

Allianz Global Equity Unconstrained

Quarterly commentary

Investment Objective

The Fund aims at long-term capital growth by investing in global equity markets to achieve a concentrated equity portfolio with a focus on stock selection 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 Q3

For global equities, Q3 2024 was defined by several major developments. The first was a sharp sell-off in early August as weaker-than-expected US jobs data sparked recessionary fears. This was followed by a swift rebound, with many markets finishing the quarter at/near record highs, as the US Federal Reserve's (Fed's) decision to start cutting rates increased hopes of a soft landing. At the end of the quarter, China's announcement of the biggest stimulus measures since the pandemic further boosted shares. The quarter was also notable for a rotation out of highly valued growth stocks, particularly in the Information Technology and Communication Services sectors, into sectors seen to be bond proxies, such as Utilities and Real Estate.

Inflation continued to slow, falling to 2.5% in the US and 2.2% in the euro zone in August. Concerns over the health of the labour market finally persuaded the Fed to start cutting rates in September. The Fed's larger-than-usual 50 basis points (bps) cut was accompanied by forecasts of further cuts this year and in 2025. In the same month, the European Central Bank (ECB) also reduced borrowing costs, marking its second cut this year, while the Bank of England (BoE) started its easing programme in August but kept rates on hold in September. In contrast, the Bank of Japan (BoJ) raised rates to 0.25%, indicating it was confident that inflation was sustainably above 2%. Meanwhile, the People's Bank of China (PBoC) cut rates as growth remained subdued and the Chinese authorities announced the biggest monetary stimulus since the pandemic.

The US dollar weakened as signs of slowing US economic activity led to growing speculation that the Fed may cut rates more than once in 2024. In contrast, the Japanese yen, which had started the quarter at its weakest level in almost 40 years against the greenback, rallied sharply as BoJ signalled it was committed to tightening monetary policy. While both the euro and British pound lost ground against the Japanese yen, they appreciated versus the dollar, with the sterling pound edging ahead as ongoing inflationary pressures meant the BoE kept rates on hold in September while the ECB cut rates.

Oil prices, which started the period just under USD 90 a barrel (Brent crude), trended lower, briefly moving back below USD 70 a barrel in early September. While heightened tensions in the Middle East and production cuts from the Organization of the Petroleum Exporting Countries Plus (OPEC+) countries helped to support prices, this was offset by abundant supply and fears that a slowdown in global growth could depress demand. In contrast, gold, which is often seen to be a safe haven in times of uncertainty, rallied, with the precious metal breaching USD 2,600 an ounce for the first time on record.

Portfolio Review and Strategy

The world's leading maker of security locks and door entry systems Assa Abloy, had the biggest positive contribution to performance in Q3. The company provides mechanical and electromechanical locks, entrance automation and identification products to customers in 70 countries, with North America making up roughly 50% of total sales. Q2 results in July were in line with expectations, with US non-residential demand proving resilient. The recent quarterly organic growth declines have been slowing and are showing signs of stabilisation on the early stages of recovery in the key US residential segment. The first interest rate cuts in the US also provided a tailwind to the wider home and construction sectors.

Corpay was also a positive contributor to performance in Q3. The company is a leading provider of payment solutions and services that help businesses manage, control and simplify their payment expenses. Their core offerings include fleet vehicle payment processing services for commercial and government fleets, corporate payments transaction services for small-to-mid sized business, toll and in-vehicle electronic payment processing under the Sem Parar brand in Brazil, and corporate lodging discount cards. The core geographies for the company are the United States, Brazil and the UK but they operate in over 50 countries worldwide, with a diverse customer base of major oil companies, various commercial business and government entities. Their Q2 2024 earnings release was viewed positively by the market, with revenue and earnings per share (EPS) coming in ahead of analyst expectations. Corporate payments continued to show excellent organic growth with growing spend volumes and direct business revenue. Their virtual card showed increasing penetration levels and vehicle payments were also ahead of expectations. This offset some lingering weakness in the North American fleet business and lodging, which the company believes are showing signs of stabilisation and should return to growth in Q4. Management also re-iterated their financial year (FY) 2024 guidance.

A Danish pharmaceutical company was the biggest performance detractor in Q3. The company has world leading positions in diabetes care (and is the world's leading insulin producer with over 50% share) obesity management, haemophilia and hormone therapy. In the quarter, the company announced mildly disappointing results from a Phase 2a trial of its obesity pill, which although offering higher weight loss benefits than an injectable, has additional safety concerns that require attention. Heightened scrutiny over pricing for its blockbuster drugs, 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 one of its drugs. Positively, the geographical rollout of another drug continues, now available in 12 markets ex-US and including China, alongside further drug indications. We continue to review our position size.

A global leader in providing smart, connected, and secure embedded control solutions also detracted from performance in Q3. The company offers a broad product portfolio, including microcontrollers and analog devices, designed to serve a wide range of applications across various markets such as industrial, automotive, consumer and aerospace computing. The company reported in-line results but provided a disappointing guidance as the industry recovery elongates. Demand from automotive customers and broad-based industrials remains soft and both customers and distributors are destocking inventories. Our view is that the company is a well-positioned growth cyclical company in microcontrollers and benefits from long-term megatrends. It has a strong moat in an oligopolistic market and will come out of the current downcycle.

There were two significant transactions in September, a new position in a credit bureau, financed by a sale of a cosmetics giant. The former is best known as one of the three US credit bureaus (ie, a business which provides lenders with information about an individual's debts and payment history). However, today the majority of the company's profits come from a unique dataset of employment and income data that has recently achieved critical mass. Having grown the number of individuals in the database at a 13% compound annual growth rate (CAGR) since 2015, the database now covers approximately 70% of the US working population. The company is now in a position to drive greater adoption of the database by mortgage providers (only 60% penetrated today), non-mortgage lenders (eg, auto, credit card and personal loans, where penetration is currently very low), employers (doing background checks on new employees), and government agencies (eg, verifying eligibility for social security programs). Its closest competitor has 1/3 of the records and a much less developed monetisation engine. The high level of exposure to mortgages has provided a headwind in recent years, but with Fed rate cuts now expected to flow through to mortgage rates in 2025, we could see a recovery in mortgage volumes in the near term.

We sold the long-term holding of the afore-mentioned cosmetics giant. The company sees continued weakness in mainland China and market share losses in the core US market. Recent management execution does not provide confidence that these can be fixed in the shorter term and we believe that there are better opportunities and better visibility elsewhere.

Market Outlook

September may have provided a pivot point for global equity markets, with investors welcoming the first interest rate cut by the Fed since 2020. The Chinese government also announced a stronger-than-expected stimulus package with the aim of improving consumer confidence and returning the country to their 'around 5%' growth target. Both these events had a significant effect on markets towards the end of the quarter.

Whilst the September Fed rate cut was widely expected, the magnitude of a 50 bps cut was a signal that the focus of the Fed is now on ensuring a soft landing of the economy (where inflation moderates and growth slows but a recession is avoided). This continues to remain the most likely outcome but there are questions regarding the speed of cuts and the new neutral rate. The market expects significant cuts by the end of 2025 but the difficult balance act between controlling inflation, finding the correct level for growth and maintaining confidence remains. Markets will continue to closely monitor economic data and any divergence could lead to increased volatility. From our perspective, lower rates should be positive for equities and an environment of slower growth could lead to a broader market than we have seen recently, enabling the higher quality companies to shine.

The magnitude and wide range of stimulus announced by the Chinese government in mid-September led to a surge in both the mainland and Hong Kong stock exchange towards the end of the month. Swap facilities for qualified financial firms to buy stocks and cheap lending facilities for listed companies to buy back shares buoyed the stock markets, while

there were also cuts to a range of credit rates to encourage borrowing. Stabilising the property sector is however key in resuming to a healthy growth dynamic in China and a number of measures were announced to try and address this. As 90% of the Chinese population own property (much higher than other parts of the world) the right solution must be found for fragile consumer confidence to return.

Geopolitics will continue to be a source of volatility as conflicts in the Middle East and the Ukraine show little sign of abating. Further escalation could lead to potential surges in commodity prices. The US election also looms large and the policies of the winner will have a lasting market impact, while there are also risks in Europe where France and Germany are absorbed by domestic issues and growth and financial stability are vulnerable.

Over the next month or so, Q3 earnings results will take centre stage. Market expectations are lower than they have been, with full year growth projections downgraded for a number of companies. We are hopeful that our holdings that have pointed to a stronger H2 can positively surprise. We see a strong story into 2025, where the impact of a lower interest rate will begin to be felt and the market may look beyond the dominant 2024 themes of artificial intelligence and higher for longer interest rates. Our companies have historically performed well when growth becomes scarcer and we remain convinced of our strategy that returns above-market earnings growth, compounding meaningfully over time. Ultimately, this drives stock prices over the longer term.

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