

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 September

The Fund underperformed the benchmark in September, with previously resilient stocks generally lagging the strong market rebound. Stock selection in the Financials and Materials sectors was the main detractor.

At a single stock level, a key detractor last month was a power generation company. There was no negative fundamental news that influenced the share price. Overall, the Utilities sector lagged the broader market in the strong rally towards the end of the month. The company had previously been a strong absolute and relative performer and we see the share price pullback as a function of market rotation into higher beta names.

Conversely, a key contributor was Citic Securities, a large full-service brokerage house in China. Citic operates across diverse business segments including research, asset management and underwriting. After a challenging year, the securities/brokerage sector rallied strongly after the announcement of supportive policy measures. If there is a sustained recovery in equity market sentiment, Citic should be a key beneficiary given its broad investment banking capabilities.

Portfolio Strategy and Outlook

Towards the end of the month, China launched a series of wide-ranging policy initiatives designed to provide support both to the real economy and, perhaps more eye-catchingly, to domestic equity markets.

The initiatives, amounting to a significant and coordinated package of easing measures, were a significant “policy beat” in our view. They included lower interest rates, reduced rates on existing mortgages (note: mortgage refinancing is only permitted in China in special circumstances approved by the central bank), and the provision of significant liquidity for share buybacks and stock purchases. There was also an unscheduled top cabinet meeting which, for the first time during the current downturn, called for property market stabilisation.

The timing and extent of these measures were triggered by two recent developments. First, the strong rally in US bond markets and the 0.5% US Federal Reserve (Fed) rate cut. With lower rate differentials between China and the US, the risk of capital outflows from China and a weaker currency were also reduced. In other words, the People’s Bank of China (PBoC) had significant additional flexibility.

The second development has been the weakness of China economic data in recent months. This is, to a large extent, because of the sustained downturn in the property market, and the associated erosion of the biggest component of household wealth. The monthly macro data was consistent with gross domestic product (GDP) growth well below the official 2024 target of “around 5%”. With just over three months to go, there was increasing urgency to take actions to boost economic growth.

Equity markets reacted positively and vigorously following the announcements. The China A-shares market rallied by around 15% in the final week of the month alone and is now in positive territory year to date. It was a broad-based advance with all sectors in positive territory and on high volumes.

Looking ahead, the key question for equity investors is whether this rally marks a change or will it turn out to be another false dawn. Our view is that this announcement should at least provide a floor to the China A-shares market and, in a more optimistic scenario, potentially sets the scene for a more sustained market rally.

Certainly, Beijing seems determined to reignite animal spirits in China’s onshore equity markets. The policy tools announced, including a RMB 500 billion swap facility (that could be increased to RMB 1 trillion) and a RMB 300 billion relending programme (that could be doubled if warranted) to support share buybacks and equity purchases from eligible institutions, are unprecedented measures. An equity market stabilisation fund is also under consideration.

Whether the measures also have a meaningful impact on the macro situation is more questionable, with the key issues of weak consumption and the property market remaining unresolved. A key issue is whether the door is now open to further policy initiatives, and especially if they end up being the prelude to more stimulative fiscal policy which is needed to spur a more robust economic environment.

In summary, the policy initiatives undoubtedly provide important support for market valuations. The next step is to build greater confidence in the outlook for corporate earnings which has been the major drag on equities over the last year.

In terms of portfolio activity, there have not been significant changes to positioning over the last month. We added slightly to selective banks and insurance companies, where we expect the higher dividend yields should provide support, especially as China’s bond yields have continued to decline. Conversely, we trimmed some exposure to artificial intelligence-related (AI-related) stocks.

The portfolio continues to have relatively close-to-benchmark sector allocations. At month-end, the largest sector overweight is Industrials (+3.1%), while the largest underweight is Health Care (-2.9%).

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

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