

Allianz Global Sustainability

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth by investing in global equity markets in accordance with environmental and social characteristics.

What Happened in December

Global equities moved sideways again in December despite the end of the US government shutdown and the 25-basis point (25-bps) US Federal Reserve (Fed) rate cut. The US 10-year closed the month higher despite some delayed US data suggesting inflation surprised to the downside. Markets were very quick to dismiss the data for irregularities and some faster moving indicators looked more inflationary.

What was very notable for equities was a risk-on sentiment despite the flat index level. Cyclical led with Materials, Banks, Autos and Retail in particular performing well. Silver was up 15% for the month and the liquidity and speculative nature of markets found a new outlet. This is despite bitcoin and other speculative assets having a weaker time lately.

Although overall sales and earnings for Q3 exceeded expectations, this was mainly due to downward revisions made after April. In reality, most US companies are experiencing economic difficulties, and only those with significant exposure to the artificial intelligence (AI) sector are performing well. As a result, the recent uptick in cyclical stocks that depends on lower interest rates may not lead to further positive earnings revisions unless there is substantial tariff reduction or additional economic stimulus. Therefore, it is more likely that earnings forecasts for the average company will return to a negative trend.

Q4 earnings will begin mid-January, and this will be the start of a phase of earnings revisions for the full year (typically lower).

Regional leadership came from Europe (perhaps some increased positivity on Ukraine resolution) and APAC (mainly Korea) with the US slightly lagging.

Portfolio Review

We had slightly positive allocations regionally and neutral by sector, but negative stock selection.

Stock picking detracted over December. Nintendo suffered in December on fears that rising memory prices would reduce the company's profit margins. However, we believe this concern is overstated and we remain confident in the company's prospects linked to the release of the new console Switch 2.

US medical equipment company Medtronic suffered from a slight rotation out of Health Care after recent strength despite a positive news flow. Next Era was also among the main detractors after its analyst day, where long-term guidance was seen as too vague, prompting some profit taking.

In contrast, our position in UK consumer staples Reckitt Benckiser continued to perform well despite weakness in the sector. In fact, this was one of our most successful investments of the year and they held an emerging markets-focused analyst day which was well received. Another non-AI investment that is beginning to bear fruit is our holding in pest control Rentokil which had both an upgrade and a broker's initiation at buy in December.

TSMC also had a good month as it brought on new lines successfully and publicly contemplated accelerating some capital expenditure (capex) into next year.

Significant transactions

There were no significant transactions over the month, but we added to TSMC following some weakness.

Market Outlook

There seems to be three ways that the market will play out in 2026 but even more likely is that we will have to re-write this outlook as things are likely to change materially throughout the year.

The big three questions for markets will be

- 1) Can AI pay the capex bill?
- 2) Will the Trump economy improve excluding AI?
- 3) If there was peace in Ukraine or a stimulus in China, would it derail momentum elsewhere?

The Fund has a slight overweight positioning in the AI winners group with the remainder being relatively defensive prioritising stable earnings and returns in the current environment of economic uncertainty. That means we do have a marginal position in saying that the broader US economy is weakening which transpires to a marginally defensive posture of the portfolio.

We believe there will be a pause in the outperformance of the Magnificent 7 as a unilateral group, and market returns will broaden in financial year (FY) 2026 and beyond, as valuations and earnings revisions become less compelling for that group. In fact, we can already see dispersion of returns between them beginning to emerge.

The Magnificent 7 companies are spending record levels of capex and will need to show a return on this spend shortly. They are also running the risk that there simply isn't enough power to satisfy the expectations of the market, and this will be interesting during 2026. The recent narrative is that demand still outweighs supply, but this is coming to the point where more questions are being asked about sustaining this level of performance. Power is becoming political in this critical mid-term election year, and we expect to see some volatility.

We continue to find attractive valuations and investment cases that will work well if the market rotates away from its narrow leadership.

It is no industry secret that stockpicking has been agonising in the last two years and generationally successful playbooks in portfolio construction and stockpicking have been tested to the core. We have been ruthless in selling out where we see risk of capital loss and will continue to bring in AI proof investments where we find attractive valuations. When we see a chance to take more risk, you will see us act swiftly as 2026 is highly likely to be volatile.

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