Allianz Global Investors

Allianz Global Floating Rate Notes Plus

Monthly commentary

- The Fund aims to capture income from a global universe of floating-rate notes and seeks potential for long-term capital growth in accordance with environmental and social characteristics. With the adoption of the sustainable and responsible investment ("SRI") (Proprietary Scoring) strategy ("SRI (Proprietary Scoring) Strategy"), the Fund takes into account sustainability factors based on United Nations Global Compact Principles and follows the principles of SRI. The Fund does not constitute as an ESG fund pursuant to the SFC's circular issued on 29 June 2021.
- The Fund is exposed to significant risks of investment/general market, currency, creditworthiness/credit rating, interest rate, default, valuation, volatility and liquidity, and sovereign debt.
- The Fund is exposed to risks relating to SRI (Proprietary Scoring) Strategy investment (such as foregoing opportunities to buy certain securities when it might otherwise be advantageous to do so, selling securities when it might be disadvantageous to do so, and/or reducing risk diversifications compared to broadly based funds) which may result in the Fund being more volatile and have adverse impact on the performance of the Fund and consequently adversely affect an investor's investment in the Fund.
- The Fund may invest in high-yield (non-investment grade and unrated) investments 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 increase the risk of loss of original investment.
- 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 February

In In February, global investment grade corporate spreads widened by 5bps to 90bps, with USD spreads wider by 7bps to 89bps, EUR spreads remaining flat at 91bps, and GBP spreads widening by 4bps to 91bps. Relative to government bonds, investment grade corporates delivered -31bps of excess returns. Market volatility remained the dominant theme throughout the month, as participants grappled with complex and volatile market conditions. Concerns included weaker demand from China in the East and escalating geopolitical tensions in the West.

On a global scale, uncertainty continues to weigh on sentiment. Markets have been particularly focused on President Trump's tariff policies, targeting China, Canada, and Mexico, and the potential inflationary consequences of these measures. Hopes for a diplomatic resolution to the Russia-Ukraine conflict were quickly dashed after a contentious meeting between President Trump and President Zelensky, further contributing to the fragile geopolitical backdrop.

US Consumer confidence came in below expectations in February as well as a similar tone in consumer sentiment and services PMI raising concerns. Non-Farm Payrolls came in under projections at 143,000 (vs 175,000 estimate) with a prior upwardly revised read of 307,000. Conversely consumer spending remains strong, with confidence in the growth of the underlying economy. Corporate earnings continue to hold firm in an uncertain market but looking forward the picture is looking far more unclear as firms pause to take heed to the rapidly changing political tides. Market focus remained on tariffs and geopolitical developments with threats of tariffs on key sectors, including autos, semiconductors, and pharmaceuticals. With US consumer price index (CPI) also surprising to the upside (0.5% versus 0.3% month-on-month) this will not provide welcome news.

In the US, investment grade gross supply totalled to USD 157.8bn in February down from USD 192.2bn in January. February supply consisted of USD 106.8bn non-financials and USD 51bn financials. In Europe this has been the busiest February in recent years, with issuance up sharply (+45% year-on-year), led by financials (+65%). For the month, EUR 107bn was brought to market which surpasses February supply over the last decade.

Portfolio overview

The Fund generated positive gross return in February, ahead of its cash reference index (SOFR). Positive absolute performance was generated by attractive underlying yields inbuilt within the fund, with SOFR at 4.39% by the end of the period.

We continued to be active in the primary market seeking to harvest new issue premiums and benefiting from and uptick in Floating Rate Notes (FRNs) supply. Notable new issuance activity included the participation in a deal from German wholesale retailer which attracted significant demand and performed very well on the break, demonstrating the demand for higher spread names in Europe. We invested cash into highly rated Sub-Sovereign & Agency FRNs to continue to benefit from elevated front-end rates without increasing overall portfolio corporate risk. Consistent with our theme of moving up the capital structure in financials, we disposed of subordinated risk in JP Morgan bonds. Overall, we maintained our modest position of circa 2 years of spread duration.

Outlook

We consider the global corporate market to be at fair value to modestly rich, with the market pricing in strong fundamentals across the majority of sectors, as evidenced by the recent earnings season, but also discounting future growth concerns. Therefore, we maintain a modest overall credit risk in the portfolio, allowing us to maintain maximum flexibility to future positioning in response to valuations, while continuing to capture credit risk premia through carry and roll-down.

Notably, risks to growth exist from US political/policy decisions, such as tariffs, impacting growth – including in external regions such as Europe. However, expectations of fiscal loosening from Germany have supported the European growth outlook. In this context, spread levels between EUR and USD spreads have compressed meaningfully leading us to look for opportunities to rotate EUR paper into USD paper to benefit from this move.

Generally, we continue to favour financial issuers given the benefits associated with the elevated interest rate environment and attractive valuations relative to industrial issuers, while acknowledging the recent compression makes this less attractive at the margin. Consistent with this, we prefer instruments higher up the capital structure in general. However, we believe that selectivity is key at both the issuer and instrument level and there remain attractive opportunities in subordinated paper for high-quality, well-capitalised banks.

We remain cautious on cyclical issuers, particularly in the connect of the relative value to financials, meaning risks in the sector appear to be skewed to the downside. High yield issuers are typically more sensitive to growth, leaving us cautious on overall High Yield risk. Finally, we continue to view securitised products as an attractive portfolio diversifier.

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