

# Allianz

## Flexi Asia Bond

### Monthly commentary

- The Fund aims at long-term capital growth and income by investing in debt securities of Asian bond markets denominated in EUR, USD, GBP, JPY, AUD, NZD or any Asian currency. With the adoption of the Sustainability Key Performance Indicator Strategy (Relative) ("KPI Strategy (Relative)"), the Fund also seeks to achieve the reduction in greenhouse gas emissions ("GHG") of the Fund's portfolio which shall be at least 20% lower than that of its benchmark index within the same period ("Sustainability KPI").
  - The Fund is exposed to significant risks of investment/general market, country and region, interest rate, creditworthiness/credit rating/downgrading, default, valuation, sovereign debt, emerging market, RMB debt securities, currency (such as exchange controls, in particular RMB), and the adverse impact on RMB share classes due to currency depreciation.
  - The Fund is exposed to sustainable investment risks relating to KPI Strategy (Relative) (such as foregoing opportunities to buy certain securities when it might otherwise be advantageous to do so, and/or selling securities when it might be disadvantageous to do so or relying on information and data from third party ESG research data providers and internal analyses which may be subjective, incomplete, inaccurate or unavailable). The Fund focuses on the Sustainability KPI which may reduce risk diversifications and may be more volatile compared to broadly based funds. Also, the Fund may be particularly focusing on the GHG emission efficiency of the investee companies rather than their financial performance which may have an adverse impact on the Fund's performance.
  - Investing in share class with fixed distribution percentage (Class AMF) is not an alternative to fixed interest paying investment. Investors should note that fixed distribution percentage is not guaranteed. The percentage of distributions paid by these share classes is unrelated to expected or past income or returns of these share classes or the Fund. Distribution will continue even the fund has negative returns and may adversely impact the net asset value of the Fund. Positive distribution yield does not imply positive return.
  - 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 the assets in interest-bearing securities issued or guaranteed by a non-investment grade sovereign issuer (e.g. Philippines) and is subject to higher risks of liquidity, credit, concentration and default of the sovereign issuer as well as greater volatility and higher risk profile that may result in significant losses to the investors.
  - 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 May

In May, bonds market started off strong largely driven by the dovish statement from the latest Federal Open Market Committee (FOMC) meeting and the softer than expected Non-Farm Payroll (NFP). In addition, US Federal Reserve (Fed) Chairman Powell indicated policy rates are sufficiently restrictive and that the Fed's next move is unlikely to be a hike. All these reversed the rise in US treasury yields, which had weakened market sentiments in the prior weeks.

Middle of the month, China's regulators announced a slew of policy measures to boost the real estate sector. China's Politburo meeting in April had earlier pledged to study how to digest the existing housing inventory. All these boosted markets sentiments, and both Investment Grade (IG) and High Yield (HY) markets displayed strong performance. The JP Morgan Asia Credit Index (JACI) composite rose by 1.3%, led by JACI High Yield (HY) which rose 2.8% while JACI Investment Grade (IG) increased by 1.1%.

In Asia IG, credit spreads traded around a wide 19 basis points (bps) range but ended the month relatively flat at 84bps. Most of the performance came from the interest rate duration return as US Treasury yields declined, given spread return was largely flat. Within Asia Investment Grade (IG), Indonesia IG outperformed while Korea IG lagged. Indonesia IG benefited from the rally in US Treasury as they are duration proxies and thus were sensitive to interest rates movement.

In China, it was reported that the US government could potentially unveil new tariffs on Chinese goods, but it was mostly shrugged off by investors. Instead, China technology saw credit spreads tightened modestly on the back of their Q1 2024 earnings announcement, which saw most still recording topline growth. Moreover, several technology related companies issued convertible bonds during the month, likely reducing potential supply of straight bonds.

In the last week of May, S&P moved India's sovereign's outlook to positive, while affirming its BBB- rating. This benefited credits whose ratings are tied to sovereign ratings. In addition, India concluded its general elections on June 1 with exit polls out and predicting a landslide victory for the Bharatiya Janata Party led the National Democratic Alliance party (BJP-led NDA party). All these elevated the positive sentiments on India's IG bonds. The credit primary market picked up in May, taking the YTD total to USD 60 billion, about 9% higher than the same period last year. Most of the new issues performed well on debut, reflecting investor demand for bonds to deploy cash.

In Asia HY, the market delivered 2.8% returns in May, significantly outperforming Global HY (+1.2%) and US HY (+1.2%). Among the countries, China HY led the returns while Macau HY lagged.

China real estate bonds rallied strongly on the back of revived optimism in the sector. The Chinese authorities a slew of measures to accelerate the destocking of existing housing inventory and were looking at proposed plans for local governments to acquire unsold homes. Following these announcements, several provinces scrapped home purchase restrictions and lowered down payment for home purchases. All these measures lifted China real estate bond prices. China industrial bonds also rallied, driven by the positive sentiments to the Chinese HY bond market.

Macau gaming companies showed resilience in earnings before interest, taxes, depreciation, and amortization (EBITDA) growth while their gross gaming revenue (GGR) continued to increase, beating market expectations. Although there were some divergences in earnings momentum between the operators, most of them were in deleveraging mode. There, we expect most operators to continue to see improved credit metrics.

### Portfolio Review

The Fund outperforming its benchmark for the month.

The Fund's outperformance has been driven by our overweight allocation to HY. Our HY positioning was mostly overweighted in BB rated bonds, avoiding most of the riskiest CCC rated bonds. We also took profits on our long duration position and remained largely flat on duration. However, we increased our 5 year versus 30 year curve steepener position. We added more BB-rated high-yield to beef up carry in the portfolio given our positive view on Asian high-yield's total return potential as default rate is expected to come down.

## Outlook and Strategy

Asia investors should stay invested in Asia credits as current conditions remain benign with credit fundamentals improving and corporates deleveraging their balance sheets. All in yield remains attractive providing high carry. Although credit spreads have continued to tighten YTD, we expect credit spreads to stay at their current tight levels, given the strong demand / supply technicals and attractive credit cycle. Corporate earnings out of most Asia companies had generally been positive. In China, the Tech sector is still in an upswing, with the consumption sector being a developing bright spot. India's corporates credit and fundamentals backdrop remain strong, and their latest results did not disappoint. Most of the Southeast Asia credits which have reported earnings show stable fundamentals.

The activity in the credit primary market has picked up, compared to April. The overall tone remains positive on both the supply and demand sides, with issuers achieving small new issue concessions. We have been active in the new issuance market, taking the opportunity to switch out of bonds which have tightened beyond fair valuation, and into new issuance with attractive valuation. We do seek a careful balance between quality and carry from a positioning perspective while at the same time, minimize spread duration risk. Interest rate volatility remains a key risk, and our strategy is to maintain a highly diversified portfolio with high portfolio yield and carry.


In the IG credit space, we anticipate continued sideways trading of credit spreads due to low supply of bonds. Although spread levels are tight, but the overall yield is high, which is positive for quality carry. We have a preference for BBB Indonesia Utilities credits, which is supported by stable earnings. At the same time, we also like Hong Kong A rated real estate companies – fundamentals seem to be bottoming out and lower rates into 2025 should support valuations and reduce costs of debt.

On Asia HY credits, we hold a constructive view, expecting modest spread compression. Current spread levels still imply a higher probability of defaults than estimated, which mean there is a potential for further spread compression. We do advocate increasing allocations to high yield credits, and we believe credit selection remains key to finding alpha opportunities. Within this segment, we like BB rated India renewables which have shown steady interim results, improvements in working capital cycles and strong access to onshore and offshore funding. We also like the Macau Gaming sector which has shown continued recovery and all issuers have turned EBITDA positive with continued debt reduction.

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

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