Allianz Global Investors

Allianz European Equity Dividend

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth by investing in companies of European equity markets that are expected to achieve sustainable dividend returns in accordance with the Sustainability Key Performance Indicator Strategy (Absolute). In this context, the aim is, at least, a year-on-year improvement pathway on the sub-fund's weighted average Sustainability KPI to achieve the investment objective.

What Happened in February

European equities advanced over the course of February. Consumer Discretionary companies were particularly strong, as luxury goods companies were boosted by better-than-expected results from a leading luxury brand. The Technology and Industrials sectors also outpaced the overall market, while Real Estate and Utilities were the weakest sectors, notching up sizeable falls.

The flash estimate of the Hamburg Commercial Bank (HCOB)'s eurozone composite purchasing managers' index (PMI) improved further in February, while service sector activity jumped to the highest level in seven months. While manufacturing activity deteriorated to 46.1, it indicated activity had improved from last year's late-summer slump. The European Commission revised down its growth and inflation projections, saying it expected the eurozone economy to grow by 0.8% in 2024, down from a prior estimate of 1.2%, while inflation is now forecast to fall to 2.7%, from a previous estimate of 3.2%.

German shares posted solid gains, with the DAX reaching fresh all-time highs. In contrast to the broader eurozone, German economic activity weakened further in February, mainly due to a steeper contraction in the manufacturing sector. After a 0.3 % fall in German economic output in Q4 2023, the Bundesbank warned that the economy may contract further in Q1 2024, citing uncertainty over government policy, transport strikes and weak consumer and industrial demand. German inflation dropped to 2.5% in February, the lowest rate since June 2021.

The UK fell into an official recession in H2 2023, but the economy appears to have started 2024 on a stronger footing, with the flash S&P Global UK composite PMI surging to the highest level since May 2023. The Bank of England (BoE) kept rates on hold but dropped a warning that rates could rise again. UK inflation held steady at 4.0% in January.

Portfolio Review

The Fund performed almost in line with the broader market represented by the MSCI Europe Index despite a challenging market for income strategies. This is also reflected in the fact that the MSCI High Dividend Yield Index once again underperformed the broader index. February was a less volatile month for the European equity markets than the previous months.

The strongest increases resulted from the more cyclical and growth-oriented sectors. While sector allocation impacted overall performance, stock selection demonstrated strength, particularly in Industrials (overweight an automotive company, Schneider Electric, and Siemens) and Information Technology (overweight a semiconductor company), sectors that thrived in the buoyant market conditions.

Conversely, the strategy's returns were weighed down by selection in the Health Care sector. While our overweight position in GSK and not holding a biopharmaceutical company resulted in a positive contribution, being overweight in Sanofi and a health care company detracted. Not holding a leading pharmaceuticals group also hurt, as the company continued its rise fuelled by market expectations for its diabetes and weight loss drugs, which are expected to become global bestsellers. A semiconductor equipment giant also delivered another robust performance this month. However, due to its high valuation and a dividend yield of less than 1%, it is not part of our strategy.

In addition, our positioning in the Energy and Materials sectors had a negative impact due to our overweight positions in an energy company and a mining group. On the positive side, our holdings in the Financials sector made a notable contribution, supported by a reinsurer and several bank positions.

At the individual stock level, overweighted positions in a financial services company, a water, energy and waste recycling management services company, and Nestle, as well as the exclusion of a luxury goods group hurt, while the overweight position in a manufacturer and marketer of automobiles and commercial vehicles helped.

Portfolio Strategy and Activity

During the month, we continued to adjust the portfolio allocations, particularly in the banking sector, where we divested from an investment bank. Despite a promising performance at the start of the year, the dividend yield has now fallen significantly to just 2.1% for financial year (FY) 2024. While the market is optimistic about the merger with its peer, it is worth bearing in mind that the company's potential rise to wealth management juggernaut could be overshadowed by its reduced attractiveness from a dividend perspective. In turn, we have increased our position in an Irish bank. Consolidation in the Irish banking market means we could swap one strong franchise for another, but at a lower valuation and with a much higher prospective dividend yield.

As our Industrial holdings continued to perform well, we reduced holdings to take advantage of higher prices, similar to last month. We also adjusted positions in some pharmaceutical companies as their results gave us insights into the prospects for their key drugs. The overall positioning of the strategy is similar to before: we are looking for quality companies that offer attractive dividend yields and are cautious of overleveraged and poorly capitalised companies.

Market Outlook

Robust US growth has been the main source of support for the equity markets so far. At the same time, there are more and more indications that sentiment in Europe is cautiously, but steadily improving. It seems that fears of a "hard landing" in the US can be put safely aside for the next few quarters. This view is supported by the trend in corporate earnings, which have been quite healthy overall in recent weeks and months. As the economy is humming along, the US Federal Reserve needs to deal with the challenge of bringing inflation down towards the target without choking off growth. As long as earnings growth is stable, market participants should remain optimistic even in the face of new record highs. Nevertheless, equity valuations appear ambitious in many markets, which makes them vulnerable to a slowdown in earnings trends and/or a significant deterioration of the economic environment. In addition, the general uptrend is driven by the development of a comparatively small number of stocks. This is particularly true for the US. Many investors are obviously still focussed on future-oriented topics such as digitisation or artificial intelligence. Against the background of this market concentration, it probably makes sense to pursue a differentiated, active approach to stock and sector selection.

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