investments either fully or partially to a robo-advisor.

Only 36% of investors in 2017 were willing to try a robo-advisor, down from 44% in 2016

Advisors see selective value in robo-advice

Financial advisors also told us that robo-advisors are not very disruptive to their businesses: Only 10 per cent saw any client interest vs. 24 per cent last year. Some of this may be due to a slightly older demographic in our newer study, and advisors did say they expect to see a higher impact from robo-advisors as millennials earn more money to invest.

Investor net worth is another important factor: Advisors say that sophisticated investors with large portfolios expect a personalized approach that robo-advisors do not offer. This reinforces the finding that robo-advisors are more relevant to investors with smaller portfolios who are more sensitive to costs. We also found that advisors themselves are beginning to use robo-advisors as part of the services they provide – primarily to manage smaller accounts more efficiently. This again shows the cost-management value of robo-advice, which may end up bringing more lower-value investors into the advice realm.

Robo-advisors are helping advisors manage smaller accounts more efficiently, which could prompt more investors to seek advice

The future is digital

Looking ahead, robo-advisors could become a greater competitive challenge to financial intermediaries – particularly given that younger investors expect to have more digital engagement with their finances. In the face of this challenge, advisors we surveyed said they will continue to emphasize and reinforce their value propositions, specifically their broad financial-planning expertise and the relationships they can form with clients.

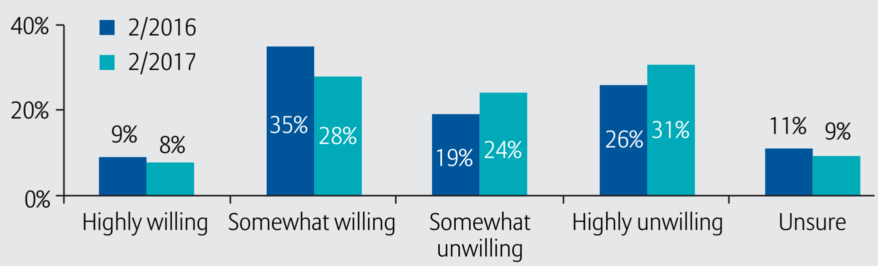
At the same time, we also found that advisors are committed to incorporating the latest technologies into their practices to help them work more efficiently with their clients:

- Several advisors use improved planning and analytics software, including risk tools that help them have more informed conversations with their clients.
- Others are also investing in improved customer relationship management tools.
- Some advisors point to the future ability of AI and virtual reality to help them customize services for clients and respond dynamically to their needs.

While robo-advisors may be struggling to gain ground in some areas of the market, there is no doubt that digital technology could play a bigger role in private wealth management in the future.

A Majority of Investors Aren't Attracted to Robo-Advice

Our 2017 investor survey showed that 55 per cent are somewhat or highly unwilling to try robo-advisors.



Source: Grassroots℠ Research as at February 2017.

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