Allianz Global Investors

Allianz American Income

Monthly commentary

- The Fund aims at long-term capital growth and income by investing in debt securities of American bond markets with a focus on the US bond markets.
- The Fund is exposed to significant risks of investment/general market, country, emerging market, creditworthiness/credit rating, default, interest rate, volatility and liquidity, counterparty, valuation, sovereign debt, currency (such as exchange controls, in particular RMB), and the adverse impact on RMB share classes due to currency depreciation.
- The Fund may invest in high-yield (non-investment grade and unrated) investments and convertible bonds which may subject to higher risks, such as volatility, loss of principal and interest, creditworthiness and downgrading, default, interest rate, general market and liquidity risks and therefore may adversely impact the net asset value of the Fund. Convertibles may also expose to risks such as prepayment, equity movement, and greater volatility than straight bond investments.
- The Fund may invest in financial derivative instruments ("FDI") which may expose to higher leverage, counterparty, liquidity, valuation, volatility, market and over the counter transaction risks. The Fund's net derivative exposure may be up to 50% of the Fund's net asset value.
- This investment may involve risks that could result in loss of part or entire amount of investors' investment.
- In making investment decisions, investors should not rely solely on this material.

Note: Dividend payments may, at the sole discretion of the Investment Manager, be made out of the Fund's capital or effectively out of the Fund's capital which represents a return or withdrawal of part of the amount investors originally invested and/or capital gains attributable to the original investment. This may result in an immediate decrease in the NAV per share and the capital of the Fund available for investment in the future and capital growth may be reduced, in particular for hedged share classes for which the distribution amount and NAV of any hedged share classes (HSC) may be adversely affected by differences in the interests rates of the reference currency of the HSC and the base currency of the Fund, particularly if such HSC are applying the IRD Neutral Policy.

What Happened in September

Fixed income markets finished higher in September, driven by a dovish shift in monetary policy that stemmed from an array of new economic data. Multiple inflation measures continued to ease, consumer spending surprised to the upside, and the service sector remained in expansionary territory. However, some labor market measures were weaker, the manufacturing sector continued to contract, and consumer confidence declined. The simultaneous deceleration of inflation and jobs growth proved to be the catalyst for the first monetary easing campaign in four years, as the US Federal Reserve (Fed) cut interest rates by 50 basis points at the September Federal Open Market Committee (FOMC) meeting. Markets responded favorably, with risk assets moving broadly higher into the end of the month to solidify monthly gains.

Investment Grade Bond Market Environment

The ICE BofA US Corporate Index returned +1.72%, outperforming the shorter-dated ICE BofA 1-10 Year US Corporate Index which returned +1.29%.^ AAA, AA, A and BBB rated bonds returned +1.82%, +1.62%, +1.74% and +1.72%, respectively.^

Spreads narrowed to 92bp from 96bp, the average bond price rose to 96.11, and the market's yield fell to 4.81%.^

Gross new issuance for the period was USD 179.8 billion.*

The 10-year US Treasury returned +1.37%.* The note's yield fell to 3.79% compared to 3.92% the prior month.*

High-Yield Bond Market Environment

The ICE BofA US High Yield Index returned +1.63% for the month. ^BB, B, and CCC rated bonds returned +1.09%, +1.18%, and +5.20%, respectively.^

Spreads narrowed to 303bp from 317bp, the average bond price rose to 96.72, and the market's yield fell to 7.21%.^

All industries advanced with cable, telecoms, and media outperforming, while energy, autos, and capital goods underperformed.

Trailing 12-month default rates finished the period at 1.64% (par) and 1.35% (issues). **

New issuance saw 56 issues priced, raising USD 36.7 billion in proceeds. **

Portfolio Review

September performance was positively impacted by broad based strength across fixed income markets as interest rates moved lower ahead of the FOMC's decision.

Among corporate bonds, industries that contributed the most to performance included technology, financial services, and banking. Strength in technology was broad-based, with select longer-maturity issues in consulting, software, and semiconductors having the greatest impact on performance. Within financial services, the largest contributors were holdings with exposure to credit card services and aircraft leasing. Banking outperformance was widespread as well, led by issues from major multinational and US banks.

There were no industries that detracted from performance during the period.

Transactions during the period included a new purchase in insurance brokers, electric utilities, and diversified banks, and complete sells in health care distributors, hotels/resorts/cruise lines, and integrated telecommunication services.

Outlook and Strategy

The easing cycle has begun, with the Fed cutting interest rates by 50 basis points in September as inflation normalizes and the labor market softens.

Apart from an accommodative shift in monetary policy, potential economic tailwinds include steady consumption, continued government spending, improving productivity, increasing capital expenditures, and the proliferation of artificial intelligence. Risk to the economy may increase if these trends weaken. Other potential headwinds include escalating geopolitical tensions, prolonged labor market softening, deteriorating consumer sentiment, and continued manufacturing contraction.

US investment grade corporate bond's risk/reward opportunity is compelling. Rising interest rates are a risk for high grade corporates, however the investment opportunity remains attractive given higher coupons and yields, and a positive fundamental outlook with limited default risk. The asset class trades at a discount to par, offering compelling total return potential and downside cushioning.

US Treasuries – a low-risk source of reliable income – are an attractive investment given relatively high interest rates.

The US high-yield market, yielding over 7%[1], offers the potential for equity-like returns but with less volatility. The market's attractive total return potential is a function of its discount to face value and higher coupon, which also serves to cushion downside volatility. Credit fundamentals are stable, near-term refinancing obligations remain low, and management teams continue to prioritize debt reduction. Given these factors, the default rate has been below the long-term average with expectations for it to trend toward the historical average in 2025. Regarding credits spreads, they can stay tight for many years. This was the case in the mid-1990s and 2000s – periods like today when high-yield balance sheets were healthy and defaults were low, the economy was stable, and interest rates were elevated.

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All data are sourced from Allianz Global Investors dated 30 September 2024 unless otherwise stated.

* Source: BofA Merrill Lynch, as at 30 September 2024.

^Source: ICE Data Systems, as at 30 September 2024.

**Source: JP Morgan, as at 30 September 2024.

[1] Source: ICE Data Services; data as 30 September 2024.

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