Allianz Global Investors

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 environmental and social characteristics.

What Happened in Q2

Q2 was a volatile period for global equities as investor sentiment was buffeted by President Donald Trump's disruptive trade policies. Stock markets initially plunged on heightened global recession risk in the immediate aftermath of Trump's self-dubbed "Liberation Day" tariff offensive at the start of April but subsequently recovered as most tariffs were postponed. In June, geopolitical tensions in the Middle East moved sharply into focus. Shares sold off on news of Israeli strikes against Iran as oil prices spiked amid supply disruption fears. However, the risk-on mood resumed after Tehran's restrained response to US strikes heralded a de-escalation in tensions and a ceasefire between Israel and Iran appeared to take hold.

All regions in the MSCI All Country World Index posted gains in Q2, with the S&P 500 reaching an all-time high towards the end of the quarter. Pockets of emerging markets also performed strongly, as did Japan. In contrast, European stocks posted only modest gains after the strong relative performance in Q1 and the UK continued to lag other developed markets. At a sector level, Information Technology shares rose the most, with Communication Services stocks also ending significantly higher. Meanwhile, shares in Health Care and Energy fell.

Elevated fears about a global trade war leading to a sharp downturn in global economic growth eased as the quarter progressed, although uncertainty persisted. Investors and policymakers alike grappled with Trump's trade policy chaos. While the US Federal Reserve (Fed) and Bank of Japan (BoJ) respectively held rates steady over the quarter, the European Central Bank (ECB), the Bank of England (BoE), and the People's Bank of China (PBoC) implemented rate cuts.

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In currency markets, the US Dollar Index, an indication of how the dollar is faring versus other major currencies, touched a series of 3-year lows as the darkening US economic outlook prompted speculation that the Fed may soon cut rates. President Trump's comments about replacing Fed Chair Jerome Powell also fuelled concerns about the US central bank's independence. The euro and British pound strengthened into quarter-end, both touching multi-year highs on dollar weakness, while the Japanese yen closed modestly higher against the dollar.

Oil prices had a turbulent quarter. Brent crude briefly dipped below USD 60 a barrel for the first time in four years following Trump's "Liberation Day" tariff announcement in April on fears of oversupply and reduced global demand. Oil prices were in focus once again towards the end of the period amid spiralling geopolitical tensions in the Middle East. Brent crude hit a 5-month high of USD 80 a barrel after the US launched a series of targeted strikes on Iranian nuclear facilities, before easing back on news of Iran's restrained response and reports of a ceasefire between Iran and Israel and ending the month below USD 67 a barrel. Meanwhile, gold continued to soar on safe-haven demand, breaching USD 3,500 an ounce in April for the first time on record, before easing modestly over the remainder of the period on profit taking.

Portfolio Review and Strategy

Contributors

An electrical, electronic and fibre connectors designer and maker was the largest contributor to performance. The company is a leading designer and manufacturer of interconnect systems and sensors for a broad set of applications, benefitting from structural tailwinds linked to efficiency, connectivity, and higher speed data. Its high-performance, reliable products for mission-critical, harsh environments create sticky customer relationships, as switching involves significant cost and performance risk. Strong execution from decentralised management and culture supports its competitive advantage, allowing for strong margins and cash flow. Historically, the company delivered about 5% organic and 5% inorganic growth. It was the star of the Q1 earnings season show: sales rocketed 48% to a record of USD 4.8 billion, with organic growth up 33% year-on-year. Sales and earnings per share (EPS) exceeded consensus by 13% and 22% respectively, and the stock gained 17%. Information technology (IT) and datacom was primarily responsible, with artificial intelligence (AI)-related demand driving around two-thirds. Mobile (+20%), miliary (+14%), and communications networks (+11%) all made strong organic contributions, and highlight the resilience of the company's diversified end markets. There was little evidence of any tariff-related impact and its outlook on Q2 was again well ahead of consensus. The company is an active acquirer, which could help compensate for any potential sales slowdown ahead.

US-listed Intuit was another strong positive performer. Its QuickBooks software accounts for roughly half of company revenues and is the leading accounting software in the US for small- and medium-sized businesses. The company can also offer adjacent services such as payroll and payments through this software. It can offer consumers the leading do-it-yourself (DIY) tax filing software in the US via its Turbo Tax application, which holds a considerable advantage over its competitors due to its early entry into the market and continuous innovation. Towards the end of the month, Intuit reported Q3 earnings and revenues that were comfortably ahead of consensus estimates while also raising their guidance for the full year. There was healthy growth in the tax segment, driven by TurboTax Live which grew 47%, well above the long-term guidance. TurboTax Live provides expert assisted tax returns and management noted that there had been healthy adoption of this premium service by existing TurboTax customers, first time filers and those that would otherwise have left the Intuit ecosystem. There was also strong growth from Credit Karma, a personal finance platform that provides insights into financial health and credit scores, while Quickbooks grew nicely in-line with expectations.

Detractors

A life science and medical equipment manufacturer was the biggest detractor to performance. It is the largest in the scientific tools sector, offering a comprehensive suite of analytical instruments, software, services, consumables, and reagents. In financial year (FY) 2024, its customer base comprised biopharma (42%), academic (19%), clinical and diagnostic (23%), industrial (14%), and applied science (2%) sectors. The company has a strong focus on innovation and is geographically expanding into high-growth markets. In terms of quality, it is typically highly cash generative with strength in capital allocation. As a lab equipment leader, it has delivered a 10-year EPS compound annual growth rate (CAGR) of approximately 15%. The company declined in April after it revised down their FY 2025 organic revenue guidance (from 3-4% to 1-3%) as well as EPS guidance, due to the anticipated impact of tariffs. A decrease in US-made goods sold in China, and an increase in cost of China-sourced parts and sub-assemblies, requires a one-off mitigation effort. Management highlighted how their scale was a significant advantage, having numerous twin factories in different geographies, allowing them to move with speed, and suggesting even potential market share gains ahead from less agile peers. The company expects to recover the impact of tariffs over the next 12 months by raising prices. While China and capital equipment spend remain muted, pharma and biotech are slowly improving. The company has been active in mergers and acquisitions (M&A) recently.

A medical insurer and care operator was also a significant detractor to performance over the quarter. It is the largest US health care company, operating through two synergistic platforms: insurance and health services. The former covers over 50 million people, while the latter delivers pharmacy, care, and tech-enabled services to more than 130 million individuals. A disappointing Q1 update in April with EPS missing expectations, alongside a major downward revision to their 2025 earnings guidance provided a major headwind with the company cutting its FY 2025 EPS by roughly 12%, citing higher-than-expected medical costs, particularly in some plans where care utilisation increased at double the forecast rate. Changes in the health services member profiles and lower-than-expected reimbursements also contributed to the weaker outlook. The company then extended losses with the abrupt departure of the CEO, complete removal of the guidance from just one month earlier and the escalation of a Department of Justice (DoJ) investigation into business practices. We subsequently exited the position.

Significant Transactions

Following on from an active Q1, continued market volatility enabled us to initiate two new holdings while exiting two positions where the investment case has become challenged.

In April, we purchased a UK-based industrial technology group operating in niche safety, health, and environmental markets. The company benefits from structural growth drivers such as aging infrastructure, increasing safety regulations, and health care innovation. The company operates with a highly decentralised operating model, allowing operating unit managers to fully exploit growth opportunities. Its consistent M&A roll-up strategy creates additional value. The company benefits from strong pricing power, high return on invested capital (ROIC), and resilient free cash flow. While trade tariffs pose a potential risk, its local-for-local production strategy and pricing flexibility should limit the impact. Trading at an attractive valuation, it remains a high-quality, long-duration compounder, albeit with some cyclical sensitivity.

In May, we initiated a position in an integrated waste services company that provides waste collection, transfer, disposal and recycling services. The company is the third largest operator in the North American waste management industry, and it provides waste collection, transfer, disposal and recycling services to circa 9 million customers across selected markets in the US and Canada. The company is a high-quality operator in an attractive industry benefitting from resilient demand, strong revenue visibility through multi-year contracts and significant barriers to entry due to stringent regulations, unique infrastructure requirement (ie, landfill), and economies of scale inherent to its route-based business.

The company focuses on exclusive and secondary markets, where reduced competition, higher density and lower customer churn allow for stronger pricing and more consistent growth. When this is coupled with their unique philosophy centred on local accountability and efficiency, the company has consistently delivered best in class margins and cashflow generation when compared to peers.

A pharmaceutical company was sold in Apil. It is a global leader in diabetes care, obesity treatments, and rare disease therapeutics, with market-leading GLP-1 products. However, the investment case has become increasingly binary, hinging on the future success of next generation drug (still some time away) where we have no proprietary insight into the likelihood of success. In the meantime, the company is expected to lose market share in its existing GLP-1 portfolio to key competitors. Management's credibility has been strained due to underwhelming execution in production scale-up, declining research and development (R&D) productivity, and weaker handling of emerging competitive threats. Given reduced visibility, execution risks, and better opportunities elsewhere, we are exiting the position.

The long-term holding in the afore-mentioned medical insurer and care operator was also sold during the May. The sentiment around the stock reached a new low when the CEO stepped down and the guidance for the rest of the year was withdrawn. Coupled with the uncertainty regarding internal controls at the company and the overhang of the DoJ investigation, it led us to exit the position.

Market Outlook

In June, US indices reached new highs while many European stocks underperformed, weighed down by macro uncertainty and geopolitical tensions. Still, quality growth remains well supported by historically attractive valuations, remaining the case for our global holdings but especially in Europe, where valuations are widening versus the US. The region is also experiencing increasing fiscal and monetary stimulus, including Germany's boost to defence and infrastructure spending and the ECB's further decrease of interest rates to just 2.0% in June.

Investors have been gradually tuning out tariff noise, however currency has now emerged as a more immediate challenge, with a significant weakening of the US dollar in recent months. Our companies generally have strong pricing power, sell critical products and services that are well integrated into production processes, and benefit from geographically diversified sales and manufacturing. We believe they will be relatively resilient, although several are flagging some headwinds. Encouragingly, we note a rise in M&A dialogue that can boost growth, with numerous management teams signalling healthy pipelines and renewed strategic intent.

We are clearly moving past the semiconductor cycle trough. Early signs of stabilisation in memory and analog demand, combined with ongoing momentum in AI infrastructure, are now broadly lifting sentiment across IT infrastructure. Our funds have broad exposure to this upswing through investments in leaders in the semiconductor manufacturing, packaging, and equipment subsectors. Innovation is moving rapidly across adjacent domains, and we are closely monitoring emerging themes such as agentic AI and stablecoins for potential disruption. These structural shifts make this a highly dynamic and rewarding environment for active stock pickers.

As we approach the Q2 earnings season, expectations appear fairly low. Many listed companies have delivered subdued business outlooks, particularly following the "Liberation Day" turmoil in April, while analysts have been eagerly revising their earnings estimates downwards. We see this as an attractive setup for our high-quality, structurally growing companies to surprise on the upside. Our investment discipline remains unchanged: we continue to favour companies with high returns on capital, pricing power, and strong balance sheets, traits that have helped our holdings stay resilient as macro conditions evolve.

As the macro backdrop remains relatively benign, we believe the stage is set for high-quality global equities to continue compounding through market noise and deliver attractive long-term returns. In this environment, we may see our relatively more resilient companies shine, with the Q2 earnings season ahead serving as a valid first test.

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