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 May

It was a roller coaster ride for sovereign fixed income markets in May, with 10-year US Treasury yields trading in a 4.30-4.65% range, before ending the month at 4.50% (18bps lower on the month). Interest rate markets took some comfort from the latest US inflation data, with the US Federal Reserve's (Fed's) preferred core personal consumption expenditures (PCE) deflator coming in line with expectations at 2.8% year-over-year (y/y), even as activity and labour market data continued to suggest the US economy remains resilient. Meanwhile, the latest Fed meeting minutes and comments from Fed speakers were generally less dovish than that of Fed Chair Powell after the most recent Fed meeting; interest rate markets continued to push out the timing of Fed rate cuts to the end of this year and 2-year US Treasury yields ended the month at 4.87%. The US 7s30s curve saw some modest steepening, ending the month at 14bps (6bps higher).

In the Euro area, interest rate markets continued to anticipate the start of an European Central Bank (ECB) rate cutting cycle in June, even as activity data suggested early signs that the growth outlook was improving from the end-2023 lows and as core Euro area consumer price index (CPI) inflation edged up to 2.9% y/y; 10-year Bund yields ended the month at 2.66% (8bps higher over the month). In the UK, the Bank of England (BoE) kept the policy rate on hold at 5.25%, as expected, but BOE Governor Bailey sent a clear signal that the path to lower interest rates was approaching. Nonetheless, although headline UK CPI inflation slowed to 2.3% y/y and core CPI inflation came in at 3.9% y/y, both were above expectations, tempering market pricing on the timing and pace of UK rate cuts in 2024. On the political front, the UK Prime Minister called a surprise general election for 4th July, even though the latest polling strongly suggests that the governing Conservative party is likely to lose after 14 years in power. 10-year Gilt yields ended the month fractionally lower at 4.32% (down 3bps). In Japan, the currency continued to come under pressure, despite two rounds of intervention in April and early May. As a consequence, the pressure on the Bank of Japan (BoJ) to signal a less dovish path to monetary policy normalisation continued to grow; 10-year Japan Government Bond (JGB) yields ended the month at 1.06% (up 19bps) and their highest levels since 2011. In currency markets, signs of stable to improving activity in China and Europe saw the US dollar weaken against other G10 currencies, with the Norwegian krone (NOK) being the best performer versus the USD (up 5.6%), while the Japanese yen lagged behind (broadly flat versus the USD).

Portfolio Review and Strategy

The recovery in bond yields in the US and UK helped our duration exposure add value; we continue to favour duration exposure to markets with attractive real rates and mature interest rate cycles such as Australia, New Zealand and the UK (the latter owned as an relative value (RV) expression versus long-end German Bunds and US Treasuries). Additionally, the portfolio holds an allocation to US inflation-linked bonds. In Japan, a rise in JGB yields was sufficient to meet our target levels and we elected to take profits, closing our short position.

In active curve trades, a re-steepening in the US yield curve also drove some recovery in our Treasury curve steepener view. Meanwhile European curves remained anchored at flat levels. We continue to favour a basket of long-end curve steepeners in Germany (5s30s + 10s30s) & the US (7s30s).

In foreign exchange (FX) markets, the Euro was well supported in May, on the back of stronger than expected PMI activity surveys and consumer data; this challenged our EUR short vs JPY, Indian rupee (INR) and Brazilian real (BRL). In Japan, following end-April FX intervention from the Ministry of Finance, another wave of buying occurred on 2nd May (total circa JPY 10 trillion). While a more sustainable path to currency stability is via monetary tightening from the BOJ, in the near term, intervention risks provide a soft ceiling to JPY weakness. Our relative value position to be long NOK vs GBP contributed positively, with more cyclical currencies like the krone faring well in May. Towards month-end, we rotated the funding leg into Swedish krona (SEK), to convert the trade into an RV expression versus neighbouring Sweden, where the Riksbank has already embarked on its easing cycle (relative to a more cautious stance from the Norges Bank) and where economic fundamentals remain relatively more fragile.

Credit spreads continued to grind tighter (the global corporate index tightening 3bps on average) with Financials outperforming – supported by generally solid earnings results, and the positive backdrop from resilient US economic data. The fund retained a small exposure to Corporates, which added value, with selection focused on Financials, non-cyclical Industrials and US regulated Utilities. In addition, the fund also has an allocation to US mortgage spreads to profit from the increased carry versus Treasuries. Overall spread risk (measured using weighted duration times spread (WDTS)) remains moderately long.

Looking ahead, while it remains a challenging environment for sovereign fixed income markets, we believe that the outlook for sovereign bond returns is starting to look more asymmetric in selective markets. Following the sharp re-pricing in Fed rate cut expectations for 2024, the US macro outlook is now better-priced in US Treasury valuations, although we are looking for a catalyst to add US duration – such as early signs of labour market weakness and a material tightening in US financial conditions. We believe that the macro and policy backdrop still favours yield curve steepeners in the US via the 7s30s curve and Germany via 5s30s and 10s30s. We also expect attractive returns from sovereign relative value bond positions as economic trajectories diverge through 2024 given differences across markets in debt fundamentals, the transmission of monetary policy and fiscal support; we currently favour longs in the UK, Australia and New Zealand versus shorts in Germany. In the real rates space, against the backdrop of heightened inflation volatility and attractive valuations, we also favour an allocation to US inflation-linked bonds.

All data are sourced from Bloomberg and Allianz Global Investors as of 31 May 2024 unless otherwise stated.
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