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 January

Eurozone equities moved higher in January, hitting their highest levels since January 2022, amid growing confidence that the European Central Bank (ECB) would reduce rates in 2024. Dutch stocks were especially strong, boosted by robust gains from a semiconductor equipment maker. At a sector level, Information Technology companies posted double-digit rallies, while Energy, Materials, and Utilities companies lost the most ground.

The eurozone economy flatlined in Q4 2023. While German gross domestic product (GDP) fell 0.3% and France showed no growth, output in Italy, Spain, and Portugal was stronger than expected. The flash estimate of January's HCOB eurozone composite purchasing managers' index (PMI) rose to a 6-month high, as an improvement in manufacturing activity offset a deeper decline in services. Headline eurozone inflation accelerated to 2.9% in December, from 2.4% the prior month, but early indications suggested that inflation rates may have eased again in January. The ECB kept rates on hold. ECB President Christine Lagarde acknowledged that the worst of the inflation fight was likely over and the "disinflation process was at work", but signalled that rate cuts were more probable in the summer than the spring. A further modest increase in German equities meant the DAX Index touched another record high in the closing days of January. UK equities fell modestly. UK inflation accelerated to 4.0% in December, the first increase in 10 months, dashing hopes of an early cut in interest rates from the Bank of England (BoE).

Portfolio Review

The Fund ended the first month of the year underperforming the MSCI Europe Index, amid a growth-oriented rally towards the end of the reporting period. This surge was fuelled by the market's upbeat response to perceived shifts in the US Federal Reserve's (Fed’s) interest rate stance. Throughout this market phase, dividend stocks, in general, trailed the broader market, as the most significant gains were witnessed in growth-oriented equities and assets benefitting from low interest rates. Nevertheless, it's important to highlight that our strategy continued to exhibit significant outperformance relative to the MSCI Europe High Dividend Yield Index, demonstrating its resilience as a dividend-focused fund despite the headwinds stemming from the growth rally.

In recent months, the market has been stuck in what some call a "Goldilocks" scenario, in which investors welcome the peak in key interest rates against a backdrop of falling inflation, while resigning themselves to the prospects of a relatively mild recession or economic slowdown. In this phase, it's natural for the performance of various investment styles to fluctuate, contributing to volatility in our holdings' performance compared to the broader market. To counteract these headwinds, we maintain a balanced approach to dividend investing, diligently seeking diverse sources of income.

In terms of stock selection, the most positive contributions resulted from our positioning in Communications Services (overweight an advertising and public relations company; and a telecommunications company), Utilities (overweight a provider of environmental management services), and Health Care (overweight a pharmaceutical company), while positioning in Industrials (overweight an automotive company and Siemens), and Energy (overweight an energy company) detracted.

On a single stock view, some negative contributions resulted from not being positioned in some lower-yielding stocks such as a semiconductor equipment maker, a pharmaceutical company, and an enterprise software company. Furthermore, our overweight positioning in a banking group, the aforementioned automotive company, a renewable energy company, a private markets investment manager, and a metals and mining company hurt. On the positive side, we saw a favourable impact from overweight positioning in a luxury goods group and a reinsurance company, as well as from not holding an energy company, a diversified natural resources company, a specialty chemicals company, and a semiconductor manufacturer.

Portfolio Strategy and Activity

Throughout the month, we continued to adjust our portfolio within the Financials sector and established a position in an Irish bank. In Ireland's banking landscape, significant consolidation has bolstered the sector, accompanied by healthy loan growth and favourable margins. The bank stands to benefit from its ample deposit base, enjoying minimal competition for savings, which in turn supports rising net asset values. Moreover, its expanding book value, coupled with an attractive dividend payout, suggests potential for re-evaluation and appreciation. Furthermore, we took profit trimming actions in certain holdings, notably Information Technology and Industrials, which exhibited exceptional performance but saw diminished dividend yields.

Market Outlook

Uncertainties about growth, monetary policy and geopolitical events will persist and continue to make life difficult for equity investors for the foreseeable future. The major central banks will remain in the focus of attention. In fact, both the Fed and the ECB have recently tried to dampen exaggerated rate-cut expectations. Against this background, actual corporate earnings should play an important role for the markets. For Q4 2023, analysts forecast a slight year-on-year decline for the companies of the US benchmark S&P 500 Index, and the outlook for the European Stoxx600 Index is similar. However, downward revisions of the US earnings estimates for 2024 as a whole have been considerably smaller than those for Q4 2023. A closer look reveals that analysts hope for very strong Q3 and Q4 2024. Optimists think that these expectations reflect the chance of a soft landing of the economy, whereas pessimists believe that the earnings forecasts will need to be revised downwards in the near future. From our vantage point, active stocks and sector selection is a good strategy, as market participants will clearly differentiate between “winners” and “losers”. Clearly, the ongoing geopolitical conflict, global growth and inflation outlook remain the key drivers for the relative performance of our strategy from the macro perspective.

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