

# Allianz

## China A-Shares

### Monthly commentary

#### Investment Objective

The Fund aims at long-term capital growth by investing in China A-Shares equity markets of the PRC in accordance with environmental and social characteristics.

#### What Happened in November

The Fund outperformed the benchmark in November. Stock selection in the Information Technology sector was the main contributor.

At a stock level, a key contributor was Zhongji Innolight. 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. Innolight has reported consistently strong quarterly results through this year, confirming strong business momentum buoyed by healthy artificial intelligence (AI) related demand both in China and overseas.

Conversely, a detractor last month was a leading fabless semiconductor company that provides high-performance integrated circuit (IC) based solutions for cloud computing and AI markets. We view the recent share price pullback as some profit taking after strong gains year-to-date. The company remains one of our preferred ways to play the China AI opportunity given its very strong research and development (R&D) capabilities and ability to launch new products ahead of its peers.

#### Portfolio Strategy and Outlook

China equity markets have taken a breather in recent weeks, consolidating year-to-date gains. As part of the pullback, there has also been some notable rotation. Previous market leaders such as Tech and Health Care stocks have seen profit-taking, with more defensive and higher-yielding sectors such as Energy, Utilities and Banks being more resilient.

While the AI jitters in the US played some part, we also see a more domestic catalyst. Earlier in November, the securities regulator in China issued guidelines requiring domestic fund managers to “adhere more closely to their mandates”. As well as aiming to improve transparency in the mutual fund industry, this was also interpreted as a warning against excessive speculation and crowding in the Technology, Media, and Telecommunications (TMT) space.

Recent economic data has also been somewhat underwhelming, leading to a more muted near-term environment. This begs the question of whether China equities can make further gains in the coming year if the macro environment as a whole remains subdued.

From our perspective, we see little correlation historically between the macro and the market. China’s years of strongest economic growth often saw quite poor equity returns. And the strong returns in both China A- and H-shares this year have been achieved against a weak property market and ongoing deflationary pressures.

One reason for this is that the structure of China’s equity markets is quite different to the structure of the underlying economy. The widely followed MSCI China A Onshore Index, for example, has close to 25% exposure to the Tech sector. This weighting has more than doubled in the last decade. In contrast, the Real Estate sector is less than 1% of the index.

So, in our view, while an unexpected macro shock would no doubt impact equities, the current set-up, where monetary and fiscal policy settings are occasionally nudged to achieve the gross domestic product (GDP) growth target – likely to be in the range of 4.5%-5% again next year – should not be a barrier to future equity gains.

Indeed, as we look ahead to the new year, we are optimistic on the outlook for China equities. As well as a supportive economic policy backdrop, other key factors include strong domestic liquidity – both for corporates and households – combined with China’s technology narrative.

We expect the interlinked subjects of geopolitics and technology will remain in focus. A key question is whether the strategic competition between the US and China – which for many years has contributed to the higher risk premium on China equities and will likely continue to be a source of volatility – may also come to be seen as an opportunity.

While the recent trade truce buys some welcome breathing space, in effect both the US and China look to be buying time, digging in, and making further efforts to reduce mutual dependence. The US government has been signing a raft of deals on rare earth materials, while Beijing is doubling down on investments in chipmaking. China’s long-term policy support and infrastructure build-out are key reasons we view the tech and AI space in China positively.

Against this backdrop, recent portfolio activity has focused on using the pullback in Technology and AI-related names to add to selective positions. This includes areas such as AI servers, printed circuit board (PCB) manufacturers and high efficiency gas turbines used to power data centres.

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 Consumer Discretionary (+2.2%), while the largest underweight is Materials (-2.9%).

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