Allianz Global Investors

Allianz
US High Yield

Monthly commentary

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

What Happened in February

Markets were mixed in February. Fourth quarter earnings momentum persisted, with approximately three-quarters of companies topping bottom-line consensus estimates, while corporate guidance remained mixed as managements await clarity around the new administration's policies. Except for a key manufacturing survey and unemployment, both of which were better than expected, economic data generally underwhelmed. Services, retail sales, consumer confidence, and select inflation measures missed estimates. Against this backdrop, the 10-year US Treasury yield fell sharply.

The ICE BofA US High Yield Index returned +0.65% for the month. BB, B, and CCC rated bonds returned +0.72%, +0.61%, and +0.46%, respectively.*

Spreads widened to 287bp from 268bp, the average bond price rose modestly to 96.52, and the market's yield fell to 7.39%.*

Industry performance was broadly higher with food producers, health care, and utilities outperforming, while autos, retail, and chemicals underperformed.

Trailing 12-month default rates finished the period at 1.25% (par) and 0.68% (issues). ^ The upgrade/downgrade ratio rose to 1.1.^

Monthly new issuance saw 26 issues priced, raising USD 18.7 billion in proceeds. ^ High-yield funds reported estimated net flows of USD 2.9 billion.^

Portfolio Review

Industries that positively contributed to performance in the period were financial services, automotive, and health care. Strength in financial services was primarily driven by an outperforming consumer finance issuer, with some additional contribution from infrastructure investment exposure. Within automotive, gains were largely attributable to an issue from a component manufacturer that announced a strategic investment. The portfolio also benefited from issues in pharmaceuticals, occupational health care, and diversified health services.

Support-services and chemicals were the sole detractors from performance in the period. A car rental issuer that announced a change in management weighed on support-services, while a holding in titanium products that was lower on margin concerns pressured chemicals.

Transactions during the period consisted of new purchases in air freight/couriers, consumer finance, and interactive media & services, and complete sells in aerospace, trading companies/distributors, and industrial machinery/supplies/components.

Outlook and Strategy

Macro factors, including newly implemented tariffs and government efficiency initiatives, could weigh on consumer spending and delay corporate investment in the near term as households and companies await clarity around current and future policies. A growth slowdown would not be unexpected if these headwinds materialize. The recent increase in equity volatility likely reflects the possibility of downward revisions to short-term earnings growth estimates.

The US economy should continue to expand in 2025, supported by earnings growth, further Fed easing as inflation and the labor market continue to normalize, and the new administration's pro-US growth policies.

Apart from these factors, steady consumer spending, ongoing services sector expansion, continued fiscal spending, and improving productivity aided by the proliferation of artificial intelligence are growth tailwinds. Risk to the economy may increase if these trends weaken. Other considerations include tariff and immigration policies, geopolitical tensions, prolonged labor market softening, continued manufacturing contraction, and economic weakness outside of the US.

The US high-yield market, yielding over 7%[1], is expected to deliver a coupon-like return in 2025 with upside possible. As a result, the asset class continues to offer equity-like returns but with less volatility. The market's attractive total return potential is a function of its discount to face value and higher coupon, which also serves to cushion downside volatility. Credit fundamentals are stable, near-term refinancing obligations remain low, and management teams continue to exercise balance sheet discipline. Increased M&A activity and deregulation could also have a positive market impact. In this environment, new issuance is expected to remain elevated, the default rate should stay below the historical average of 3-4%, and spreads can remain tight.

Longer-duration issues are the most likely to be impacted by high and volatile rates, but the overall high-yield market should have a dampened response due to its larger coupon relative to other fixed income alternatives. As a result, US high-yield bonds contribute from both a diversification and a relative-performance perspective, offering a very compelling yield opportunity.

Source: Allianz Global Investors dated 28 February 2025 unless otherwise stated.

* Source: BofA Merrill Lynch, as at 28 February 2025.

^ Source: J.P. Morgan, as at 28 February 2025.

[1]Source: ICE Data Services; data as at 28 February 2025.