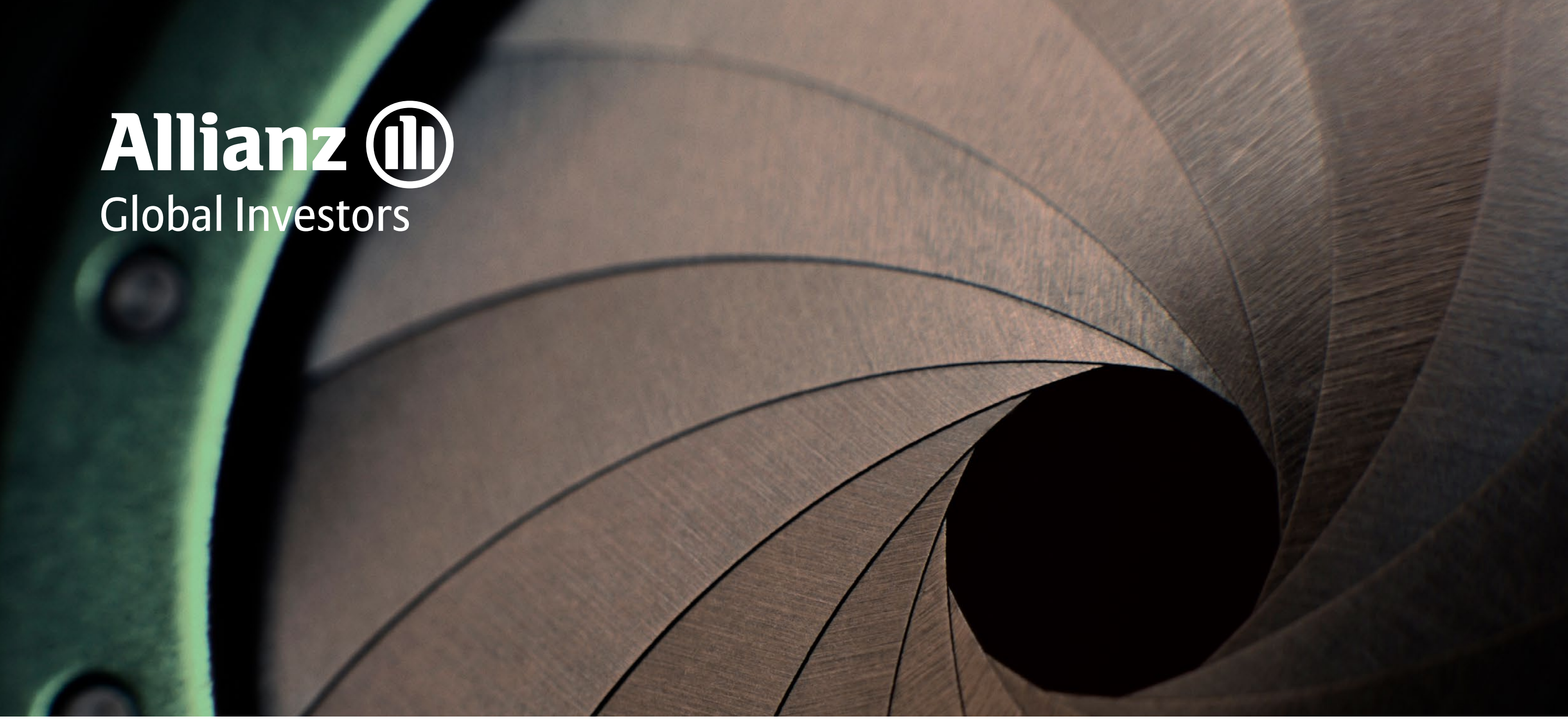


JANUARY 2025

Allianz Global Sustainability
Year in Review: 2024

2024 will be remembered as one of the most volatile years in recent history, yet equities defied expectations by performing strongly and re-rating. This occurred despite significant challenges, including two assassination attempts on the President-elect of the largest economy, a computing error grounding approximately 7,000 flights, and the most substantial turnover of incumbent politicians in developed nations in 120 years. With two major theatres of war and the assassination of the CEO of the world's largest health insurer, volatility and credit spreads remained remarkably stable, with markets experiencing only a brief dip in July.

Despite relatively neutral earnings revisions, the US market re-rated and drove the majority of the index's upside. This outcome was not our base case at the start of 2024, and the fund is behind the benchmark on a 12-month basis.

A substantial portion of this underperformance occurred in the first quarter, as the market sharply revised its interest rate expectations upward in response to persistently high inflation. This followed Q4 2023, when the opposite held true, and the fund delivered strong performance.

From an absolute return perspective, our holdings have performed well, with a significantly high number delivering returns of 20% or more, while negative returns were limited to the low-to-mid teens for only a handful of positions—precisely the return skew we aim for. This typically drives sustained outperformance;

Giles Money
CIO, Global Sustainable Equity

Alex Bibani
Senior Portfolio Manager

Achieving Sustainability

however, as noted earlier, 2024 was an unusual year, and our substantial investments in Artificial Intelligence (AI) were insufficient to offset the prevailing market optimism.

Benchmarks have been particularly challenging to match due to the concentrated nature of performance. Nonetheless, we remain confident that as markets broaden, we are well-positioned to capture considerable upside.

Stock selection – Not owning TSMC

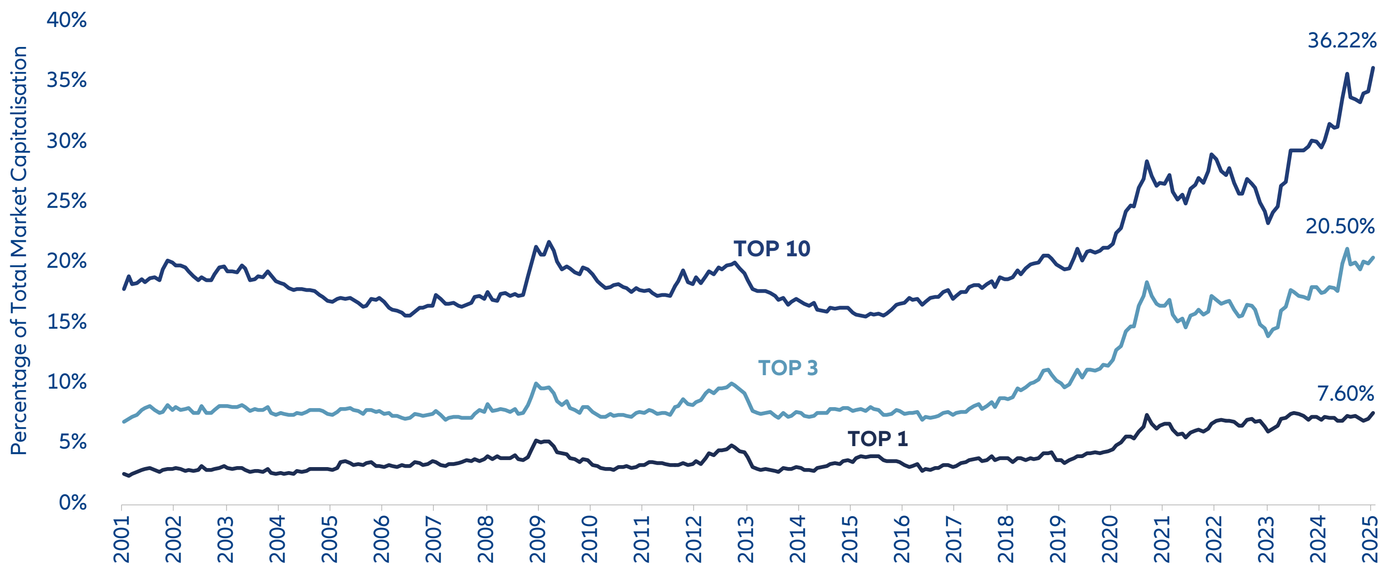
As mentioned earlier, we are generally pleased with our stock selections and the returns they generated. However, the year could be summed up as “not owning TSMC.” The absence of exposure to TSMC has been the most significant detractor from performance, accounting for over 250 basis points of underperformance in our technology holdings over the past 12 months.

Throughout most of the period, technology stocks perceived as AI beneficiaries delivered exceptionally strong performance. Since July, however, this trend has moderated and become more nuanced. We avoided exposure to TSMC due to concerns over its aggressive capital deployment cycle, which we believed would structurally lower its return on capital. While TSMC is a quality company and a recognised AI beneficiary, we were cautious about its investments in the US, Europe, and Japan, as well as the geopolitical risks stemming from China’s stated intention to annex Taiwan.

Following the US election, TSMC’s stock underperformed due to concerns over potential tariffs announced by Trump. This lack of exposure benefited our portfolio during that period. We capitalised on the weakness to initiate a position in TSMC, as we believe geopolitical risks have subsided, the stock now trades at a more reasonable valuation, and the economic implications of its capital deployment are clearer.

We have observed an exceptional concentration of performance in a small number of stocks during this period, accompanied by heightened volatility. This level of concentration is extreme by any measure (see chart below for the US market) and presents challenges even greater than those experienced during the previous tech bubble.

Exhibit 1: S&P 500 stock market concentration in the US, 2000 - 2024



Source: FactSet, Goldman Sachs Global Investment Research, Jan 2025

Among the top detractors were IT consulting group CapGemini and Asian insurer AIA. We had anticipated strong performance from IT consulting firms, expecting them to benefit from the implementation of AI projects. However, this has not materialised significantly, as IT budgets have been constrained this year, leading to disappointing results and guidance that have weighed on share prices. In response, we reduced our exposure to CapGemini and exited our position in Accenture as expectations for the consulting industry declined over the course of the year.

Asian insurer AIA has delivered mixed performance this year, with the market failing to fully recognise its long-term prospects. We continue to hold a position in the stock, which saw a significant rebound following the September stimulus but has since declined in line with broader weakness in the Chinese market. This reflects both the attractive value in the Chinese market and the fragility of investor confidence.

On a more positive note, newly added Morgan Stanley has been the top contributor to performance over the past 12 months and has performed particularly well recently. The banking sector has generally fared well, with Morgan Stanley benefiting from an anticipated rebound in investment banking revenues and solid growth in its wealth management business. We have retained our position in the stock.

Our holding in cybersecurity leader CrowdStrike was among the top contributors to performance, despite some volatility throughout the year. The stock performed exceptionally well in the first half of the year but faced a significant setback following a global IT outage it caused. It has since rebounded, and we continue to hold the stock, having added to our position during the lows.

Lonza also ranked among the top contributors over the past 12 months. As one of the world's largest providers of contract development and manufacturing (CDMO) services, the stock delivered strong performance in the first quarter, after which we decided to sell our position.

Other positive contributors include more recent acquisitions such as Compass Group and Rentokil, which are detailed in the positioning section below.

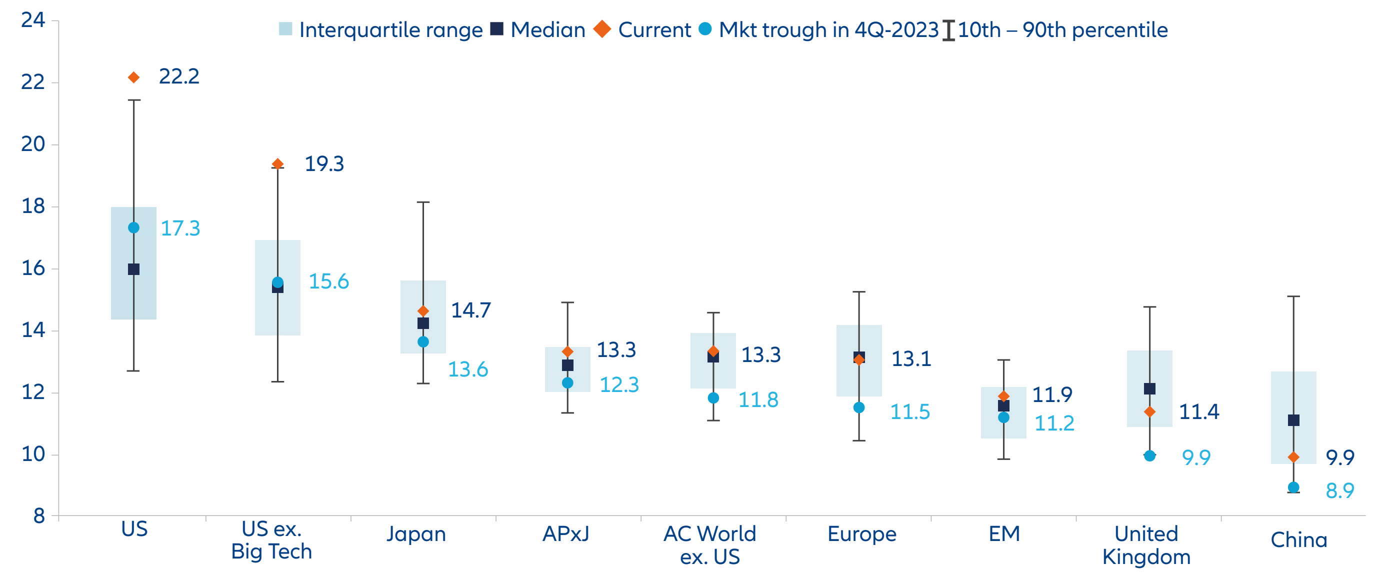
Country Allocation

Our benchmark has a significantly lower weighting to the US compared to those used by many of our peers, who often use the MSCI ACWI or developed markets indices as benchmarks. While we are overweight to the US relative to the DJ Global Sustainability Index, we remain underweight compared to the MSCI ACWI and developed markets indices.

This results in US weightings being 10-20% higher in other global funds and including more of the "Mag7+" stocks, making comparisons challenging at present. We construct the portfolio to be regionally neutral, with idiosyncratic risk serving as the primary driver of tracking error.

That said, we find the US market relatively expensive and have identified European-listed stocks with strong US exposure trading at more attractive valuations. Examples include industrial company Schneider Electric and pest control firm Rentokil, where we have increased allocations to capitalise on this arbitrage. In Rentokil's case, an activist investor is pushing for a US relisting, which could directly realise the valuation gap.

Exhibit 2: 12 month forward P/E, MSCI regions: data since 2003



Source: Bloomberg, Datastream, Goldman Sachs Global Investment Research, Jan 2025

Style

Quality Growth has underperformed in 2024, as stubbornly high US bond yields ended the period higher, despite some indications of moderating inflation. While we view this as a potential opportunity, it has been a headwind this year. Typically, this style benefits from declining rates, even if the process unfolds unevenly over time.

Portfolio activity

In terms of positioning, we have reduced our exposure to semiconductors and increased allocations to more defensive positions such as Compass Group, Zoetis, and Rentokil.

Compass Group, a business services company providing equipment and staffing for workplaces, offers an attractive valuation in an industry that has improved post-COVID, leaving smaller competitors behind. Its strong balance sheet is well-positioned for either a special dividend or additional M&A activity, both of which would enhance our investment case given the company's extremely conservative management approach. With highly visible growth and defensive characteristics, Compass Group remains a compelling addition to the portfolio.

In the second quarter, we added US animal health company Zoetis to the portfolio. The shares had underperformed earlier in the year due to negative news surrounding one of its drugs, providing us with an attractive entry point into this undisputed leader in the global animal health industry.

More recently, we initiated a position in pest control company Rentokil. The shares experienced a de-rating due to slower-than-expected integration with US peer Terminix and lacklustre organic revenue growth in the North American segment. This resulted in widespread earnings downgrades and lower valuations, creating an appealing risk-reward opportunity, particularly with an activist investor pressuring management. We see strong potential in an industry that is resilient to economic sentiment.

In November, we sold our position in Shell and initiated a position in NextEra Energy. NextEra Energy offers an attractive growth story within the defensive US regulated utilities sector. The company combines Florida Power & Light (FPL), a best-in-class regulated utility, with a leading renewable energy business, positioning it to sustain sector-leading earnings growth. Leveraging its cost leadership, NextEra is expanding its regulated asset base while capitalising on a growing backlog of renewable projects driven by the secular shift away from fossil fuels and rising power demand in the US.

Outlook

We anticipated a close election, and in October, both financial and betting markets shifted strongly toward a Republican victory, significantly impacting bond markets along the curve. Since the election, US stocks have shown mixed performance, with an initial sharp rebound, particularly among companies seen as Trump beneficiaries, such as Tesla.

What is clear now is that Trump's agenda will be a key market driver, requiring us to remain highly responsive to any policy clarity he provides. While in the short term, inflation expectations and rising fixed-income yields could challenge our style, we believe the pricing power of our quality compounders offsets this risk. Additionally, our focus on valuation further mitigates potential impacts.

We anticipate a flurry of new policies and will stay vigilant, but we believe the fund is well-positioned. We are overweight in the US and hold a strong portfolio of investment cases that we are confident can perform well across various economic scenarios.

We expect 2025 to be driven more by earnings revisions than by re-rating. Notably, Europe and Asia offer significant valuation advantages, particularly if there is an improvement in economic momentum or expectations of such. Both regions could benefit from potential stimulative policies, making them worth closely monitoring.

The US enters 2025 with record-high mortgage costs, persistent inflation, and relatively expensive equities, especially when compared to its bond market. This makes regional allocations appear balanced. We value having this optionality as the year unfolds and believe that any market broadening should enhance performance, given current conditions.

In the realm of Generative AI, 2025 is likely to be a pivotal year, where tangible progress in its agentic deployment could solidify its landscape and create opportunities for many of our investments to thrive. However, this year may also serve to prove the value of diversification, as the broad re-rating fuelled by Generative AI in the US aligns with the realities of execution. In this environment, diversified stock selection will likely play an even greater role in driving success.

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