

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 August

The Fund outperformed the benchmark in August. Stock selection in the Industrials and Information Technology sectors were the key contributors.

At a stock level, a key contributor last month was Eoptolink Technology. The company makes high speed optical transceivers which are an essential component for areas such as high-speed internet, cloud computing, and data centre communication. Eoptolink previously announced a set of strong quarterly results, well ahead of market expectations, buoyed by healthy artificial intelligence (AI)-related demand both in China and overseas.

Conversely, a detractor was China Construction Bank, one of the largest banks in China. Having previously been an outperformer, the Financials sector lagged last month with the market rotation into high growth areas. China Construction Bank remains one of our preferred bank stocks given its higher return on equity and stronger capital ratios compared to most peers. The high dividend yield should also support valuations.

Portfolio Strategy and Outlook

August was another good month for both onshore and offshore China equities. China A-shares were particularly strong with gains led by the Technology sector. Over the last 12 months, both China A- and H-shares have returned more than 40% in USD terms, a dramatic turnaround from the doldrums of previous years.

There have been a number of reasons for this turnaround. On the one hand, some factors that previously weighed heavily on markets have eased. Although China's housing market continues to be weak, for example, its impact on the country's financial markets has been lessening for some time. In the bond market, real estate indices bottomed out almost two years ago. It's taken a lot longer – and several false dawns – for confidence in equities to rebuild. But the breakout in recent weeks, supported by record trading volume, suggests that China equities have finally turned the corner.

Much of the recent equity market strength has been focused on the Tech sector. While the open-sourced AI model developed by an emerging Chinese startup was the high-profile catalyst earlier this year, the groundwork for China's AI surge has been laid for over a decade. In 2017, the government established AI as a national strategic focus, prioritising computing infrastructure, AI chips and cloud services.

Supported by a vast pool of STEM (science, technology, engineering and maths) talent, extensive data centre infrastructure, abundant and low-cost electricity, and substantial capital, China has brought together the ingredients for an AI boom. The recent news that the US revoked export curbs that required American companies to obtain licenses to provide chip design software to customers in China – as part of an agreement intended to ease trade tensions – has also provided a further boost to China's AI ambitions.

Linked to this, another catalyst for the positive market sentiment is related to geopolitics, and the turn of events since the US and China traded ever-higher tariff numbers post "Liberation Day". China's control of processed rare earth minerals has subsequently provided powerful negotiating leverage. For the time being, at least, US-China relations appear to have found a floor and previous concerns about a sharp slowdown in China's exports to the US have eased.

While each of these factors have played their part in providing the foundation for the market upturn, the most notable short-term change has been the return of China's retail investors, who until recently have largely stayed on the sidelines.

Bank deposits have been ballooning for several years reflecting the macro weakness, increased job uncertainty, and the decline in house prices. Households in China used to save around USD 1 trillion a year in aggregate, but that roughly doubled during and since COVID. As a result, there are around USD 7 trillion of "excess savings", about half the size of the China A-share market. With bond yields and deposit rates having fallen to significantly lower levels, this is leading to some reallocation from cash deposits into risk assets.

While the rapid pace of the recent upturn might prompt some profit taking, with this combination of factors in place our view is to buy the dips, not sell the rally.

Portfolio activity was quite limited during the month. We had previously added to several names that had pulled back during the period of tariff-induced weakness earlier in the year, but where we saw growth opportunities related to AI demand as well as China's ongoing push for self-sufficiency. We also added to Health Care stocks in previous months, with a focus on the biotech space where out-licensing deals with global pharmaceutical companies have become an important new growth driver.

At month end, the Fund has around 40% in China A-shares. The portfolio continues to have relatively close-to-benchmark sector allocations, so that stock selection remains the key relative performance driver. At month end, the largest sector overweight is Information Technology (+4.5%), while the largest underweight is Communication Services (-4.1%).

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