

Allianz

China Equity

Monthly commentary

- The Fund aims at long-term capital growth by investing in equity markets in the People's Republic of China ("PRC"), Hong Kong and Macau in accordance with environmental and social characteristics. The Fund aims to achieve an outperformance (i.e. achieve a higher Environment, Social and Governance ("ESG") score) of the Fund's weighted average ESG score compared to weighted average ESG score of Fund's benchmark index by the adoption of the ESG Score Strategy. The Fund does not constitute as an ESG fund pursuant to the SFC's circular issued on 29 June 2021.
- The Fund is exposed to significant risks of investment/general market, country and region, emerging market, company-specific, currency (such as exchange controls, in particular RMB), and the adverse impact on RMB share classes due to currency depreciation.
- The Fund may invest in the China A-Shares market directly via the Stock Connect or other foreign access regimes and/or other permitted means and/or indirectly through all eligible instruments and thus is subject to the associated risks (including quota limitation, change in rule and regulations, repatriation of the Fund's monies, trade restrictions, China market volatility and uncertainty, potential clearing and/or settlement difficulties, change in economic, social and political policy in PRC and Mainland China tax risks).
- The Fund is exposed to risks relating to ESG Score Strategy investment (such as foregoing opportunities to buy certain securities when it might otherwise be advantageous to do so, selling securities when it might be disadvantageous to do so, and/or reducing risk diversifications compared to broadly based funds) which may result in the Fund being more volatile and have adverse impact on the performance of the Fund and consequently adversely affect an investor's investment in the Fund.
- The Fund may invest in financial derivative instruments ("FDI") which may expose to higher leverage, counterparty, liquidity, valuation, volatility, market and over the counter transaction risks. The Fund's net derivative exposure may be up to 50% of the Fund's net asset value.
- This investment may involve risks that could result in loss of part or entire amount of investors' investment.
- In making investment decisions, investors should not rely solely on this material.

Note: Dividend payments may, at the sole discretion of the Investment Manager, be made out of the Fund's capital or effectively out of the Fund's capital which represents a return or withdrawal of part of the amount investors originally invested and/or capital gains attributable to the original investment. This may result in an immediate decrease in the NAV per share and the capital of the Fund available for investment in the future and capital growth may be reduced, in particular for hedged share classes for which the distribution amount and NAV of any hedged share classes (HSC) may be adversely affected by differences in the interests rates of the reference currency of the HSC and the base currency of the Fund.

What Happened in September

The Fund underperformed the benchmark MSCI China 10/40 Index in September, with previously resilient stocks generally lagging the strong market rebound. Stock selection in the industrials, information technology and consumer discretionary sectors were the main detractor.

At a single stock level, a leading detractor last month was one of the largest banks in China. The share price lagged the broader market rally. This is one of our favoured financial holdings because of its superior return on equity (ROE) and stronger capital ratios than peers. The stock also has a high dividend yield, and with the easier monetary policy and lower government bond yields, this should continue to provide valuation support.

Conversely, a leading contributor was a clinical-stage biotech company with a focus on oncology. The share price has rebounded strongly following positive results from a key clinical trial. We believe the company has a strong product pipeline and as the company enters into its commercialization phase, this should help to de-risk the growth outlook.

Outlook and Strategy

Towards the end of the month, China launched a series of wide-ranging policy initiatives designed to provide support both to the real economy and, perhaps more eye-catchingly, to domestic equity markets.

The initiatives, amounting to a significant and coordinated package of easing measures, were a significant “policy beat” in our view. They included lower interest rates, reduced rates on existing mortgages (note: mortgage refinancing is only permitted in China in special circumstances approved by the central bank), and the provision of significant liquidity for share buybacks and stock purchases. There was also an unscheduled top cabinet meeting which, for the first time during the current downturn, called for property market stabilization.

The timing and extent of these measures were triggered by two recent developments. First, the strong rally in US bond markets and the 0.5% Fed rate cut. With lower rate differentials between China and the US, the risk of capital outflows from China and a weaker currency were also reduced. In other words, the People’s Bank of China (PBoC) had significant additional flexibility.

The second development has been the weakness of China economic data in recent months. This is to a large extent because of the sustained downturn in the property market, and the associated erosion of the biggest component of household wealth. The monthly macro data was consistent with GDP growth well below the official 2024 target of “around 5%”. With just over three months to go, there was increasing urgency to take action to boost economic growth.

Equity markets reacted positively and vigorously following the announcements. China A markets rallied by around 15% in the final week of the month alone and are now in positive territory year-to-date. It was a broad-based advance with all sectors in positive territory and on high volumes.

Looking ahead, the key question for equity investors is whether this rally marks a change or will turn out to be another false dawn. Our view is this announcement should at worst provide a floor to China A markets and, in a more optimistic scenario, potentially sets the scene for a more sustained market rally.

Certainly, Beijing seems determined to reignite animal spirits in China’s onshore equity markets. The policy tools announced, including a RMB 500 billion swap facility (that could be increased to RMB 1 trillion) and a RMB 300 billion relending programme (that could be doubled if warranted) to support share buybacks and equity purchases from eligible institutions, are unprecedented measures. An equity market stabilization fund is also under consideration.

Whether the measures also have a meaningful impact on the macro situation is more questionable, with the key issues of weak consumption and the property market remaining unresolved. A key issue is whether the door is now open to further policy initiatives, and especially if they end up being the prelude to more stimulative fiscal policy which is needed to spur a more robust economic environment.

In summary, the policy initiatives undoubtedly provide important support for market valuations. The next step is to build greater confidence in the outlook for corporate earnings which has been the major drag on equities over the last year.

In terms of portfolio activity, we added internet exposure by increasing exposure to a web-based shopping platform where the most recent results demonstrated the strength of the business model. We also added to our holding in the Hong Kong stock exchange where the share price had derated significantly. Conversely, we trimmed exposure to the energy sector.

The portfolio is currently positioned with relatively close to benchmark sector allocations. At month end the largest sector overweight is technology, while the largest underweight is financials.

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Source: Bloomberg, Allianz Global Investors, as of 30 September 2024 unless otherwise stated.

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