p Allianz Global Investors

Allianz Europe Equity Growth Select

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth by investing in European equity markets with a focus on growth stocks of large market capitalisation companies in accordance with the Sustainability Key Performance Indicator Strategy (Relative). In this context, the aim is to outperform the Sub-Fund's Sustainability KPI compared to Sub-Fund's benchmark to achieve the investment objective.

What Happened in September

Eurozone equities closed the month little changed. To an extent, the US stock market influenced movements in Europe. Shares sold off in the first half of the month as continued weak US job growth raised recessionary fears once more, before rallying in the second half as central banks loosened monetary policy and the Chinese authorities announced additional stimulus measures. Sectoral returns were mixed: Materials, Real Estate and Utilities were the strongest sectors, while the largest losses came from Energy, Health Care and Information Technology.

Eurozone economic activity weakened in September following the short-term boost from the Paris Olympics during the previous month. The flash HCOB eurozone composite purchasing managers' index (PMI) fell to 48.9, the lowest level since January and moving back below the 50 level that separates expansion from contraction for the first time in seven months. Eurozone inflation slowed, easing to 2.2% in August, its slowest pace in three years. With growth subdued and inflation nearing its official target, the European Central Bank (ECB) cut rates for the second time this cycle. ECB President Christine Lagarde signalled more rate cuts were expected but downplayed the likelihood of one at the next rate-setting meeting in October.

German equities rallied moderately, outperforming the broader eurozone, with the DAX Index touching a fresh peak towards month end as another cut in interest rates boosted hopes for an improved economic outlook. The flash HCOB Germany composite PMI dropped to a weaker-than-expected 47.2 in September, the lowest level since March, driven by weaker activity in both manufacturing and services. German inflation fell to a three-and-a-half-year low of 1.8% on a harmonised basis in September.

UK equities slid modestly over the month, with the FTSE 100 Index dragged lower by its heavy weighting to Energy and Health Care companies, two of the weakest sectors in September. Chancellor Rachel Reeves' stern warning over the state of public finances weighed on consumer sentiment ahead of her first budget at the end of October. With headline inflation holding steady at 2.2 % in August, the Bank of England (BoE) kept rates on hold at its September meeting, although it signalled that rates would likely be cut again before year end.

Performance Review

The Fund closed the month in positive territory, outperforming the benchmark and the broader MSCI Europe. Given our clear growth style orientation, the portfolio benefitted from the sizeable US rate cut at the US Federal Reserve's (Fed's) September meeting and, especially, the surprise wave of China stimulus. The top active contributors list includes numerous holdings across the Construction, Property, and Industrials spaces, which the market simply classifies as cyclical, but whose structural growth and defensive characteristics we also highly value.

Most excitingly, our top portfolio overweight DSV (logistics) won its prized EUR 14 billion acquisition of DB Schenker. DSV have an excellent track record of buying and integrating other businesses, and this acquisition is expected to be highly accretive to earnings over the coming years.

The main active detractor was Novo Nordisk (pharma), falling 16% after trial results of its oral weight loss drug presented some safety concerns, similar to competitors like a manufacturer of pharmaceutical and diagnostic products. Secondly, ASML Holding (semiconductor equipment) continued to be a source of profit taking with investors less confident at this stage of the semiconductor cycle. Optimism from several of our management teams for a brighter second half will be tested shortly, with Q3 earnings results now due. We remain excited about new product development, continued mergers and acquisitions (M&A), geographical expansion, and indirect exposure to artificial intelligence (AI), with clear examples in our detailed stock comments. Without further rate cuts and a demonstrated improvement in the China macro situation, however, near-term performance appears particularly reliant on management commentary during this coming earnings season. The team remains confident heading into 2025 also as we move out of troughs in various sectors and onto higher ground.

Top contributors

DSV delighted the market with news they had won the major acquisition of DB Schenker, worth EUR 14 billion. Now approved, DSV will become the world's largest freight forwarder, a journey followed by our Europe Equity Growth strategy since first initiating the position back in 2006. We have a copy of the original investment case which has barely changed over time. Investors have fully embraced the opportunity: the stock rallied circa 15% in September, with some analysts expecting the deal to drive more than 30% earnings per share (EPS) upside over the coming years, while the equity offering was undiscounted and rumoured to be 5x oversubscribed. Meanwhile, DSV reported strong Q2 results, delivering a 2.3% earnings before interest and taxes (EBIT) beat and a raise to the upper end of financial year (FY) 2024 targets. We reduced our top overweight position given smaller inorganic growth opportunities ahead.

A construction and mining machinery manufacturer's gain of over 11% this month on low news flow is largely attributable to China's announcement of significant economic stimulus, which is expected to be beneficial for the mining sector generally. In the current environment, mining has held up quite well. Exploration has continued among larger miners, although more junior players were hesitant given higher interest rates. The construction segment has been far softer, however. Our structural case is defined by a growth in underground mining as surface deposits are exhausted, ageing equipment, and the need to electrify and automate in order to reduce emissions and meet climate targets. Electric equipment offers higher margins, also on servicing.

A manufacturer of high-performance insulation and building envelope technologies gained over 7%, benefitting from dovish news of lower interest rates in the US and further stimulus for China. The Grenfell Enquiry also concluded, clarifying that the company's product was not material in the tragedy, removing some uncertainty. Construction activity however remains relatively muted, particularly for residential construction. H1 profits missed consensus by -5% due to weaker margins, leading to a reduction in FY profit guidance to -3% below consensus. Insulation panels & insulation disappointed, however data & flooring was a bright spot thanks to data centre construction. Here, manufacturing capacity was recently added for products and systems like raised access flooring, with the division expected to quadruple its 2023 operating profit of EUR 51 million in the next three years.

Top detractors

Novo Nordisk dropped circa 16% this month on mildly disappointing results from a Phase 2a trial of its obesity pill. While it offers higher weight loss benefits than injectable Wegovy, the safety profile needs attention. Heightened scrutiny over pricing for its blockbuster drugs Ozempic and Wegovy, particularly in the US, added further pressure. The news comes on top of a surprise sales miss of 1% in Q2 results, predominantly due to negative gross-to-net adjustments in the US (higher rebates than expected) coupled with supply constraints on Ozempic. Positively, the geographical rollout of Wegovy continues, now available in 12 markets ex-US and including China, alongside further drug indications. We continue to review our position size.

ASML Holding slipped further on concerns of slowing demand in the semiconductor space. For several quarters, ASML has described 2024 as a "transition year", offering FY guidance roughly in line with last year's results. They suggest that 2025 will be much stronger. Q2 revenues fell 10% year-on-year but still exceeded consensus. Orders also beat, with the backlog now worth 18 months of revenue. Regarding geopolitical risk, China's access to cutting edge equipment is already extensively restricted, but there are concerns that ASML's access to this market may be further curtailed. ASML's latest high numerical aperture (NA) equipment is a bigger mid-term story, enjoying much higher pricing. While the timing of adoption is uncertain, capacity is being expanded for 2025, where greater volumes can achieve higher operating leverage and margins.

An intimate healthcare company was a minor active detractor this month. Financial results for FY Q3 sales were in line with market expectations, with a small sales acceleration and expectations of a stronger H2 supporting a FY outlook of 8% revenue growth. A small 1% miss on EBIT reflected unfavourable currency effects this quarter. The company has entered a phase of high M&A and innovation, launching several new products recently (including a digital ostomy system, and a urinary tract infection (UTI) resistant catheter). The company is also seeking to grow in advanced wound care, having acquired a medical-fish skin company (wound care developed from cod fish skin). The acquired company is now awaiting clarification from regulators on reimbursement levels for their product. Combined with easing cost pressures, the company appears to be in a stronger growth position for 2025 and beyond.

Market Outlook

September provided a welcome pivot point for global markets, as the jumbo rate cut from the Fed combined with surprise new stimulus initiatives in China. The return to risk-on was not broad based however, with some of Europe's largest companies failing to participate in the rally, the market being rather convinced that near-term prospects were muted. Counterintuitively, Growth therefore underperformed Value in the region (-1.3% versus 0.5% respectively), with several of these benchmark heavyweights being also represented in Growth indices. Abroad, Growth was ahead of Value (2.0% versus 1.8%), although this is also complicated by a few overinfluential technology names.

At this stage of the cycle, our structural growth drivers need to compete with heavy cyclical pressure and strong market sentiment. New macro tailwinds are being offset by slower economic activity and employment data threatening rate cut delays, along with sector-specific challenges. Our companies usually show resilience and fundamentally outperform in a slower economic environment, and key cyclical pressures such as within semiconductors and medtech should roll off into 2025. Ramping up is data centre expenditures, and the AI theme generally, where numerous stocks across the franchise globally including Europe have indirect exposure.

Over the next month or so, fresh Q3 earnings results will take front stage. Helpfully, the market has fairly low expectations, having downgraded full-year growth projections for numerous companies. This leaves us hopeful that some of our names pointing to a stronger H2 can positively surprise. Meanwhile, the US election campaign ramps up in the background, adding some sensitivity. We still see a strong story into 2025 and remain convinced of the Fund to follow above-market earnings growth that compounds meaningfully over time to ultimately drive stock prices higher.

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All data are sourced from Allianz Global Investors, Eurostat, IHS Markit and Office for National Statistics, as at 30 September 2024 unless otherwise stated.