LOMBARD ODIER
INVESTMENT MANAGERS

PrivilEdge – Allianz All China Equity (M share class)

Newsletter

High Conviction • Equities

28 February 2022

MARKET REVIEW

February was a relatively stable month for China equity markets overall. The MSCI China All Shares Index rose by 0.3% (USD). China A Shares outperformed in February, while offshore China equities were weaker, in line with most global equity markets.

The market saw a continuation of performance trends from January, with cyclical/value areas driving the performance. Sectors, such as energy, materials, utilities and financials, have been the standout performers year-to-date. As a result, state-owned enterprises (SOEs) – which dominate the composition of these sectors – have also outperformed. In contrast, the healthcare, technology and consumer discretionary sectors have lagged.

PERFORMANCE REVIEW

PrivilEdge Allianz All China Core lagged the benchmark in February. The main detractor was stock selection in the industrials and financials sectors. Areas, such as the electric vehicle supply chain, were notably weaker for the most part, as a result of the ongoing growth/value rotation in the market. The aggregate sector selection effect was small, an outcome of the portfolio construction, with close-to-benchmark sector allocations.

At a single stock level, a key detractor was China International Capital Corp. (CICC), one of China's leading investment banks. While there was no company-specific news, share price for the sector retreated over the month as concerns of macro risks weighed on sentiment. In the longer term, the Portfolio Managers expect the company to be a key beneficiary of ongoing financial reforms and A-share market institutionalisation in China.

On the other hand, a top contributor was SG Micro, a leading semiconductor design company. The company announced earnings significantly above market expectations. A key growth driver is the potential for further market share gains from foreign competitors, especially in its power management circuit products. The company is also expected to expand into the Apple supply chain later this year.

PORTFOLIO POSITIONING

The portfolio owned 68 positions as at the end of February, representing a diverse range of economic exposures across key sectors. The largest overweight sector position is information technology and the largest underweight is consumer discretionary. At the end of the month, the onshore/offshore allocation is close to benchmark levels, with 51% in China A Shares and 44% in offshore China. In terms of recent portfolio activity, the Portfolio Managers have added slightly to materials names that benefit from higher commodity prices and a stronger economic stimulus. They have trimmed consumer exposure, which may experience some margin squeeze from these higher costs.

Besides internet giants Alibaba and Tencent, other top holdings at the end of the month included China Construction Bank, one of the big four Chinese banks, JD.com, the second largest ecommerce giant, and CICC.

PORTFOLIO STRATEGY AND OUTLOOK

Unlike the rest of the world, where the value rally has been predicated on a rising rate environment, the situation in China is the reverse. The catalyst has been expectations of an improving macro environment as the economy responds to monetary and fiscal relaxation.

There have been ongoing signs of policy easing in recent weeks. Property remains a focus area. Restrictions on bank lending have been relaxed further and access to mortgage financing, especially for first-time buyers, has improved. There have also been early signs of stabilisation in the property market. In a monthly nationwide survey, 28 of 70 cities saw primary housing prices rise in January month-on-month compared with 15 in December.

The National People's Congress (NPC), a key event in the political calendar, took place in early-March. A 2022 GDP target of 'around 5.5%' was announced – at the upper end of expectations – and the government also signalled further monetary and fiscal stimulus.

Source: Bloomberg, Allianz Global Investors, as of end February 2022.

As China's approach is to set targets that are designed to be met or exceeded, this reinforces the Portfolio Managers' view of improved economic momentum through the course of the year.

In terms of the Russian invasion of Ukraine – the portfolio has no direct holdings in Russia.[1] Listed Chinese companies do not generally have significant operations in Russia or generate a high level of revenues there. A characteristic of the China equity universe is its local focus. As an example, over 90% of revenues from listed China A companies are from domestic sources. Based on our research, the highest level of exposure that any company in the portfolio has to Russia is a stock called Angel Yeast. The company has yeast production facilities in Russia, which contributes around 3% of the company's total revenues.

The Portfolio Managers are of course monitoring the situation in Russia very carefully. At this stage, they retain their view that events within China – especially the ongoing pivot to an easier monetary and fiscal policy setting – will be the primary longer-term driver of markets and provide a stabilising backdrop.

[1] Russian holdings mean securities issued by Russian companies, as well as derivatives, ETFs or mutual funds with underlying Russian companies.

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