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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 environmental and social characteristics.

What Happened in February

European equities rallied over February, as President Trump's push for peace in Ukraine raised hopes that the three-year war would soon end, although markets closed the month on a weaker note after he hinted that he may introduce 25% tariffs on European exports to the US. Defence stocks, in particular, benefitted from signs that European governments will be forced to increase military spending sharply. At a sector level, Financials, Communication Services and Consumer Staples rallied the most, while Information Technology (IT) was the only sector to close the month with notable losses.

The flash HCOB eurozone composite purchasing managers' index (PMI) held steady at 50.2 in February. Services activity slowed to a 3-month low of 50.7, while manufacturing activity picked up to 47.3, the weakest contraction since May 2024. Headline eurozone inflation rose to a 6-month high of 2.5% in January, but core inflation held steady at 2.7% for the fifth consecutive month. The European Central Bank (ECB) continued to signal that further rate cuts were likely.

German equities rose. The Christian Democrats (CDU/CSU) won the most seats in the country's general election, with the right-wing Alternative für Deutschland coming second and outgoing Chancellor Olaf Scholz's Social Democrats (SPD) coming third. The CDU/ CSU alliance now needs to form a coalition government, most likely with the SPD but this may prove tricky given their differing views on taxes, regulation and social spending. There is also a pressing need to address Germany's "debt brake" to allow for higher defence spending.

UK equities closed the month higher. As widely expected, the Bank of England (BoE) cut rates by 25 basis points (bps) to 4.5%. However, hopes of further rate cuts were dashed when UK inflation rose to 3.0% in January, its highest level since March 2024. February's flash S&P Global UK composite PMI eased to 50.5 from a final reading of 50.6 in January. Given lacklustre economic growth, the UK government is facing increasing pressure to break its election promises and raise personal taxes in its March budget to pay for higher spending on defence and health care.

Performance Review

The Fund gained positively in January before edging down in February, underperforming the benchmark and the broader MSCI Europe. European equities enjoyed a strong month, particularly within the value style segment, with banks leading an 8.1% surge in the Financials sector. Also prominently outperforming were numerous weapons-related companies that have surged on heightened geopolitical tensions, likely translating into a significant increase in defence spending commitments across Europe. Growth-oriented sectors were relatively soft, with IT being the weakest sector, declining -2.7%. These rotations overshadowed the positive set of Q4 earnings results and optimistic outlooks from our companies, and largely explain underperformance, given the relatively lower growth profile of the benchmark.

The top active contributor this month was a construction materials company after reporting a profit beat, healthy order books, and on rising optimism for peace and restoration of Ukraine. Adyen (payments) and a manufacturer of auto and power semiconductor also contributed especially positively. The largest active detractor was Partners Group (alternatives asset manager), posting softer H2 numbers given the weaker exit and fundraising environment, although the company has a significant structural opportunity to access the retail market with a leading asset manager ahead. A hotel group and a hygiene products company were also key detractors. As the European market accelerates even further ahead of the US, we saw net assets under management (AUM) flows returning to the region in January once again. We anticipate further strength from our companies that also have sustainability features supporting their continued growth.

Top contributors

The aforementioned construction materials company rallied over 17% this month. Despite its structural growth drivers, such as insulation's role in lowering greenhouse gas (GHG) emissions alongside its high exposure to the refurbishment market, the stock came under pressure in 2024 on lowered demand and sentiment. Management therefore surprised with a 3% profit beat for financial year (FY) 2024, with positive commentary around healthy order books (30% higher than previous year) and soaring demand in their data solutions segment. The potential for a Ukraine ceasefire has also supported the sector generally. We spoke to the CFO in our Frankfurt office following these strong results, who noted pricing power and profitability had risen since the pandemic, and that they were hardwired for growth.

Adyen was the star of the earnings season show, with volume growth rising from 27% in Q3 to 29% in Q4. Net revenue growth accelerated from 20% in Q3 to 23% in Q4. Earnings before interest, taxes, depreciation, and amortisation (EBITDA) margin also ramped up from 46% in H1 to 53% in H2 as the rapid headcount expansion of 2023 annualises. The strong results combined with a 2025 guide for a slight acceleration in net revenue growth and further expansion in EBITDA margin versus calendar year (CY) 2024. The stock gained circa 11% after the tech selloff moderated the initial surge. The runway for growth remains, with less than a third wallet share on the digital side and below 40% in unified commerce, a major growth lever where volumes also accelerated from 33% in Q3 to 36% in Q4.

The manufacturer of auto and power semiconductor mentioned above had been under dual headwinds of high automotive and China exposure, leading to several FY guidance cuts through 2024 and relatively low 12-month forward price-to-earnings (P/E) of just 16.7x by the end of Q3. In a welcome pivot, the company's Q1 results have surprised positively. Q1 revenues beat consensus by 6.5x%, although the stronger USD was a key driver, also lifting sales guidance from “down low single-digits” to now “flat to up”. The margin guide is unchanged given trade tariff uncertainty. The CFO met with us in our Frankfurt office this month. They anticipate the trough in automotive-related demand and inventory correction is passing, and have achieved several new design wins, in China and in Germany. Their silicon carbide capacity is now also ramping up.

Top detractors

Partners Group disappointed with a double miss on H2 AUM and a softer 2025 outlook, in their latest results in mid-January. Fundraising is challenging given the weak exit environment with the company guiding cautiously for some time. The market and our team are otherwise excited about their major structural growth opportunity with a leading asset manager to access the retail market. Their private wealth opportunity is indeed vast: Partners Group currently has circa USD 50 billion in AUM and a 10% market share. Management believes its private wealth AUM will be threefold in 5-10 years, with estimated tailwind from private market AUM rising from USD 500 billion to USD 10 trillion in 10 years. Additional headcount will reach these 84,000 wealth managers.

The hotel group previously mentioned reported on FY 2024 with few surprises, given continuous high frequency industry data and their stable, high margins. Revenue increased 7%, driven by 3% revenue per available room (REVPAR) growth and 4.3% net unit growth (in USD). Earnings before interest and taxes (EBIT) also lifted 10.3%, while earnings per share (EPS) was up 15% due to share buybacks. Given the stock has rallied circa 40% over the past half year, some investors took profits in this month's market rout. We continue to appreciate the company for its high single-digit growth in fee revenue expected from REVPAR and net unit gains, where their new hotel pipeline has risen 10% year-on-year. After the circa 7% stock dip, the company's valuation looks more compelling versus other companies with comparable economics and risk profiles.

Investors of the aforementioned hygiene products company look forward to accelerating sales growth in 2024/25, driven by a phase of high mergers and acquisitions (M&A and innovations including wound care developed from cod fish skin (now under Medicare coverage, a urinary tract infection (UTI) resistant catheter, and a digital Ostomy system. Unfortunately, a voluntary product recall within interventional urology, due to product sterility issues identified internally, will create a sales headwind. Most of these lost revenues should be recovered between Q2 and Q4 2025, with no guidance provided on margin impact. Combined with easing cost pressures, the company still appears to be in a stronger growth position for 2025 and beyond. Organic growth of 8-9% in FY 24/25 was reiterated.

Market Outlook

While a "soft landing" for the US economy remains the most probable scenario, recent economic data suggest that strong growth and persistent inflationary pressures could challenge expectations for a smooth transition. Additionally, uncertainty surrounding President Trump's economic and geopolitical policies is adding complexity to both the economic outlook and the trajectory of US Federal Reserve (Fed) monetary policy normalisation.

At the same time, US equity valuations remain elevated by historical standards, particularly within the IT sector, where earnings growth expectations appear highly optimistic. This disconnect between valuations and broader economic risks could contribute to increased market volatility. In this environment, risk-aware investors may seek diversification in more favourably valued markets. There are already signs of increased capital flows into European equities since January, where select companies with global business models remain resilient despite weaker regional macroeconomic conditions. Furthermore, potential US diplomatic efforts, particularly regarding Russia-Ukraine negotiations, could improve investor sentiment, supporting a more stable business climate and stimulating capex.

Despite ongoing political and economic uncertainties, corporate earnings remain robust for now, historically supportive of equity markets and our portfolios. We were pleased with our companies' Q4 and H2 results overall, although in the recent rotation, value-oriented areas of the market such as Banks, Weapons and Consumer Staples are currently shining even brighter. Much like heat came out of the US market recently, this may not be enduring.

Within our portfolios, we invest predominantly in market leading, often global businesses. Our companies offer pricing power, critical products and services, and are heavily integrated into production processes and IT infrastructure, offering resilience in a trade war scenario. In Europe, we have plenty of construction exposure which could benefit from a potential rebuild of Ukraine, not to mention the general recovery of semiconductors anticipated later this year and medtech which can benefit both our European and global portfolios. While there are considerable political uncertainties, corporate earnings should remain robust for now, and healthy corporate earnings are usually favourable for our fundamentally focused strategies.

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