Allianz Global Investors

Allianz

China A-Shares

Monthly commentary

Investment Objective

The Fund aims at capital growth over the long term by investing primarily in the A-Shares equity markets of the People's Republic of China ("PRC").

What Happened in January

The Fund slightly lagged the benchmark in January. Stock selection was the main detractor as a result of relative weakness in the Technology and Consumer Discretionary sectors, which was partly mitigated by positive selection in Materials and Financials.

At a single stock level, a key detractor was a company specialised in the development of high-tech auto parts such as chassis systems, intelligent driving and anti-vibration systems. It is a key supplier to a US electric vehicle (EV) maker, and news of that EV maker's reduced guidance for the coming year impacted the broader supply chain. While the near-term outlook for the company is more challenging than previously expected, in the longer term we believe it has good growth prospects supported by new product opportunities.

Conversely, one of the top contributors was China Construction Bank. High dividend stocks significantly outperformed last month, partly because dividend yields are now significantly higher than domestic government bond yields, and also because of the more defensive earnings profile of sectors such as Financials. China Construction Bank is the only "Big Four"' bank stock currently in the portfolio and is our preferred choice because of its higher return on equity (ROE) and higher capital ratios than peers.

JANUARY 2024

Portfolio Strategy and Outlook

China equities opened the new year on a downbeat note, with both onshore and offshore markets falling by close to 10% in USD terms.

A feature of the market in January was the outperformance of value stocks. The MSCI China A Onshore Value Index fell by 2.2% in the month, compared to the Growth index falling by 15.7%. In particular, there was a notable rotation into stocks with high dividend yields. This was spurred partly by falling domestic bond yields – the China 10-year government bond yield is now considerably less than the yield of many onshore and offshore equity indices. In addition, most high dividend stocks are state-owned enterprises, which are likely to maintain or even increase their dividend payouts to support local and central government revenues.

Another feature of the China A-shares market last month was the technical selling pressure from the liquidation of so-called “snowball” structured products. Popular in 2020-2021, snowballs were designed to pay investors a coupon if the market price remained within a set range. As China indices fell towards the lower end of the range, this triggered selling as brokers looked to hedge positions. It seems that most of these derivatives have likely already fallen through their lower strike prices, so further selling pressure from this source is expected to be less intense.

More broadly, China’s subdued economy continues to weigh on markets. Recent macro data has generally been weak but stable. The closely watched manufacturing purchasing managers’ index (PMI) for January came in at 49.2 – slightly above the figure of 49.0 in December, but still in contractionary territory.

The key property sector remains under pressure. Last month saw further signs that the government is stepping up support, for example with easier monetary policy such as a 50-basis point (50-bps) cut in the reserve ratio requirement. We expect the property sector to remain quite weak for the time being as the excess supply is worked through.

Portfolio activity in recent months has included adding to stocks with good valuation support, where they also meet our growth and quality criteria. For example, we have added to the Financials sector which is now only a slight underweight position compared to the benchmark. Conversely, we reduced exposure to areas where we see potential earnings risk, for example related to weaker consumption.

As at month-end, the largest sector overweight in the portfolio was in Consumer Discretionary, while our largest sector underweight was Information Technology.

All data are sourced from Bloomberg and Allianz Global Investors as at 31 January 2024 unless otherwise stated.