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 November

European equities struggled over November as the prospect of Donald Trump's return to the White House raised the spectre of higher tariffs. Rising political uncertainty also undermined sentiment. German Chancellor Olaf Scholz called a snap election after the 3-year-old coalition government collapsed as it battled to agree a budget. In France, Prime Minister Michel Barnier's minority government also appeared to be in peril as it struggled to gain sufficient support for a budget that contained tax increases and spending cuts.

The economic outlook darkened. The flash HCOB eurozone composite purchasing managers' index (PMI) slumped to 48.1 in November, from a final reading of 50 in October, marking the lowest reading since January. Activity in the services sector fell into contraction territory for the first time in 10 months, while the recession in manufacturing deepened. The gloomy data prompted speculation that the European Central Bank (ECB) may cut rates by 50 basis points (bps) when it next meets in December. Eurozone inflation accelerated to 2.3% in November, from 2.0% in October, but core inflation held steady at 2.7%.

German equities outpaced the broader eurozone to advance over the month. The flash HCOB Germany composite PMI slid to 47.3 in November, the lowest level since February, but the harmonised rate of inflation unexpectedly held steady at 2.4% in November, compared to forecasts of an increase. Germany faces a snap election in February after Chancellor Olaf Scholz sacked his Finance Minister, Christian Lindner, following an extended battle over how to fill a massive hole in the national budget.

NOVEMBER 2024

UK equities posted moderate gains over November, helped by strong returns from banks. The flash S&P Global UK composite PMI dropped below the 50 level in November, indicating that private sector activity may be shrinking for the first time in more than a year. Companies are continuing to baulk at the recent increase in employers' national insurance contributions, saying it will lead to job cuts and stoked inflation. While the Bank of England (BoE) reduced rates by 25 bps, hopes for further imminent cuts were dashed when UK inflation rose to a 6-month high of 2.3% in October.

Performance Review

The Fund underperformed the benchmark in November. The re-election of US President Trump spurred a risk-on environment favouring growth over value, potentially signalling investment style shifts next year. Early beneficiaries were companies with high US revenue and local manufacturing, avoiding tariffs. Later in the month, reports of potential easing of US export controls on semiconductor equipment and chips to China boosted our related holdings.

The largest active contributor was a hotel group initiated in January. It has a significant US presence and investors anticipate a stronger US economy that could boost travel expenditure. Conviction holding Partners Group (alternative asset manager) was also a top contributor, embarking on a partnership with an asset manager to unlock the major structural growth opportunity in accessing retail investors. A smaller cap name – a global group of safety equipment companies (serial acquirer) – was also very supportive.

Conversely, the main active detractor was an insulation and building envelope solutions provider, with a fellow construction-related holding and Sika not far behind. Building activity remains muted, especially in residential, although data centre-linked sales are a bright spot for growth.

The team remains confident heading into 2025 as we move out of troughs in various spaces like medtech, construction and semiconductors, areas where holdings have pressured performance this past year. Our companies still demonstrate above-market growth, and valuations are slightly less demanding. With many growth investors now looking to the US in preference to Europe, we highlight the merits of taking a high conviction, single stockpicking approach.

Top contributors

The aforementioned hotel group has rallied over 38% since we initiated the position in January, including gains of over 16% this month. With its significant US presence, the company is considered a beneficiary of the incoming Trump administration. While growth in revenue per available room (RevPAR) slowed to 1.5% from 3.5% in H1, this was well anticipated, and mostly due to China weakness. Its outlook for Q4 is brighter, with growth accelerating on easier China comparatives and more US demand. In October, we discussed the revamp of its 15-year-old credit card programme with the CEO. The updated deals with existing partners on improved financial terms were announced in November, leading analysts to upgrade earnings before interest and taxes (EBIT) expectations by 3-5%.

Partners Group gained just over 8% this month, as investors digested recent performance and management fee headwinds alongside lower interest rates, and their new partnership with another asset manager to access the retail investor market. We spoke to the management in our Frankfurt office in October. Its private wealth opportunity is vast. Partners Group has a 10% market share today, with anticipated private market assets under management (AUM) growth from USD 500 billion to USD 10 trillion in 10 years. Headcount will be raised to reach these 84,000 wealth managers. Management describes 2024 as a transition year, admitting fundraising was difficult, but should improve in 6-12 months. They have added value to investments to compensate for slower exits.

The previously mentioned global group of safety equipment companies reported excellent financial year (FY) 2024 results in June, with adjusted EBIT growing at 12% to beat both guidance and consensus expectations. A favourable outlook completed the sunny picture, well-illustrated with year-to-date orders already ahead of the comparable period last year. We met with the management in our Frankfurt office in November. They have an aspiration to double the company every five years, with inorganic and organic growth both strongly contributing. Interestingly, they have seen a broad-based recovery in their Chinese business, although from a very low base. The company sees high growth in their photonics business to continue and importantly for several of our holdings, are also confident on a health care recovery next year.

Top detractors

The insulation and building envelope solutions provider mentioned earlier slipped over 11%, after reducing full-year trading profit guidance by around 3%. Q3 sales were roughly flat on slow demand and timing of sales. The order book is healthy, setting up well for early 2025. Construction activity remains muted, particularly for residential. Supportive however, is the low likelihood of raw material inflation, and potential for pockets of deflation through the rest of the year. A clear highlight is its data solutions segment, where sales accelerated by 47% in Q3, thanks to data centre construction. Here, manufacturing capacity was recently added, with the division expected to quadruple its 2023 operating profit of EUR 51 million in the next three years.

The stock of an electrical and digital building infrastructures manufacturer was volatile this year, ultimately landing rather flat year-to-date to the end of November, after weak Q3 results. Organic sales lowered -0.8%, attributed to a depressed building market in several regions, notably in Europe. Net profit fell by 11%, compared to the same period in 2023, also reflecting the adjusted operating margin decline of 110 bps to 20.5%. Data centre sales were a bright spot, accounting for close to 30% of US sales in Q3, and surged 20% in the US with orders bringing confidence on the momentum of growth ahead. We look ahead to an eventual recovery in construction that should strongly support the stock, trading at modest valuations currently.

A life-saving medical equipment manufacturer fell over 12% after FY Q4 organic growth of 10.6% missed consensus at 12.3%. Adjusted EBIT was a 20% miss. We spoke to the company in September. Increasingly, the company is becoming a solutions provider, with software and monitors connected to endoscopes creating system advantages and network effects. The firm was financially challenged two years ago and needed to think short term, but now generates greater cash flow without debt and is setting up a longer-term strategy with some operating expenditure investment required. The company guides for 10-13% organic growth next year. About 3% of the market has converted to single-use endoscopes, highlighting the significant growth opportunity ahead.

Purchases

We purchased a Dutch producer of machinery used in semiconductor assembly and packaging, with a focus on the “die attach” processes, which represent 80% of its sales. The company’s market share has increased to 40%, up 10% over the last decade, and it holds a commanding 74% share in more advanced machines. The forecast is optimistic with revenues anticipated to reach USD 1.5 billion by 2027, due to the surge in advanced packaging driven by the rise of chiplet architectures in semi design and high bandwidth memory, both of which require more complex, sophisticated machinery to assemble.

Market Outlook

Following the clear results of the US election, the outlook for riskier assets has become more favourable. We are pleased to see growth outperform value in November once again.

Investors have been quick to reallocate from Europe to the US, reflecting conviction in the Trump administration's proclaimed pro-growth policies. Indeed, Europe is facing new geopolitical issues, and European companies are widely expected to face new US tariffs.

Generally, our European portfolios favour Europe's strongest companies. Their quality features such as clear competitive advantages, criticality in manufacturing, network effects, and long-term contracts all help lock in their above-market earnings growth. They are also typically global exporters, earning only around 40% of their revenues locally.

While the US is a key market for Europe, and much larger in this respect than China, we wish to highlight that only 6% of goods are exported. A lot of manufacturing capacity has been established in the US already. A beauty and cosmetics group is a great example, where an estimated 80% of beauty products sold in the US are manufactured locally.

Proposed lower taxes can unlock consumer spending on luxury goods, travel, and hotels, where our conviction names LVMH, another luxury goods company, and the aforementioned hotel group are positioned to benefit.

The US aside, recent data from China point to a macroeconomic stabilisation and even an upswing in the financial sector in that country. This is currently being overlooked, but the region could offer positive surprises in 2025 as stimulus eventually takes effect.

In terms of risks at this juncture, investors expect the central banks to cut their key interest rates considerably. However, that may not happen if inflation picks up again. Moreover, several geopolitical crises remain unresolved, and the second Trump administration may take decisions that have a negative impact on the world. With US import tariffs and trade conflicts looming, active management will be key for success in a global environment in which opportunities and risks are unevenly distributed.

Considering our growth portfolios, we believe when the current cyclical effects recede (in sectors like medtech, construction and semiconductors, even the consumer space), our stocks that are currently weak can recover quickly. In the US market, a broadening of stock performance could helpfully result from pockets of high valuations retracting, and artificial intelligence (AI) adoption increasing to create more winners. Lower rates and a more buoyant economy should bring support to our consumer names and overall, accelerate growth above value once again. We remain optimistic about the year ahead.

Connect with Us | sg.allianzgi.com | +65 6438 0828 | Search more Allianz Global Investors

Like us on Facebook **Allianz Global Investors Singapore**

Connect on LinkedIn **Allianz Global Investors**

Subscribe to YouTube channel **Allianz Global Investors**

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