Fund Commentary

Allianz Europe Income and Growth

08/2020

- The Fund aims at long term capital growth and income by investing in European corporate debt securities and equities.
- The Fund is exposed to significant risks of investment/general market, European country, company-specific, creditworthiness/credit rating/downgrading, interest rate, default, valuation, currency, emerging market, country and region, asset allocation, volatility and liquidity, and the adverse impact on RMB share classes due to currency depreciation.
- The Fund is also exposed to risks relating to securities lending transactions, repurchase agreements and reverse repurchase agreements.
- The Fund may invest in high-yield (non-investment grade and unrated) investments and convertible bonds which may subject to higher risks, such as volatility, loss of principal and interest, creditworthiness and downgrading, default, interest rate, general market, company-specific and liquidity risks and therefore may adversely impact the net asset value of the Fund. Convertibles will be exposed to prepayment risk, equity movement and greater volatility than straight bond investments.
- 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 and market 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 August

While European stocks found support from signs that economic recovery was gaining traction, rising new daily COVID-19 cases across continental Europe provided some cause for caution. There were especially sharp increases in Spain and France, which both saw the number of new daily infections creep past the peaks experienced in March. Euro-zone business activity strengthened in July, signalling the fastest growth rate in two years, according to final data based on surveys. The composite Purchasing Managers' Index, which combines manufacturing and services output, rose six points to 54.9. However, firms operated with considerable spare capacity and continued to shrink their headcounts. The EU labour market contracted by a record 5.5 million in the second quarter, a 2.6% reduction of the number of people in work. Eurozone retail sales reverted to pre-crisis levels in June, jumping 5.7% month on month. German industrial production continued to recover in June, rising 8.9% on the month, compared with 7.4% in May. German factory orders jumped by 27.9% over the month of June, although they were 11.3% lower than the levels recorded in February 2020, before restrictions were put in place to stop the spread of coronavirus. Data showed the UK economy shrank 20.4% in the second quarter versus the prior quarter, the biggest contraction of any major European economy in the period: a factor attributed to the UK's relatively long lockdown and the economy's large tilt to consumer services. The UK appeared on course to recover much of the lost ground in the third quarter, helped by a rebound in consumer spending.

Allianz
Global Investors

Portfolio Review

During August, the Fund made solid returns. Within the equity portion, sector positioning had a negative impact on the overall result mainly driven by the overweight in Utilities and the underweight in Consumer Discretionary. Stock selection had a positive impact on performance due to the positioning in the Materials, Financials and Consumer Staples sectors. On the fixed income side, August is traditionally a calm month with lower liquidity and a lack of new issuance. After a tightening in the first half of the month, spreads remained unchanged towards the end of the month. Since the widening in March the market tightened back around 80% but remains still wider than in January. The bond portfolio was able to gain in this environment and absolute return has turned positive for the year-to-date period. Since fundamentals and leverage are not back to pre-crisis levels, we consider this spread level as fair at best. It remains of upmost importance to remain selective to avoid losers from this crisis.

In the equity portion, we exited our remaining position in German telecommunications company, since the stock has had a strong run over the last few months, and we now see better alternatives in some laggards. Additionally, we sold a British asset financial services company.

The bond portion of the portfolio was mostly stable in August. We added corporate hybrids of energy companies and telecommunications company to the portfolio via the primary market.

Outlook and Strategy

The world economy has started to emerge from the deep, lockdown-induced trough. However, the quick initial recovery has recently slowed down. Moreover, regional differences are becoming more pronounced. China, for example, once again registered positive growth in Q2 2020, with most monthly data series improving. In Europe, too, most indicators are trending upwards. In contrast, the US economy is giving rise to concerns. The number of initial claims rose again recently, and consumer confidence has deteriorated. All in all, the COVID-19 pandemic obviously continues to have a significant impact on growth. The world's regions are following different strategies in dealing with the crisis. Meanwhile, the European Union has sent a clear signal by reaching agreement on the Recovery Fund. In general, the latest corporate reports have exceeded analysts' expectations so far. Moreover, progress with developing a COVID-19 vaccine has raised investors' hopes. At the same time, equity prices appear to be reflecting many of these encouraging developments – a fact which may lead to disappointment later on. And rising infection figures in some European and Asian countries and numerous US federal states show that the virus is not yet defeated. Against this background, differences in coping with the crisis are starting to emerge. This offers opportunities for active investors. With a wave of dividend cuts in the last quarter, investors cannot take the predictability of income from equities for granted. In these more unpredictable markets once more deep research is necessary to find well-managed companies which can reward investors with a dividend today while leaving capital available to grow shareholder value and enhance the dividend for tomorrow. The current situation has highlighted that identifying sustainable dividend opportunities requires an active selection approach with long-term return in mind. Taking into account the high valuations of the US market, Europe could be a geography to invest in for those expecting improvements off the lows seen in Q2 2020.

On the fixed income side, market appear to already discount a quick recovery. We think that the main driver is the unprecedented support by central banks and governments worldwide which were very successful in propping up asset prices. Especially bonds and corporate bonds benefit from the monetary support since the ECB buys corporate bonds directly. It remains to be seen if central banks will be equally successful in helping the real economy. The jury is out if governments can continue to spend at this pace as their indebtedness rises very quickly. For now, the flood of money by fiscal and monetary measures lift every boat but as Warren Buffett once said: "Only when the tide goes out do you discover who's been swimming naked." In the light of the strong technical drivers we maintain our constructive positioning on credit but remain vigilant concerning weak credits.

All data are sourced from Bloomberg, IDS and Allianz Global Investors and as at 31 August 2020 unless otherwise stated.
Information herein is based on sources we believe to be accurate and reliable as at the date it was made. We reserve the right to revise any information herein at any time without notice. No offer or solicitation to buy or sell securities and no investment advice or recommendation is made herein. In making investment decisions, investors should not rely solely on this material but should seek independent professional advice.
Investing in fixed income instruments (if applicable) may expose investors to various risks, including but not limited to creditworthiness, interest rate, liquidity and restricted flexibility risks. Changes to the economic environment and market conditions may affect these risks, resulting in an adverse effect to the value of the investment. During periods of rising nominal interest rates, the values of fixed income instruments (including short positions with respect to fixed income instruments) are generally expected to decline. Conversely, during periods of declining interest rates, the values are generally expected to rise. Liquidity risk may possibly delay or prevent account withdrawals or redemptions.
Investment involves risks, in particular, risks associated with investment in emerging and less developed markets. Past performance is not indicative of future performance. Investors should read the offering documents for further details, including the risk factors, before investing. This material and website have not been reviewed by the Securities and Futures Commission of Hong Kong. Issued by Allianz Global Investors Asia Pacific Limited.
Allianz Global Investors Asia Pacific Limited (27/F, ICBC Tower, 3 Garden Road, Central, Hong Kong) is the Hong Kong Representative and is regulated by the Securities and Futures Commission of Hong Kong (54/F, One Island East, 18 Westlands Road, Quarry Bay, Hong Kong).