Allianz Global Investors

Allianz Global Sustainability

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth by investing in global equity markets of developed countries in accordance with the Sustainable and Responsible Investment Strategy (SRI Strategy). The Investment Manager may engage in foreign currency overlay and thus assume separate foreign currency risks with regard to currencies of OECD member states, even if the Sub-Fund does not include any assets denominated in these respective currencies.

What Happened in February

In February, global equities experienced a significant rally, driven by robust performances in key markets such as China, Japan, and the US. This surge was fuelled by optimistic expectations of further stimulus measures in China, ongoing strength in the US economy, and impressive corporate earnings.

Within the MSCI All Countries World Index, growth stocks in sectors like Consumer Discretionary, Industrials, and Information Technology emerged as top performers. Conversely, sectors like Utilities, Consumer Staples, Real Estate, and Energy faced challenges and lagged behind.

Despite this positive momentum, global central banks signalled a cautious approach towards reducing borrowing costs, while leaving room for potential rate cuts later in the year. Although headline inflation rates showed modest slowing, policymakers remained vigilant for any signs of inflationary pressures, particularly related to wage growth. While economic activity in Europe showed signs of improvement, slight deteriorations were observed in the US and Japan.

Meanwhile, oil prices hovered around USD 80 a barrel (Brent crude) throughout the month, influenced by conflicting factors such as hopes for a ceasefire in the Israel/Hamas conflict and the pending decision by the Organisation of the Petroleum Exporting Countries plus (OPEC+) regarding production cuts. European gas prices experienced a notable decline, reaching their lowest levels since May 2021 due to a combination of a mild winter and ample inventories. Gold briefly dipped below USD 2,000 a troy ounce before recovering to close the month relatively unchanged.

In currency markets, the Japanese yen weakened against other major currencies as the Bank of Japan (BoJ) maintained its ultra-accommodative stance. Conversely, the US dollar and euro appreciated against the British pound. Central banks in the US and the eurozone moved to dispel speculation about imminent rate cuts in March but left open the possibility of such cuts later in 2024.

Portfolio Review

The Fund returned positively in February.

Stock selection was to be the largest driver of returns over the month. Positions in Technology, Financials and Real Estate stocks performed strongest, offset by picks in Basic Materials and Industrials stocks. Our underweight in Telecommunications helped performance, as those stocks fell back, whilst an underweight in Consumer Discretionary stocks impaired as they performed well over February.

Contributors

Applied Materials was the biggest contributor to returns over February. The global leader in nano manufacturing technology solutions rallied 23% in February after they forecast a better-than-expected Q2 on strong demand from customers looking to make artificial intelligence (AI)-enabled chips. The company beat Q1 revenue expectations and is well positioned to benefit from upcoming technology inflections.

A semiconductor manufacturer also contributed to returns over February. The company is firmly placed in the AI winners group with several chips that are able to compete with another graphics processing units manufacturer. The AI industry is forecasted to expand massively over the next few years, and the company is in a prime position to capitalise on this growth.

A cyber security company also contributed positively to returns. A leader in endpoint detection and response (EDR), the company has continued its strong performance undoubtedly benefitting from the rallying technology sector as well as leveraging the buzz around AI.

Detractors

In February, an air conditioning manufacturer emerged as the primary detractor to performance. The company reported underwhelming Q3 financial year (FY) 23/24 results, falling short of internal profit targets primarily due to sluggish heat pump heater sales in Europe and a downturn in residential ducted unitary systems in the US. Nevertheless, sales in China exhibited resilience, soaring by 20% year-over-year.

A multinational packaged food company also detracted from performance over the month. It released 2024 sales growth guidance in line with their mid-term goals but very slightly behind consensus. This comes as many consumer-goods companies have seen a sharp slowdown in volume after imposing steep price rises to offset higher costs. However, we maintain conviction as we see the company's resilient financial performance, coupled with its diverse category and geographic exposure, positions it for superior and consistent growth prospects compared to other Consumer Staples.

Not owning a manufacturer and marketer of integrated circuits also detracted from performance as the company reported February revenue that showed growth was accelerating year-over-year from January to February.

Significant Transactions

Over the month, we initiated a new position in a transcontinental freight railway operator. The merger of two railway companies created the best interconnected and wholly owned railroad reaching Canada, the US and Mexico. The merger should generate substantial revenue and cost synergies even beyond the stated targets. There are opportunities for operational efficiencies, fuel savings as well as for increased service levels and reach and they are uniquely positioned for long-term growth.

Market Outlook

After the prospect of interest rate cuts dominated the end to 2023, February saw the markets shrug off news that the first cut would be later and the downward trending path slower than many participants expected. With growth in the US remaining strong, inflation within the services industries proving sticky and continued strength in the jobs market, there is little pressure on the US Federal Reserve (Fed) to cut rates aggressively. The most recent minutes from the Federal Open Market Committee (FOMC) showed that US policymakers remain “highly attentive” to the risk of rising inflation and that data needs to confirm that inflation is moving towards 2% in a sustainable way.

Alongside the robust growth in the US, there are tentative signs that sentiment may be shifting within the eurozone and the UK, as purchasing managers’ indices (PMIs) climbed to the highest levels since the middle of 2023. As revised economic data showed that some economies entered a technical recession at the tail end of last year, any positive momentum is greatly received. The Chinese real estate sector remains an area of concern with a developer issued with a liquidation order by a Hong Kong judge and a fellow developer hit with a wind-up petition from a creditor. A number of policies that aim to provide growth stimulus for the economy, primarily through infrastructure projects, were announced at the National People’s Congress but it remains to be seen if this is enough to sustain an ambitious 5% growth target.

The geopolitical landscape remains uncertain, with ongoing conflicts in the Ukraine and the Middle East. Attacks in the Red Sea have also caused disruption to shipping, but it seems that the swift action taken has mitigated the impact for the time being. 2024 is also a big year for elections as 40% of the world’s population vote for new leaders, including the US and the UK. A variety of fiscal stimulus could be used or promised in an attempt to sway voters.

The recent earnings season has been generally healthy with the portfolio companies mainly on the right side of earnings numbers. FY 2023 earnings numbers for the MSCI AC World have been flat but distorted by the extraordinary growth trajectory of the “Magnificent 7”. 2024 estimates and where available 2025, show a slightly wider base of positive earnings. Anecdotally, this is also what we are hearing in company management meetings, where optimism is higher for H2 and beyond. Higher but not yet prohibitive valuations mean that earnings visibility will be key in the coming months. The recent results from three of the “Magnificent 7” and the following positive share price reaction show that there is still capacity to surprise on the upside. Another “Magnificent 7” company however dropped after its earnings release, as otherwise positive numbers were overshadowed by declining smartphone sales in China, highlighting the fact that at these heightened valuations, a small misstep can have a disproportionate impact on share prices. We are confident that the structural growth, low debt levels and high earnings visibility of our companies means the portfolio is well positioned, but will be mindful of valuations and adjust position sizes where we feel appropriate.

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All data are sourced from Bloomberg and Allianz Global Investors as at 29 February 2024 unless otherwise stated.

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