

Allianz

All China Equity

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth by investing in onshore and offshore Equity Markets of the PRC, Hong Kong and Macau in accordance with environmental and social characteristics.

What Happened in December

The Fund outperformed the benchmark in December. Positive stock selection in the Financials sector was the main contributor.

At a single stock level, a key contributor last month was China Merchants Bank. A leader in China's retail banking sector, the bank is a preferred pick given its strong retail franchise and higher return on equity compared to most peers. A high level of provision coverage ratio also helps provide an earnings buffer. Overall, the Bank sector had a good recovery to end the year with their high dividend yields providing valuation support in an environment where domestic government bond yields have fallen significantly.

Conversely, a detractor was a semiconductor equipment producer. The stock saw some profit taking after a strong rally earlier in Q4. This was fuelled by expectations that further US restrictions on China's access to semiconductor technologies would lead to enhanced opportunities for domestic players. The company has been gaining market share given its technological edge over other equipment players in China and in the longer term should benefit from the increased localisation of semiconductor production.

Portfolio Strategy and Outlook

China equities ended the year with double-digit gains in US dollar terms in both onshore and offshore markets, making them one of the better performing global asset classes in 2024 and ending a three-year losing streak.

Most of the gains in the last year occurred in a relatively short period towards the end of September and into October, spurred by a significant change in government policy focused on stabilising the economy as well as financial markets. Since then, China equities have remained broadly stable, as investors wait for more detail on the extent of the expected fiscal stimulus, as well as a potential market stabilisation package.

In addition, a further market headwind has been to what extent higher US tariffs, which weighed heavily on sentiment in China equities in 2018, will again become a major factor. Our view is that the "shock factor" of a Trump presidency will be somewhat less the second time around, and that China authorities will react with further domestically focused stimulus measures in the event of a major hike in tariffs.

Looking ahead to the coming year, a fundamental issue will be the sustainability of the improved economic momentum seen in recent months. In particular, China's export momentum – a key driver of growth last year – will likely fade in 2025. As such, an improvement in domestic demand will be needed to achieve the expected gross domestic product (GDP) growth target of around 4.5-5.0%.

In our view, the main reasons for the weakness in domestic consumption in recent years are related both to concerns of future income prospects in the uncertain macro environment, and also the erosion of wealth linked to falling house prices.

In this area, while recent government initiatives, such as reducing mortgage rates and downpayment ratios, and improving access to funding for cash-strapped developers have undoubtedly been a step in the right direction, more policy support will likely be needed to underpin the property market. The National People's Congress, held each March, is typically when more policy details are announced.

Notwithstanding the uncertainty regarding what the Trump presidency will bring, overall our view is to be more optimistic on the outlook for China equities, particularly in the context of risk/reward outcomes. The government has sent strong signals that it will step in to support the China A-shares market in particular, which should help limit downside risks.

While we do not expect a massive fiscal boost in coming months, there is nonetheless a higher probability that a more expansionary approach benefits the real economy, and helps support corporate earnings, which have been the main drag on China equities this year. With the likelihood of more supportive government measures to come, and with valuations still reasonable, our view – and the way we have been managing the Fund – is to use periods of market weakness to "buy the dips".

In line with this approach, in recent months we have added to stocks which are more sensitive to an improvement in the domestic economy and financial markets. These include financial services companies such as investment banking and mutual fund management businesses, as well as consumption-related stocks. We also believe higher yielding stocks should be well supported given the lower interest rate environment in China. Conversely, we have trimmed exposure to previous outperformers such as selective technology semiconductor stocks.

At year-end, the portfolio has around 41% in China A-shares. Sector weightings continue to be relatively close to the benchmark, so that stock selection remains the key relative performance driver. At year-end, the largest sector overweight is Consumer Discretionary (+1.2%), while the largest underweight is Communication Services (-2.7%).

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