

Allianz

Dynamic Asian High Yield Bond

Monthly commentary

- The Fund aims at long-term capital growth and income by investing in high yield rated debt securities of Asian bond markets.
- The Fund is exposed to significant risks of investment/general market, interest rate, valuation, sovereign debt, creditworthiness/credit rating/downgrading, default, emerging market, country and region and 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 be exposed to risks such as prepayment risk, 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.

What Happened in December

In December, market activities for Asian credit slowed down as we entered the holiday season. US Treasury rates remained volatile with the 10-year yield rising to 4.6%, a level which was last seen in May this year. During the month, the Federal Open Market Committee (FOMC) cut rates by 25bps as expected, but the latest dot projections indicated only two cuts in 2025, and the long-run neutral rate was revised up to 3.0%. Investors were surprised by the hawkish projections. Markets are now pricing in less than 40bps of rate cut in 2025 versus more than 60bps previously.

For Asian credit, the JP Morgan Asia Credit Index (JACI) composite reported negative return of -0.8% in December. High Yield (HY) credits did slightly better, delivering -0.6% with -0.3% coming from credit spread and -0.3% from US Treasury. Year to date, Asian credit delivered 5.7% in total return, driven by a mix of spread return (3.8%) and Treasury return (1.8%). Asian High Yield continued to report outstanding return of 15.2%, significantly outperforming other High Yield markets.

In Asian High Yield, negative spread return was mainly driven by idiosyncrasies, rather than beta moves. In fact, most of the major sectors delivered positive spread return except for Hong Kong real estate and Sri Lanka sovereign. Company specific negative headline news in the Hong Kong real estate sector was the largest detractor, with news reporting that a leading Hong Kong property developer was in discussion with banks to extend some bilateral loans and had asked for a waiver of a debt ratio covenant. Bonds were priced down significantly as the development contradicts with the common perception that the company continues to have access to bank loan funding at competitive levels. For Sri Lanka, the underperformance was due to technical reasons with retail accounts taking profit ahead of the bond exchange deadline. The bond exchange was well accepted with a high participation rate.

It was a quiet month for the new issue market in Asia with only USD 6.9bn printed, bringing year to date Asia ex-Japan USD bond issuance to USD 202bn. Net supply remains negative as Asian corporates and sovereigns have ample financing optionality.

Portfolio Review

Fund performance was driven by carry and our positioning in Sovereigns while our exposure to Hong Kong property was a drag. We continue to maintain a portfolio beta of slightly above 1 and look for pullbacks to increase our market exposure further. While we have overweights in core sectors such as Macau Gaming and Indian Renewables, selection remains key for this portfolio.

Outlook and Strategy

Going into January, primary activities should pick up after the holiday season and may put pressure on credit spread in the near term given the tight valuation. We expect supply to increase in 2025, but net supply should still be negative or close to zero. We are still comfortable with the corporate fundamental in Asian credits and expect limited impact from the potential trade war in 2025 as most of the Asian issuers do not have large direct exposures to the US market. That said, given current tight valuation and the less supportive technicals, we do not see much room for IG credit spreads to tighten and expect most of the return to come from carry moving forward.

In Asia High Yield, although valuation is not as attractive as a year ago, we continue to favor HY as valuations look less stretched compared to Investment Grade. We also take comfort from the stable to improving fundamental outlook for most of the high yield issuers. Nevertheless, prudent credit selection remains the key for outperformance given the idiosyncrasies of Asian High Yield.

Overall, the all-in yield of Asian credit remains attractive and the stable-to-improving credit fundamentals should keep spread volatility in check. Trump 2.0 may bring volatility to the market, but we are not worried about default risk in Asian credit given the favorable credit cycle. We will continue to take market corrections, if any, as opportunities to buy into credits that we have high conviction on.

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Source: from Bloomberg, IDS and Allianz Global Investors and as at 31 December 2024 unless otherwise stated.

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