

Allianz

Japan Equity

Monthly commentary

Investment Objective

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

What Happened in February

The Japanese equity market declined in local terms in February although returns to international investors were supported by a further appreciation of the Japanese yen.

Overall, the latest quarterly earnings were generally better than expected. Despite this, however, the market was pressured by concerns over President Trump's policies as well as the stronger currency and higher bond yields, with Japan's headline inflation rate climbing to a 2-year high of 4.0%. This data reinforced the view that the Bank of Japan (BoJ) will continue to raise rates this year. There were also further signs of modest economic recovery as Japan's gross domestic product (GDP) grew at an annualised rate of 2.8% in the final three months of 2024, marking the third consecutive quarterly expansion. February's flash au Jibun Bank Japan composite purchasing managers' index (PMI) increased to 51.6, indicating the private sector was expanding at the fastest pace since last September.

Tariff-related concerns caused significant market rotation, leading to underperformance of large-cap, export-oriented companies in particular. In terms of sectors, Shipping and Utilities outperformed, while Technology and Machinery lagged.

Portfolio Review

The Fund underperformed the benchmark TOPIX index in February, mainly due to negative stock selection in Health Care and Communication Services.

At an individual stock level, companies which announced weaker-than-expected earnings such as a provider of information infrastructure for the health care field, a provider of medical statistics data services, and a company specialised in over-the-counter drugs, skincare and functional foods underperformed. Although non-holding of a video game company weighed in relative returns, to an extent this was offset by positions in other game stocks such as Sony. On the other hand, stocks with steady fundamentals like a material-handling equipment company and a construction company were positive contributors. In addition, an electronics company also outperformed as the market appreciated the announcement of its restructuring strategy.

Market Outlook

In the near term, given the potential for escalation of tariff and trade wars, combined with speculation surrounding President Trump's other policies, the stock market is expected to be volatile. Monetary policies in Japan and the US will also continue to be key factors driving market fluctuations. At the most recent Monetary Policy Meeting, the Governor of the BoJ stated that the current policy rate level is still far from its neutral range estimate, suggesting that additional rate hikes cannot be ruled out.

Notwithstanding this, we have a constructive longer-term view on the Japan equity market. We believe that structural drivers remain in place for a more positive outlook. In particular, the combination of higher inflation as well as ongoing governance reforms should contribute both to improved earnings as well as a greater focus on shareholder value.

Over recent years, the Tokyo Stock Exchange (TSE) has initiated reforms to improve corporate governance by requiring companies to focus on capital management and returns on invested capital. This addresses a key criticism often made about corporate management in Japan, especially the high levels of cash held on company balance sheets during a period of very low interest rates. It is notable that the level of dividend payouts and share buybacks in Japan has increased in recent years. The unwinding of cross-shareholdings is also progressing and represents a positive trend.

Under these circumstances, we aim to maintain a balanced portfolio, combining growth stocks with higher earnings visibility as well as selective value-oriented stocks with potential positive catalysts, such as turnaround prospects and an improvement in shareholder returns. The portfolio also has a relatively close-to-benchmark sector positioning, so that we expect stock selection to be the main driver of returns.

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