Allianz Global Investors

Allianz Global Opportunistic Bond

Monthly commentary

- The Fund aims at long-term capital growth and income by investing in global bond markets.
- The Fund is exposed to significant risks of investment/general market, creditworthiness/credit rating, interest rate, default, valuation, sovereign debt, emerging markets, and currency.
- 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 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, particularly if such HSC are applying the IRD Neutral Policy.

What Happened in October

In October, the US federal government shut down after Congress failed to agree on a budget deal. As with previous shutdowns, it was shrugged off by financial markets, although the lack of official economic data releases has reduced some visibility on the performance of the US economy. This was acknowledged by the US Federal Reserve, which delivered an expected further 25bp rate cut, taking the Fed funds target range to 3.75-4.00%. However, Fed Chair Powell did cast doubt on a further cut in December, which highlights the deepening divisions within the Fed on how to interpret an economy where consumer spending is holding up, but labour market activity has weakened. 10-year US Treasury yields ended the month at 4.08% (7bp lower); the US7s30s curve was fractionally flatter at 78bp.

In the Euro area, the European Central Bank kept its deposit rate unchanged at 2%, with ECB President Lagarde repeating the line from September's meeting that policy "is in a good place" given a relatively benign inflation backdrop and an economy growing close to its trend rate. 10-year Bund yields ended the month at 2.63% (8bp lower). In the UK, meanwhile, inflation prospects may finally be turning a corner; September's inflation data saw both headline and core CPI inflation coming in below expectations at 3.8% y/y and 3.5% y/y, respectively, below the Bank of England's own projections. Along with a growing expectation that the UK government will commit to a tight fiscal stance in its end-November Budget, market pricing shifted to reflect a more dovish BOE policy stance in the coming months. Against this backdrop, Gilts had a strong month versus other developed sovereign bond markets; 10-year Gilt yields ended the month at 4.41% (29bp lower), while the spread between 30-year Gilts versus US Treasuries fell to 53bp (25bp lower in October).

Portfolio Review and Strategy

A re-emergence of US/China trade tensions and the resulting risk-off sentiment led to a rally in US Treasury yields towards the middle of the month, with 10-year yields falling by 20bp before recovering into month-end as another trade truce started to take shape ahead of a summit meeting between President Trump and Xi. Our duration longs in Switzerland and New Zealand contributed to performance, as did our exposure to 5-10 year US Treasuries. During the month, we elected to take profit on our NZGB holdings having hit our target. We also elected to add a long position in 2-year US rates as the prospect of a more dovish monetary policy path ahead under a new Fed Chair are rising, with the new Chair expected to be chosen towards the end of this year.

Our positioning for a steeper US yield curve detracted at the margin as some of the September flattening momentum carried over into October. We decided to add to this theme in October by pairing our flattener on the Canadian yield curve against new positioning for a steeper US 2s10s curve. Our 2s10s flattener on the German yield curve, meanwhile, added to performance and we elected to take profit within the month.

UK Gilts had a strong month in October, outperforming other sovereign bond markets, against a backdrop of lower-than-feared inflation and increasing signals of a fiscally prudent Autumn Budget. This strongly benefitted portfolios as we are positioned long in 30-year Gilts vs US Treasuries.

Our short USD theme (vs EUR and KRW) was challenged in October as the USD was better bid with the Fed imposing some optionality on a December rate cut. The GBP, meanwhile, continued to come under pressure in October as an improving inflation outlook and incremental signals of fiscal tightening in the Autumn Budget brought near-term BOE rate cuts back into sight. This benefited our short Sterling theme which produced good returns in October. On the back of this positive performance, we elected to take profit on two of our relative value trades to be short GBP vs CNH and AUD. We maintain a short in GBP paired against the Norwegian krone.

Within the month, we added a new relative value trade to be short the Euro against the New Zealand dollar. Economic activity in the Euro area remains lacklustre and tightening financial conditions will likely weigh on future growth prospects. Monetary policy support in New Zealand, meanwhile, is quickly turning accommodative which should benefit the economy that is recovering from subdued growth rates. In this environment of near-term cyclical tailwinds, we see the NZD outperforming the Euro – the trade posted an initial positive contribution to performance in October.

Elsewhere, we decided to tactically reduce our NOK exposure against the JPY given a weakening in oil prices, which raised the possibility of a positive terms of trade boost for the Japanese economy. However, oil prices quickly rebounded following headlines of further sanctions on Russian oil supplies; the short NOKJPY trade detracted from performance and we elected to close it at a loss.

In credit markets, global investment grade corporate spreads widened 2bp in September, driven by underperformance in US corporates. The strategy retained a moderate long footprint via allocations to IG corporates (sector focus on senior financials and utilities versus cyclical industrials). Within European sovereigns, we continue to favour Spain over Germany.

Looking ahead, we think global economic growth expectations are tilting in a cyclically favourable direction given a generally pro-growth policy setting in the major economies. We favour a long headline duration position. We maintain a structurally bearish view on the US dollar given ongoing concerns about large US twin deficits (fiscal + current account), potential worries about institutional credibility (such as those related to a more politicized Federal Reserve ahead), and the potential for currency re-alignment in those markets that run large bilateral trade and current account surpluses versus the US. We also maintain a structurally bearish view on GBP.

In investment grade credit, we retain a moderate overall credit allocation given that fundamentals and technicals still remain supportive for the asset class. The credit allocation leans into higher quality tiers, with a bias to favour senior financials and utilities versus cyclical industrials.

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