

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 February

The Fund outperformed the benchmark MSCI China 10/40 Index in February. Stock selection in the financials and health care sectors were the main contributors.

At a single stock level, a key contributor last month was Xiaomi*. Previously known for its smartphones, the company has expanded across a range of consumer products including smart home devices and more recently electric vehicles. The strategy of targeting higher quality, premium priced products has been well executed so far, leading to enhanced revenue growth and profitability. Consensus sell-side growth forecasts have risen significantly, and the stock has also benefited from the rerating of China technology companies since the DeepSeek announcement.

Conversely a detractor was the largest online travel booking platform in China. The trigger for the recent share price weakness was management guidance for higher marketing costs as the company looks to further build out its international operations. Overall we expect the company should continue to see sustained earnings growth as a result of increased travel volumes as well as potentially improving operational efficiency through the adoption of Gen AI.

Outlook and Strategy

Recent weeks have seen the second major rally in China equities in the last six months. The underlying reasons, though, are very different.

The previous rally started last September in response to an unexpectedly strong pivot in government policy including clear support for domestic equities. The emphasis was primarily focused on reducing the risk of significant further property and equity market weakness.

The strength of the “Beijing put” helped put a floor under China A markets, in particular, and also triggered a recovery in domestic animal spirits. The level of margin trading, a good real-time sentiment indicator, recovered to levels last seen three years ago.

This latest rally is very different. The initial trigger was the release of a new AI model by DeepSeek, China’s equivalent of ChatGPT. While DeepSeek is not new – its first model was released in November 2023 – the timing of this latest announcement on President Trump’s inauguration day catapulted the firm into global consciousness. And their announcement also focused attention on other recent innovation-driven headlines across a range of areas including humanoid robots, advanced driver assistance systems and high speed rail capabilities.

The key takeaway is that China is more advanced in the global technology and AI race than was previously understood. And from an equity perspective, this realisation has triggered a substantial re-rating of technology stocks. This is also the reason why offshore China equities have performed particularly well – eight of the top 10 constituents of the MSCI China Index are related to technology, either as internet platform, ecommerce or gaming stocks.

Adding fuel to the market rally was a high-profile symposium held by President Xi Jinping and attended by prominent private sector business leaders. In a highly symbolic move, this was the first time that Jack Ma, founder of Alibaba, had publicly attended a government meeting since the Ant Financial IPO was pulled in 2021. The fact that Xi Jinping chaired the meeting is, in our view, clear confirmation of an important shift in policy direction with a focus on boosting private sector confidence.

While there are clearly still risks to be faced – tariffs, property, weaker export momentum – nonetheless there does appear to have been a significant mindset change in China equities. For a long time, much of the focus on China has been on what could go wrong. Now attention has started to shift. And this momentum will likely be encouraged as China’s technological advances are increasingly visible.

In this environment, portfolio activity has been focused on adding selectively to companies which are expected to benefit from the more rapid adoption of AI. This includes software development, Artificial Intelligence of Things (AIoT) and exposure to the development of humanoid robots. Conversely, we have reduced exposure to consumer related stocks where we see some earnings risks.

The portfolio is currently positioned with relatively close to benchmark sector allocations so that stock selection is the key relative performance driver. At month end the largest sector overweight is industrials, while the largest underweight is consumer staples.

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Source: Bloomberg, Allianz Global Investors, as of 28 February 2025 unless otherwise stated.

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