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 June

Eurozone equities fell modestly over June, as sentiment was undermined by an unexpected stagnation in eurozone economic activity and rising political uncertainty. French President Emmanuel Macron unexpectedly called a snap parliamentary election. A victory for the far-right could threaten the integrity of the European Union (EU) and lead to a sharp increase in government spending, further increasing France's already large budget deficit. As a result, French stocks declined sharply to a 5-month low, underperforming the broader region.

The HCOB eurozone composite purchasing managers' index (PMI) slumped to 50.8 in June, from a 1-year high of 52.2 in May. The weaker-than-expected reading was mainly down to a slump in manufacturing activity which contracted at the fastest pace in six months. Headline eurozone inflation quickened to 2.6% in May, up from 2.4% in the previous two months, although early inflation indicators for France and Spain indicated that inflation may have slowed again in June. As widely expected, the European Central Bank (ECB) cut rates by 25 basis points (bps) in June, its first reduction in five years, but signalled that movements thereafter would be data dependent.

German equities declined but held up better than the broader eurozone market. The HCOB Germany composite PMI dropped to a weaker-than-forecast 50.6, from a 1-year high of 52.4 in May. Services activity remained robust, but manufacturing activity declined more than expected. German inflation rose to a 4-month high of 2.8% in May on a harmonised basis. On the political front, Germany's coalition government faces some tough decisions as it seeks to agree to next year's budget ahead of a deadline of early July. Finance Minister Christian Lindner wants to slash spending to bring debt under control, but other coalition partners disagree.

UK equities closed the month slightly lower amid uncertainty ahead of July's general election. The S&P Global UK Composite PMI slumped to a 7-month low of 51.7 in June. The slowdown was primarily driven by a deceleration in the service sector, despite a stronger performance in manufacturing. The Bank of England (BoE) kept rates on hold, although hopes of a cut grew after May's inflation rate fell to 2.0%, the lowest level in almost three years. UK retail sales rebounded 2.9% over May, from an upwardly revised drop of 1.8% in April.

## Performance Review

The Fund gained in June. We find many tech-related companies in our top 10 active contributors this month: global market leaders from Europe that are helping to enable a higher level of digitalisation and artificial intelligence (AI). They were led by top-ranked ASML Holding, being very well positioned with a monopoly on equipment essential to produce cutting edge semiconductors. In other sectors, we also hold a number of firms whose products aim to reduce power consumption, another important factor for a successful digital transition.

On the flip side, our slightly more cyclical names with exposure to construction (a manufacturer of high-performance insulation and building envelope technologies;  a manufacturer of electrical devices such as switches, sockets and cable management; and Sika) fell out of favour, driven by softer local PMI data, while there was continued pressure in the medtech space (an integrated ophthalmology equipment manufacturer and a pharmaceutical and laboratory equipment supplier) where slower demand has been exacerbated by high inventories and ongoing weakness in China. We see this situation as temporary. Overall, the local macroeconomic picture strengthened in the past few months, which may be enough to outweigh geopolitical uncertainty. With the ECB lowering interest rates in recent weeks, our backdrop seems more positive. We look forward to the stronger fundamentals in H2 that a wide range of our companies' management are expecting.

**Top contributors**

ASML Holding jumped over 10% in June, after trading flatly over the preceding three months amid the semiconductor cycle trough. We remained bullish, noting management's comments that 2024 would be a transition year before "significant growth" in 2025. In June, we met with the CFO at our Frankfurt office, who substantiated this further. Demand has accelerated in key end-markets, and elevated tech competition among customers is raising demand for extreme ultraviolet (EUV), including ASML's latest "high numerical aperture (NA)" equipment. China (typically 15% of sales) remains strong, despite greater export controls. ASML expanded capacity over the last few years. As volumes ramp up, management expects more operating leverage on these costs, supporting margins.

Novo Nordisk is our best absolute this year to June, returning 45% to slightly outpace ASML Holding's 42% return. Optimism surrounds their new generation oral weight loss drug Amycretin, which boasts early Phase 1 results that are far superior to injectable Wegovy and peer drugs. Meanwhile, the US Centers for Medicare and Medicaid Services (CMS) has indicated medicare coverage for Wegovy in those patients with cardiovascular disease and obesity, and this month China approved the drug for sale. Novo Nordisk's purchase of a major contract manufacturing organisation helps secure supply. Our June discussion with the company focused on competition, rising growth comparatives and the patent cliff.

A global group of safety equipment companies reported excellent financial year (FY) 2024 results mid-month, with adjusted earnings before interest and taxes (EBIT) growing at 12% to beat both guidance and consensus expectations. A favourable outlook completed the sunny picture, well-illustrated with year-to-date (YTD) orders already ahead of the comparable period last year. The company is another holding believing in an H2 recovery. Importantly, organic and acquired profit growth equalised, allaying market fears of stunted inorganic growth now that it is a larger organisation. Operating cash flow growth of 48% year-over-year can fuel further acquisitions. Annual price increases of 3% strongly contributed to the 40 basis points (bps) increase in operating margins to 20.8%, confirming our pricing power thesis. The stock catapulted over 22% this month.

**Top detractors**

Stock of the afore-mentioned manufacturer of high-performance insulation and building envelope technologies fell close to 10% on limited news flow, as we wait for Q2 earnings release in August. Their Q1 results showed lower raw materials prices being passed through to customers, resulting in a sales growth contraction. Management expects this negative effect to annualise by mid-year. Recent market concern mostly centres around valuation. We appreciate the company's clear secular growth opportunities, for example insulation panels in a giant renovation market to reduce emissions. A majority stake in a wood fibre insulation materials company further bolsters their insulation product range. Also, its data and flooring solutions sales grew circa 14% in Q1. Here, the company recently added capacity to manufacture specialised products and systems such as raised access flooring.

A semiconductor manufacturer had a positive quarter overall, rising circa 9%, with the company having a relatively low price-to-earnings (P/E) of under 14x prior. In June however, the stock slipped almost 7%, even after management delivered a second major guidance reset earlier this year. Investors are still concerned that automotive semiconductors will be impacted by slowing electric vehicle (EV) demand, plus competition from China. The company remains technologically ahead, especially in silicon carbide (SiC) where it is building the world's largest 200mm SiC fab. Its leadership position in power semiconductors is another important counterbalance. It sees 50% or more expansion compound annual growth rate (CAGR) from 2023-27 for the AI server power semiconductor market.

Sika has been under pressure, with many construction projects on hold as developers wait for more favourable interest rates. Meanwhile, Sika has around 45% exposure to the more resilient refurbishment market, including infrastructure. Rising market share is another structural growth driver, including the integration of EUR 5.3 billion acquisition of a supplier of construction chemicals. We spoke to management in May, who laid out a varied growth picture by country depending on rates, elections, and even the Olympics. Like the afore-mentioned semiconductor manufacturer, Sika also has exposure to the challenged EV market through its adhesives business. Optimism for major upcoming construction projects continues. Bolt-on acquisitions and market share gains will be key.

**Purchases**

Purchases included a contract food services provider operating in circa 40 countries which is renowned for its robust business model. It boasts exceptional customer retention (~95%), a proven track record of resilient growth, and consistently high cash flow return on investment (CFROI) across various market conditions (COVID-19, global financial crisis, etc). The company's operational excellence drives superior organic growth and industry-leading margins, achieved through strategic focus on higher-margin opportunities and disciplined execution. Anticipated organic growth in the high single digits, well above the historical 4-6%, is supported by increasing venue outsourcing (given labour shortages, inflation, stricter regulations, etc.) and strengthened customer retention strategies. Built-in inflation protection safeguards margins, while shareholder-friendly capital allocation enhances the investment proposition.

## Market Outlook

Surprise elections in France have generated volatility over the past month, in what was an otherwise quiet period ahead of Q2 earnings results. We see limited disruption to our high-quality names from this event, although the volatility may offer some single stock opportunities.

Impressive technological developments in the AI space have absorbed much investor interest in recent months, especially in the growth space and in the US. We hold a range of lesser known, market leading companies that are enabling both the AI and climate transitions, which are now also somewhat connected.

Below we make a case for investing in the Fund at this juncture:

- Overall, we remain confident with the fundamental picture of our portfolio, noting a lot of companies are also pointing to a stronger H2 across diverse sectors from Information Technology (IT) to Industrials, and Health Care to Materials.

- Recent volatility has tempered valuations of many high-quality companies, although it will be important not to see disappointments in the Q2 earnings season.

- Europe reduced interest rates several weeks ago and further rate decreases, particularly from the US, would be supportive for our style (effectively reducing discount rates and encouraging economic growth broadly).

- More structurally, the portfolio has relatively high IT exposure versus peers, particularly to semiconductor-related stocks where the AI story could provide a boost.

- We also have strong exposure to sustainability themes, whose importance only rises given rapid data centre capacity growth.

- The portfolio has overall more of a business-to-business (B2B) tilt and is underweight in the consumer space, which we see as advantageous in a weaker macro environment, with consumer spending hurt more than the sticky B2B revenues of software (often subscription-based) and Industrials companies (which benefit from essential maintenance and servicing of equipment), for example.

- We expect our group of weak medtech names, affected by post-pandemic inventory build-up and slower demand in China, to be close to trough currently and look forward to their recovery in the coming quarters.

- Over in the US, a potential re-election of President Trump later this year could offer any number of surprises, but typically his policies were expansionary and supportive of growth.

- In China, stimulus and any economic momentum would be a bonus for a number of our global businesses which are currently experiencing revenue slowdowns in this historically high growth region.

- In the longer term, we feel our companies are well positioned as global market leaders and stock prices will eventually reflect fundamentals.

All data are sourced from Allianz Global Investors, Eurostat, IHS Markit and Office for National Statistics, as at 30 June 2024 unless otherwise stated.

The information presented here is intended for general circulation and does not constitute a recommendation to anyone; it also has not taken into account the specific investment objectives, financial situation or particular needs of any particular person. Information herein is based on sources we believe to be accurate and reliable as at the date it was made. We reserve the right to revise any information herein at any time without notice. No offer or solicitation to buy or sell securities and no investment advice or recommendation is made herein. In making investment decisions, investors should not rely solely on this publication but should seek independent professional advice. However, if you choose not to seek professional advice, you should consider the suitability of the product for yourself. Past performance of the fund manager(s) and the fund is not indicative of future performance. Prices of units in the Fund and the income from them, if any, may fall as well as rise and cannot be guaranteed. Distribution payments of the Fund, where applicable, may at the sole discretion of the Manager, be made out of either income and/or net capital gains or capital of the Fund. As a result of the payment, the Fund's net asset value is expected to be immediately reduced. The dividend yields and payouts are not guaranteed and might change depending on the market conditions or at the Manager's discretion; past payout yields and payments do not represent future payout yields and payments. Investment involves risks including the possible loss of principal amount invested and risks associated with investment in emerging and less developed markets. The Fund may invest in financial derivative instruments and/or structured products and be subject to various risks (including counterparty, liquidity, credit and market risks etc.). Past performance, or any prediction, projection or forecast, is not indicative of future performance. Investors should read the Prospectus obtainable from Allianz Global Investors Singapore Limited or any of its appointed distributors for further details including the risk factors, before investing. The duplication, publication, extraction, or transmission of the contents, irrespective of the form is not permitted, except for the case of explicit permission by Allianz Global Investors. This publication has not been reviewed by the Monetary Authority of Singapore (MAS). MAS authorization/recognition is not a recommendation or endorsement. The issuer of this publication is Allianz Global Investors Singapore Limited (79 Robinson Road, #09-03, Singapore 068897, Company Registration No. 199907169Z).



ADM-3722296