Allianz
Global Investors

Allianz Europe Equity Growth

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth by investing in European equity markets with a focus on growth stocks in accordance with the Sustainability Key Performance Indicator Strategy (Relative). In this context, the aim is to outperform the Sub-Fund's Sustainability KPI compared to Sub-Fund's benchmark to achieve the investment objective.

What Happened in August

Eurozone equities rose modestly over August, closing near record highs as they recovered from a sharp reversal early in the month when global stocks took fright over fears of an imminent US recession. At a sector level, Real Estate, Health Care and Communication Services rose the most, while Energy companies were the weakest as oil prices weakened.

The HCOB Eurozone Composite Purchasing Managers ' Index (PMI) rose to 51.2 in August, compared with a five-month low of 50.2 in July, as the Paris Olympics boosted the French economy. The euro-zone services sector expanded at the strongest pace since April, although manufacturing dropped to an eight-month low of 45.6. Euro-zone inflation slowed to 2.2% in July, its slowest pace in three years, opening the door for the European Central Bank (ECB) to follow its July cut with another reduction in September. Minutes of the ECB's July meeting showed policymakers had an "open mind" regarding September's meeting, despite concerns over wage growth.

German equities rallied, outperforming the broader Eurozone, with the DAX Index touching a fresh high amid optimism over future rate cuts. The HCOB Germany composite PMI dropped to a weaker-than-expected 48.5 in August, the lowest level since March, driven by weaker activity in both manufacturing and services. Mirroring the broader decline in euro-zone consumer prices, German inflation fell to a three-year low of 2.0% on a harmonised basis in August.

UK equities advanced slightly. The UK economy expanded by 0.6% in Q2 and growth appeared to be accelerating in Q3, with the S&P Global UK Composite PMI rising to 53.4 in August, helped by easing price pressures. While the Bank of England reduced rates by 25 basis points (bps), it stressed it was "too early" to declare victory. UK inflation rose more

than forecasted in July to a year-on-year rate of 2.2%.

Performance Review

The Fund increased in August, however underperformed the style benchmark and the broader MSCI Europe. In connection with US and global markets, volatility in Europe also reached extreme levels this month. Investors raised alarm about slowing economic growth, especially in the US and China, alongside rising inflationary pressures. This weak investor sentiment coupled with lower market liquidity levels, and the unravelling of Japan's carry trade, following a novel increase to interest rates in the country. Eventually the rotation reversed. By the end of August, the MSCI Europe had returned to near record highs.

An insulation and building envelope solutions provider (building materials) was the top active detractor, falling nearly 9% after reporting an H1 earnings miss and lowering guidance, as price/cost and margins came under pressure. The management provided a positive outlook for better performance in H2.

Top overweight DSV (logistics) also underperformed, with higher longer-term business uncertainty also seeing our team take profits, despite an earnings beat and improved guidance in Q2 results.

A provider of payment solutions (payments) was the top active contributor, with the stock climbing over 17% after the company demonstrated sustained revenue growth of over 20% in Q2.

Fundamentally, we are optimistic given numerous positive outlooks on H2 from the management teams, where better growth is broadly expected and greater capacity is being readied in some spaces. Rate cuts appear to be key.

Top contributors

The afore-mentioned payments company grew revenues by 21% in Q1, creating some ambiguity for investors around the guided 20-30% for financial year (FY) 2024, with an unsupportive macro backdrop. A lower take rate of -7% quarter-on-quarter also disappointed by 5%, although it is due to mix effects, as larger enterprises outgrew smaller merchants. In Q2, the revenue growth acceleration to 26% reassured, with the management citing strong commercial momentum. There was also a small sequential improvement in their take rate. Investors rewarded the stock with a rally of over 17%. The runway for growth remains, with less than a third wallet share on the digital side and below 40% in unified commerce. Over 500 sales and tech recruits hired recently can fuel the next stage of growth.

A company that acquires market-leading niche businesses to develop further, in the areas of Dental, Demolition & Tools, and Systems Solutions reported extremely well in Q2, sending the stock up over 10%. Organic growth improved from -8% year on year in Q1 to 0% in Q2. Revenues came in 4% ahead of consensus, and adjusted earnings before interest, taxes, and amortisation (EBITA) 10% ahead, with all segments rising above expectations and particularly strong results in Systems Solutions. Around half of the company's business is made up of these high margin, niche industrial companies, that were much more resilient than the market expected. There was further support for the stock given it had been trading at discount to peers on weak sentiment. The company has also recently been deleveraging, thanks to very strong cash flow and very good capital allocation, which bodes well for further merger & acquisitions (M&A).

Partners Group stock has been influenced by interest rate narratives this year. The overweighted position made a small gain of over 4% on light newsflow, ahead of earnings results posted in September. Overall, the firm proved more robust than the market initially believed in the higher interest rate environment: adding value to investments to compensate for slower exits and enjoying increasing client demand. In July, new H1 client commitments of USD 11.1 billion beat

consensus of USD 10 billion. Potential interest rate cuts can drive higher volumes of transactions, particularly exits, and support higher investment income and fundraising momentum. In terms of outlook, the management recently raised their performance fee expectations post 2026.

Top detractors

The afore-mentioned insulation and building envelope solutions provider gained approximately 8% in July on improving sentiment that surrounded many stocks in the home improvement and construction spaces, however the optimism was premature. The stock fell approximately 9% in August after H1 profits missed consensus by -5% due to weaker margins. The management downgraded FY profit guidance -3% below consensus. Insulation Panels and Insulation disappointed, however Data & Flooring was a bright spot thanks to data centre construction, with 8% like-for-like growth in H1 and margins rising 30bps to 15%. Here, manufacturing capacity was recently added for products and systems like raised access flooring, expecting the division will quadruple its 2023 operating profit of EUR 51 million in the next three years.

DSV slipped just over 4% this month. The firm reported strong Q2 results, delivering a 2.3% earnings before interest and taxes (EBIT) beat on higher Air volume growth and better yields in Sea. An improved H2 outlook raised guidance to the upper end of FY2024 targets. DSV is shifting focus from M&A to organic growth and market share gains, with operational changes aimed at enhancing collaboration and supporting key customers with value added services, another route to structural growth. A new cost savings initiative aims to add DKK 750 million in run rate savings through digital and automation initiatives. DSV is one of two bidders left for the major acquisition of DB Schenker, one of its last major inorganic growth opportunities. On lower visibility, we reduced the position.

ASML Holding has not escaped recent tech stock volatility, slipping just over 4% in August. Year to date, the stock is up approximately 20%. Q2 revenues fell 10% year-on-year but exceeded market expectations. Orders also beat consensus, the backlog now worth 18 months of revenue. Guidance was maintained. Overshadowing these results was geopolitical risk, however China's equipment access is already extensively restricted. ASML's latest High Numerical Aperture (NA) equipment is a bigger mid mid-term story, enjoying far higher price, margin, and servicing fees. The management always described 2024 as a "transition year" with H2 set to outpace H1. Capacity has been expanded for 2025, where greater volumes should achieve higher operating leverage and margins.

Sales

We have decided to exit the small position in a British online real estate portal and add to a German platform for residential and commercial real estate, which operates under a similar business model but demonstrates better growth prospects. Unlike the former, latter avoids the tail risk associated with a US-based online real estate marketplace's acquisition of another British property portal, which may lead to increased marketing investments and potential market share grabs by the acquiring company. This activity could result in earnings volatility and downside pressure for the British online real estate portal. The German company offers a comparable valuation, making it a more attractive option in this context.

We have exited the position in a founder-led business that provides IT services, focused on complex and business critical IT solutions, and primarily catering to large customers in the public sector, taking advantage of the recent recovery, due to reduced confidence in the long-term business model.

Market Outlook

August built upon July's volatility, adding the collapse of the Japanese yen, heightened recession fears and associated

sector rotations, on low market liquidity. The euro area and the UK, which had appeared to be recovering over the last few months, now seem to be heading towards weaker growth. This is perhaps in connection and sympathy with the US, which has clearly seen its expansion slow. Overall, we witnessed a stunning surge in volatility that even rivalled the 2020 Pandemic and 2008 Global Financial Crisis.

The stage is surely set for the US Federal Reserve to loosen the monetary reins later in September. An interest rate cut may be on the cards in both the US and Europe. Overall, our equity market outlook is still optimistic even though the risks to a "soft landing" of the global economy have increased slightly and inflation continues to weigh on consumer demand, particularly in Europe. Corporate earnings look set to remain healthy for now and support equities. Nevertheless, we might expect more volatility if investors' expectations are disappointed or political risks come to the foreground. In this environment, an active investment approach appears useful.

Our Q2 earnings results were generally robust, although with low reward at this time. Key headwinds represented the Consumer space (rather than B2B which we tend to favour), selected cyclical end markets like construction and automotive, and especially China, being a major market for our global leaders. Investors seem to view Q2 as the trough however, with stocks in more cyclical sectors rebounding to enjoy some of the best performance in July. Smaller cap companies, and Value names, were also beneficiaries of this rotation that pre-empts the first interest rate cuts in the US. Funding this was profits taken from crowded large tech and semiconductor linked names, following the incredible run of some artificial intelligence (AI) leaders. Most recently, investors have been querying how long it will take for the major AI infrastructure investments to pay off. This change in optimism also affected semiconductor linked companies in Europe.

As we look ahead to the remainder of 2024, we look forward to the positive sentiment effects of rate cuts, as well as their technical effect on valuations. They are also valuable to unlock capital expenditure, with our companies across various industries relaying that customers are waiting for lower rates seemingly just around the corner. This could support our numerous Industrial names, while our semiconductor leaders should enter a cyclical upswing, and our fallen medtech stars appear to have troughed with upside from here. Meanwhile, M&A seems to be increasing with our cashed-up firms not beholden to interest rates noting, there are great opportunities at the current time.

Fundamentals look robust in general, though we have seen some companies temper their guidance with caution recently. By owning high high-quality market leaders actively navigating these challenges, we believe we are well positioned. Valuations have helpfully reduced slightly.

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