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 July

There were various factors behind the technology sell-off. US inflation was slower than expected in June, boosting hopes that US rates would soon be cut – an outcome that could weigh on mega-cap companies' cash piles; an electric vehicle (EV) manufacturer and Alphabet delivered disappointing earnings; Donald Trump said Taiwan, which is at the core of the global chipmaking industry, should pay for its own defence; and the Biden administration threatened severe export curbs if non-US companies continued to provide China with access to advanced chips.

As expected, central banks in the US and eurozone kept rates on hold. However, expectations of a September cut grew after the US Federal Reserve (Fed) Chair Jerome Powell signalled that rates could be cut in September if inflation continues to moderate. European Central Bank (ECB) President Christine Lagarde said the decision on a possible rate cut in September was "wide open", but downplayed fears of sticky price pressures. In contrast, the Bank of Japan (BoJ) tightened monetary policy, raising rates to 0.25% and setting out plans to halve its monthly bond purchases.

The Japanese yen surged against the US dollar, boosted by speculation that the BoJ may raise interest rates at its meeting at the end of July. The British pound also strengthened against the euro and the dollar, buoyed by growing hopes of political stability following a landslide victory for the Labour Party in the UK general election. Meanwhile, the US dollar weakened against the euro amid growing hopes that the Fed would start to cut rates in September.

Presidential candidate Donald Trump also signalled he might seek to weaken the US currency if he wins November's election.

Commodity prices were hit by signs of slowing growth, particularly in China.

Portfolio Review

The Fund lagged the Dow Jones Sustainability Index benchmark.

Volatility spiked since mid-July as we saw geopolitical risk increasing, the release of Q2 earnings and interest rate views all happening at once. The market was then both overbought and over-concentrated in the ultra-cap US tech trade. Earnings season has seen some large negative share price moves although we don't expect estimates to change much. ISM manufacturing indices have also been weaker, leading to a rate cut narrative and to a rotation away from technology companies in favour of value stocks.

Stock selection was detrimental over the month, whilst sector allocation was positive.

Contributors

The top contributors included lack of exposure to a semiconductor manufacturing company, and an underweight in Alphabet and Unilever.

As we saw a reversal of performance for technology stocks over the month, the top contributors of last month became the top detractors for this month and vice versa. Therefore, whilst the lack of exposure to a semiconductor manufacturing company was the top detractor to performance last month, it became the top contribution to performance this month.

Detractors

Top detractors included a cyber security company, technology holdings and underweight in pharmaceuticals.

A cyber security company mentioned above fell significantly due to the global IT outage provoked by a failed update implementation of one of their products and was the top detractor this month. We had trimmed the position ahead of the incident as the stock had had an amazing performance year-to-date. We now have a circa 1% position which we are keeping as we expect a slowdown in revenue growth rate that the market has already overly discounted. Similarly, a semiconductor equipment company had poor performance over the month as they got caught up in the technology sell-off.

Significant Transactions

We reduced our semiconductor exposure early in the month. We reduced our positions in the aforementioned cyber security company, a semiconductor equipment company, and a semiconductor lithography manufacturer. We also sold a Swiss multinational packaged food company, a provider of bio-analytical and measurement solutions, and a Norwegian financial services group.

The Swiss multinational packaged food company, whilst inexpensive, is missing numbers and investors have lost faith in the relatively new CEO. They are heavily exposed to coffee and chocolate which are exposed to commodities that are in a state of flux as consumers are entrenched. Food is challenging due to the affordability crisis and downtrading so having trust in management is key. We have switched into a UK household goods manufacturer that has an attractive valuation and is better positioned in the sector.

We sold the provider of bio-analytical and measurement solutions, having lost confidence on an inflection of the business given hard-to-dissect end markets and a valuation that we do not feel compensates in that vein. Sustained China weakness has not been fully priced in our view and we have an overweight position in the sector.

We also initiated a position in a business service company which provides the equipment and staffing for workplaces. They have an attractive valuation in an improved industry post-COVID where smaller players have been left behind. The balance sheet looks poised for either a special dividend or more mergers and acquisitions (M&A), both of which would be accretive to our investment case given this extremely conservative management team. The growth is extremely visible and we like the defensive characteristics of the company.

Market Outlook

We expect macro weakness will impact stock market positioning and the central banks' actions will be key to absolute levels of market performance as well as any style rotation. Low levels of leverage in the portfolio should provide drawdown protection. The US election is very hard to call, but we do not expect any significant performance/risk exposure to either candidate winning. Both will make statements that will reverberate globally and domestically so we are watching closely. We have plenty of idiosyncratic risks that we feel very good about and we believe that the market rotation will suit stockpickers.

All data are sourced from Bloomberg and Allianz Global Investors as at 31 July 2024 unless otherwise stated.

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