

Allianz

Thematic Income

Monthly commentary

- The Fund aims at income and long-term capital appreciation by investing in global interest bearing securities and global equities with a focus on theme and stock selection.
- The Fund is exposed to significant risks which include investment/general market, thematic concentration, thematic-based investment strategy, asset allocation, emerging market, company-specific, creditworthiness/credit rating/downgrading, interest rate changes, default, volatility and liquidity, valuation, and 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 financial derivative instruments ("FDI") which may expose the Fund to higher leverage, counterparty, liquidity, valuation, volatility, market and over the counter transaction risks. The use of derivatives may result in losses to the Fund which are greater than the amount originally invested. 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 income and/or capital which in the latter case 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 distribution unit 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, particularly if such HSC are applying the IRD Neutral Policy.

What Happened in February

Global equities delivered mixed returns over February as markets struggled to navigate President Trump's deliberately disruptive and unpredictable agenda. Chinese stocks surged, boosted by strength in technology companies. European shares also advanced, underpinned by growing optimism over a potential end to the war in Ukraine. In contrast, US and Japanese equities lost ground.

Global bonds delivered positive returns. US Treasuries were among the strongest performers, boosted by signs of slowing US economic momentum. European government bonds also rose but lagged their US counterparts in anticipation that higher European defence commitments will likely cause government spending to balloon across the continent. In contrast, Japanese government bonds sold off, with yields touching the highest level since 2009 mid-month.

Emerging market bonds were mixed over February. Hard currency bonds, which are denominated in currencies such as the US dollar, advanced, while local currency bonds sold off slightly. From a regional perspective, there was little difference in regional returns of hard currency bonds, while Latin America was the strongest sector among local currency debt.

Portfolio Review

The equity investments focus on themes and topics of strong secular drives to generate long-term alpha. The strategy benefitted from the overweight to Utilities as well as to the underweight to Communication Services and Consumer Discretionary. On the other hand, the overweight to Technology as well as the underweight to Health Care and Consumer Staples has been a burden. Stock selection has been a burden especially in the Technology sector. China's technological advances are increasingly visible. In this environment, portfolio activity has been focused on adding to companies which are expected to benefit from the more rapid adoption of AI. We have also decided to respond to the recent evolution of technology within the financial services market and the wider adoption of AI beyond the initial investment phase. Therefore, we decided to bring two new themes to the portfolio. To capture these growth trends more effectively we have split the broad Digital Life theme into two, more distinct themes. Adoption will focus on the next wave of implementation and proliferation of efficiency-enhancing applications based on the recent advancements of AI, and Digital Finance, which captures companies within the evolving financial sector benefitting from FinTech, blockchain and decentralized finance developments. In response to the US election outcome, the Health Technology theme is being phased out due to the increase in regulatory uncertainties. In our view, a diversified multi-thematic portfolio continues to offer many opportunities for investors to benefit from structural megatrends in the current year. Regarding the positioning, we have moved to a higher degree of concentration as we have sought to strengthen our investment conviction.

The fixed income investments in the fund focus on global and emerging markets investment grade corporate bonds. Positive momentum in global fixed income markets continued in February. Our portfolio generated a positive performance and outperformed the respective broad markets and positively contributing to the overall fund. Amid economic data in the US surprised to the downside along with ongoing uncertainty on trade tariffs and other policies of the new US administration, US Treasury bond yields fell during the month and boosted the total return on corporate bonds. Despite mixed global macro sentiment, credit spreads of investment grade corporates have stayed resilient. The Ukraine/Russia peace negotiations were the major market focus in February and a ceasefire agreement would be positive to Eurozone and Eastern Europe growth through lower energy prices and recovery in business activities. Emerging markets exposures in our portfolio performed better than developed market credits in the month as macro dynamics improved on the back of weaker US dollar. In terms of sector breakdown, consumer discretionary and real estate management outperformed while automobiles and telecommunication services lagged.

During February, we have slightly reduced overall risk assets exposure. Within equities, we have reduced US exposure and increased European market exposure. We continue to maintain a tactical allocation to HK/China market. Gold exposure has been slightly trimmed to lock in profit. Exposure to fixed income was maintained during this month.

Outlook and Strategy

While a "soft landing" of the US economy remains the most probable scenario for us, strong US data, persistently high inflation, and uncertainty about the impact of President Trump's policies increasingly raise doubts about both the outlook for the economy and a complete normalisation of the Fed's monetary policy. At the same time, US equity valuations appear high in a historical comparison. Obviously, investors' earnings growth expectations are very optimistic, above all in the tech segment. This may ultimately lead to higher volatility on the US equity market. In this environment, risk-aware investors might turn to more favourably valued markets. In fact, it seems that they have recently channelled more capital into the European markets, not least because a number of companies pursue global business models which are less affected by the weak macro environment in Europe. In addition, several political initiatives from the US, in particular the dialogue with Russia about an end to the conflict in Ukraine, might support higher investments and a better business environment. While there are considerable political uncertainties, corporate earnings should remain robust for now, and healthy corporate earnings are usually favourable for equity investments. However, in view of concentration risks it makes sense to diversify the portfolio and pursue a dynamic approach at both the sector and the individual stock level.

Against the background of robust economic data and persistently high inflation, we expect the Fed to continue its cautious monetary policy and to reduce the Fed funds rate in small steps. It may even end the rate-cut cycle or hike rates during the remainder of the year. In contrast, the euro-area economies still need to deal with cyclical and structural headwinds, which is why we believe the European Central Bank will loosen the monetary reins further in the coming months. We continue to expect a rate-curve steepening in both the US and Germany, as maturity premiums still appear too low against the background of persistent inflation risks. In this environment, investors should take only well-selected duration risks, if any. Meanwhile, high-quality corporate bonds are an attractive source of additional income in view of usually robust corporate earnings and moderate default rates. At the same time, investors should be cautious about high-yield and emerging-markets bonds, as the spreads tend to hover around multi-year lows and do not compensate for the risks across all segments.

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All data sourced from Allianz Global Investors and Bloomberg as at 28 February 2025 unless otherwise stated.

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