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 March

The Fund outperformed the benchmark in March. Stock selection in the Information Technology and Industrials sectors was the key contributor.

At a single stock level, a key contributor was Zijin Mining, a large mining group engaged primarily in the exploration and development of gold, copper and zinc. As well as benefitting from higher raw material prices, the company also announced strong results including positive free cash flow and a significant hike in dividend payout ratio. Looking ahead, we believe that Zijin's growth should be underpinned by increased production output and growing volumes.

Conversely, a leading detractor was Citic Securities, a large full-service brokerage house in China. The company announced relatively lacklustre results, not surprising given the capital market weakness. Citic operates across diverse business segments including research, asset management and underwriting. The company is a beneficiary of ongoing financial reforms given its investment banking capabilities. It should also benefit if there is a sustained recovery in equity market sentiment.

Portfolio Strategy and Outlook

China equities were relatively stable in March, consolidating the pre- and post-Chinese New Year rally. Both onshore and offshore markets have recovered from previous weakness to deliver relatively flat returns year-to-date.

MARCH 2024

The initial catalyst for the recovery was an abrupt change in supply and demand dynamics within the market. On the supply side, there had been extensive selling pressure from the unwinding of "snowball" derivative products linked to small cap indices. This pressure plateaued in January. Many of these products have subsequently been closed so this is unlikely to be a source of weakness going forward. There has also been tightened scrutiny over initial public offerings (IPOs), leading to a marked reduction in new issuance, and curbs on short selling.

The increased demand for equities was initially spurred by "national team" buying, evident through a significant pick-up in domestic exchange-traded fund (ETF) volumes. More recently, the buying appears to have broadened out somewhat with market volumes overall picking up and retail margin balances – a good proxy for local investor sentiment – increasing notably since Chinese New Year.

Also contributing to the improved demand/supply balance was a slew of coordinated share buyback announcements from state-owned enterprises, as well as some high-profile companies hiking dividend payouts. This looks likely to become more of a market feature going forward. The newly appointed head of the Chinese securities regulator has pushed for companies to enhance shareholder returns, in a move that echoes recent governance changes in Japan and Korea.

Looking ahead, our view is that the balance of risk and reward is looking considerably more favourable now than before. Certainly, the "Beijing put" appears to have been successful so far in putting a floor under the market.

Valuations are also helpful in providing some downside cushion. The forward price-to-earnings ratio (P/E) of the MSCI China A Onshore Index is around 12x. Also notable is that the dividend yield of the China A-share market has risen well above China government bond yields – an important consideration for domestic investors who have limited investment options given the country's capital controls.

In recent months, we have quite significantly rebalanced the portfolio. On the one hand, we have added to some "older economy" businesses where reduced capital expenditure (capex) requirements are significantly boosting free cash flow, and in turn the potential for higher dividends and share buybacks. We have also added to stocks in key growth areas such as industrial automation, power grid development, the semiconductor supply chain, and artificial intelligence-related (AI-related) applications. Conversely, we reduced exposure to areas where we see potential earnings risk, for example related to weaker consumption.

As at month-end, the portfolio continues to have relatively close-to-benchmark sector allocations. The largest sector overweight is Industrials (+2.4%), while the largest underweight is Financials (-2.9%).

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

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