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 June

The Fund outperformed the benchmark in June. Stock selection in the Information Technology sector was the key contributor, with a number of stocks performing well on the back of improving business momentum ahead of the upcoming quarterly results season.

As an example, a leading contributor was a maker of optical transceivers that allow high levels of data to be transmitted quickly across a network. These play an important role in areas such as the development of artificial intelligence (AI) applications, especially in data centres where high speed data transmission is required. After a brief period of profit taking in May, the stock has subsequently moved higher on expectations of strong order growth related to AI-driven demand.

Conversely, a detractor last month was a producer of thermal control components which are primarily used in electric vehicles (EV). The share price has corrected on concerns regarding pricing pressure and volume uncertainty in the EV supply chain. Over the longer term, we believe the company has good growth prospects and valuations have come back to more attractive levels. In addition, the company has been expanding into humanoid robot development and will likely be a key supplier for the robot of an EV maker.

Portfolio Strategy and Outlook

The last month or so has been a period of consolidation for China equities from their year-to-date peak in mid-May. Although returns overall so far in 2024 are quite muted, nonetheless markets have held on to significant gains from their low point. Since Chinese New Year, China A-shares are up around 14% and H-shares more than 20% (USD).

The big question now, of course, is whether this rally is for real or just another "head fake" similar to what occurred last year. In our view, we see considerable differences this time around. Most notably, there has been an important shift in policy direction, in particular with a focus on containing downside risks in both the property market and also domestic equities.

Real Estate stocks were some of the biggest winners of the market rally post-Chinese New Year. And they have also pulled back in recent weeks. This reflects the initial market hope that the property market is getting closer to a turning point. And subsequent concerns about how policy rhetoric will translate into reality. Our perspective is that the recent policy measures, especially government support for buying up housing inventories, is an important turning point that sends a strong message about intentions to put a floor under the housing market.

Further measures are certainly needed – the oversupply of property remains high in many areas and the RMB 300 billion (approximately USD 42 billion) quota provided by the China central bank for local governments to purchase existing housing inventory makes a somewhat modest dent in the overall oversupply situation. As such, there is continued weakness in the housing market which, more broadly, is still pressuring broader macroeconomic data.

Nonetheless, financial markets appear to indicate that tail risks for property developers have eased. Reflecting this, the iBoxx USD Asia ex Japan China Real Estate High Yield Index bottomed in November 2023 and has moved steadily higher since then.

In terms of equity markets, while the direct government support was most apparent in January when the "national team" stepped in to buy onshore exchange-traded funds (ETFs) in size, since then the main focus has been the securities regulator, the China Securities Regulatory Commission (CSRC), taking other actions to restore confidence in markets. There has been a swathe of announcements relating to the level of new listings, challenging the use of funds raised from equity issuance and increasing dividend payouts.

In our view, reducing the supply of equity is a key issue. Secondary issuance and initial public offerings (IPOs) combined have typically averaged around 1-2% of total capitalisation of the China A-shares market over the last decade. This far outweighs the level of share buybacks (0.2% in 2023, for example).

In years when there has been a strong investor appetite for equities, this excess supply can be absorbed. But when confidence is low – as in recent years – then the supply weighs heavily on the market. So far in 2024, the level of share buybacks is similar to the level of equity supply. If this pattern continues, then the impact of one of the equity market's major headwinds should be significantly reduced.

In terms of portfolio activity, we have typically been adding to positions where we see an improvement in operating momentum. One example in the last month has been in the smartphone supply chain, where we expect orders to pick up after a challenging period. The portfolio continues to have relatively close-to-benchmark sector allocations. At month-end, the largest sector overweight is Utilities (+1.6%), while the largest underweight is Health Care (-3.3%).

All data are sourced from Bloomberg and Allianz Global Investors as at 30 June 2024 unless otherwise stated.