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 October

European equities retreated over October. Sentiment was knocked by the growing possibility that Donald Trump may win November's presidential election, as the former president vowed to impose a 20% tariff on imports from Europe. At a sector level, Information Technology, Real Estate and Materials companies fell the most, while Energy was the only sector in the MSCI Europe Index to deliver a positive return.

The eurozone economy expanded by a stronger-than-expected 0.4% in Q3, marking the strongest growth rate in two years. Spain remained the strongest economy in the region, with 0.8% growth, while France's gross domestic product (GDP) grew 0.4%, boosted by the Paris Olympics. Germany also surprised on the upside, with GDP rising 0.2% in Q3.

The flash HCOB eurozone composite purchasing managers' index (PMI) rose to 49.7 in October, marginally above September's 7-month low of 49.6. Growth in the services sector slowed slightly but remained positive, while the downturn in manufacturing softened. Headline eurozone inflation accelerated to 2.0% in October – the uptick was mainly due to base effects. The European Central Bank (ECB) cut rates by 25 basis points (bps), marking its third rate cut so far this year.

German equities fell over the month. The German economy avoided falling into a recession in Q3, with GDP expanding 0.2% compared with forecasts of a 0.1% contraction. However, Q2 GDP growth was revised down to a 0.3% fall, from an initial estimate of a 0.1% contraction. The flash HCOB Germany composite PMI rose to 48.4 in October, from

September's 7-month low of 47.5, with activity in both services and manufacturing showing some improvement. Political risk is rising, however, with the coalition government struggling to agree a budget ahead of the mid-November deadline.

UK equities lost ground over October. The flash S&P Global UK composite PMI fell to a 11-month low of 51.7 in October, as investors awaited the new Labour government's budget. Chancellor Rachel Reeves announced a GBP 40 billion tax increase, the biggest in a generation, to plug the black hole in the fiscal deficit and fund massive investment in public services. UK inflation fell to a 3-year low of 1.7% in September.

Performance Review

The Fund declined in October, underperforming the benchmark and the MSCI Europe. Sika (construction chemicals) was the largest active detractor, posting reasonably in line results and an optimistic outlook that was overshadowed by concerns about slow construction and automotive markets. The top active contributor was DSV (freight forwarding), still rising after the EUR 14 billion DB Schenker acquisition, set to showcase their proven execution strengths.

The Q3 earnings season yielded mixed results. Top 10 holdings SAP and Adidas delivered elusive beats and raises this season, while LVMH disappointed, alongside ASML. Artificial intelligence-related (AI-related) demand remains impressive, but delays in global semiconductor capital expenditure (capex), plus weak consumer and software demand resulted in an Information Technology (IT) selloff. Therefore, our top detractors include ASML, now targeting the lower end of its 2025 revenue range, along with Atlas Copco, a supplier of vacuum valves and vacuum components, and an IT product distributor, service and solutions provider. The medtech recovery is also unhelpfully delayed. We maintain our long-term views, convinced that demand will return in due course next year.

The US presidential election will likely set the tone for markets in the weeks ahead. As usual, we do not try to position for any specific outcomes. The team remains confident heading into 2025 as we move out of troughs in various sectors and onto higher ground. Our companies still demonstrate above-market growth, and valuations are slightly less demanding.

Top contributors

DSV delighted the market in September with news that they had won the major acquisition of DB Schenker, worth EUR 14 billion. Now approved, DSV will become the world's largest freight forwarder, a journey followed by our Fund since first initiating the position back in 2006. The stock has rallied almost 20% since, with some analysts expecting the deal to drive more than 30% earnings per share (EPS) upside over the coming years. The rights issue was undiscounted, oversubscribed, and will combine with bank debt and bonds to fund the transaction. Meanwhile, earnings growth resumed in Q3. Volume growth of 8% year-on-year in both air and sea demonstrated clear market share gains. We took some profits last month.

A building information modelling (BIM) software stock's 8.5% rise this month pre-empted its Q3 results, expected to extrapolate from a strong H1 that aligned with their full-year revenue growth guide of 10-11%. Despite a tougher environment for construction, the company has been able to deliver high-single-digit revenue growth over recent quarters, underpinned by the industrial and public sectors, renovation projects, activity ex Europe, higher prices, and a general structural shift of construction projects to incorporate cost-saving BIM. Management had anticipated the build segment (a third of sales) could even accelerate to over 30% growth in Q4. GoCanvas, a leading provider of field worker collaboration software was recently acquired for USD 770 million, a subscription tool that supports field worker collaboration.

A hotel chain performed well since we initiated the position in January, with the stock rising over 20% since. In Q3, revenue per available room (RevPar) growth slowed to 1.5% from 3% in H1. This was well anticipated however, and largely due to a decline of circa 10% in China. The market responded positively to management's outlook for Q4: growth accelerating on easier China comparatives and strong US demand. In our meeting with the CEO this month, we discussed their substantial improvements in quality over the past decade and potential to surpass historical growth rates. This is supported by a range of factors such as rising travel demand, significant unbranded hotel estate, and revamp of their 15-year-old credit card programme.

Top detractors

Sika reported Q3 sales in line with expectations. North America was a bright spot, due to infrastructure, reshoring of manufacturing, and semiconductor/data centre projects, while the Europe, Middle East, and Africa (EMEA) and Asia Pacific (APAC) regions were relatively softer. Earnings missed by -2%, with higher fixed costs impacting margins. The stock fell over 12%, with sentiment still sour on Sika's exposure to construction, the challenged electric vehicle (EV) market through its adhesives business, and a sluggish China. Yet management confirmed their financial year (FY) 2024 outlook, for 6-9% sales growth in constant currencies and an over-proportional earnings before interest, taxes, depreciation, and amortisation (EBITDA) increase, meaning that an acceleration is assumed in Q4. Meanwhile, Sika has been increasing its market share via significant mergers and acquisitions (M&A).

ASML Holding reported Q3 revenues and profits ahead of expectations, however cut their 2025 outlook to the lower end of their 30-40 billion revenue range. This led the stock down circa 15%. The lower guidance accounts for a slower-than-expected recovery in personal computer and mobile end markets, normalisation of deep ultraviolet (DUV) demand from China, and wider sales restrictions to the country (although these are not yet decided). We view this as a conservative update from a relatively new CEO, and look forward to attending the Capital Markets Day in mid-November for further insight on their growth path. The updated valuation of 26x 2025 earnings is in line with the broad portfolio, and attractive given the longer-term growth outlook and competitive position.

An engineered polymer solutions provider reported a mixed Q3, with weaker shipments affecting the margin and EBITDA landing 2% below consensus. The company cited lower demand late in the quarter, mostly owing to underproduction at construction and agricultural equipment manufacturers, and guided for somewhat lower demand over the next quarter. We appreciate the company for its structural organic end-market growth, and inorganic opportunities supported by its solid balance sheet, that in turn provide scope for margin expansion. Also, the business model notably increased in quality after divestment of their wheel systems and printing solutions segments. Management believes the company can maintain double-digit growth.

Market Outlook

After the first rate cut by the US Federal Reserve (Fed) in September, early November events in the US mean that the politics of the world's largest economy remain at the forefront of investors' minds. At the end of a fiercely contested campaign, with the candidates polling neck and neck for the majority of the time, Donald Trump eased to a surprisingly comfortable victory. At the time of writing, a subsequent clean sweep of the Senate and the House of Representatives looks probable, providing the president-elect with a powerful mandate to carry out his "America First" policy aims. The initial market reaction saw the US market experience the largest post-election day move in history, led by industries linked to the so-called "Trump trade". The likelihood of tax cuts, deregulation and tariffs on imports meant that US banks soared, Energy and Materials advanced at the expense of renewables and smaller domestic-focused companies performed well.

It remains to be seen if the rhetoric of an election campaign feeds through to legislation, but the impact of policies will undoubtedly be felt throughout the world. Fiscal largesse – together with higher tariffs, tougher immigration policy and looser regulations – tends to be inflationary. In response, the Fed may moderate its easing cycle, potentially supporting the dollar. Mr Trump has also pledged to impose a 20% blanket levy on all US imports, plus a 60-100% tax on Chinese products. The assumption is that this is a negotiation tactic for better deals on US exports, and that the levels suggested will not be reached, but any tariff hikes that do materialise will likely trigger retaliation by other economies. We foresee more regional nearshoring and onshoring as companies diversify their manufacturing bases and supply chains – a move that could strain balance sheets. Higher tariffs could hit European and emerging market stocks, particularly those reliant on the US market, such as makers of luxury goods, cars, aircraft producers and steel companies. Navigating potentially wide disparities in performance between winners and losers within sectors and themes and between regions will require active investment management.

The geopolitical backdrop could shift markedly under Mr. Trump. As well as a more aggressive approach to China, we anticipate a higher probability of a military confrontation with Iran and a potential escalation in the Middle East conflict. In contrast, there may be a quicker end to the Ukraine war if Mr. Trump pushes for a deal with Russian President Vladimir Putin. An end to that conflict could lead to lower commodity prices if Russia officially re-enters the market. Europe would have to beef up its military spending, leading to higher debt and less productive fiscal expenditure. We also expect more tensions with some European countries, with potential tax increases on imports which could weigh on European growth.

In the midst of the Q3 reporting season, results within the European market have been mixed with Financials continuing to strongly outperform the more cyclical areas. Against this backdrop, the portfolio holdings have generally provided solid results. Expectations are lower than they have been, with full-year growth projections downgraded for a number of companies and we are hopeful that our holdings that have pointed to a stronger H2 can positively surprise. We see a strong story into 2025, where the impact of a lower interest rate will begin to be felt and the market may look beyond the dominant 2024 themes of AI and higher for longer interest rates. Our companies have historically performed well when growth becomes scarcer and we remain convinced of our Fund that returns above-market earnings growth, compounding meaningfully over time. Ultimately, this drives stock prices over the longer term.

All data are sourced from Allianz Global Investors, Eurostat, IHS Markit and Office for National Statistics, as at 31 October 2024 unless otherwise stated.

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