Allianz Global Investors

Allianz US Short Duration High Income Bond

Monthly commentary

- The Fund aims at long-term income and lower volatility by investing in short duration high yield rated corporate bonds of the United States of America ("US") bond markets in accordance with environmental and social characteristics. The Fund aims to achieve the Sustainability KPI with the adoption of the Sustainability Key Performance Indicator Strategy (Absolute) ("KPI Strategy (Absolute)"). 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, creditworthiness/credit rating/downgrading, default, interest rate, valuation, sovereign debt, country and region, 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 (Absolute) (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 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. Convertible may also expose to risks such as prepayment, equity movement and greater volatility than straight bond investments.
- 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 November

Risk assets advanced in November, with high yield bonds finishing higher for the period. US election results and an anticipated pro-growth agenda under the new administration were the primary drivers of market gains. In addition, the US Federal Reserve (Fed) cut interest rates by 25 basis points, boosting investor sentiment further. Lastly, the third quarter earnings season ended on a strong note with both top- and bottom-line results tracking to exceed consensus estimates. On the economic front, inflation gauges were generally in-line with expectations, the services sector's expansion improved, jobless claims remained low, and retail sales beat consensus. In contrast, housing market statistics were mixed, and consumer sentiment and monthly payrolls declined relative to the prior period.

NOVEMBER 2024

The ICE BofA US High Yield Index returned +1.15% for the month.* BB, B, and CCC rated bonds returned +1.05%, +1.11%, and +1.63%, respectively.*

Spreads narrowed to 274bp from 288bp, the average bond price rose to 96.40, and the market's yield fell to 7.38%.*

All industries finished higher with cable, telecoms, and energy outperforming, while technology, utilities, and packaging/paper underperformed.

Trailing 12-month default rates finished the period at 1.14% (par) and 0.91% (issues). ^ The upgrade/downgrade ratio decreased to 0.8.^

New issuance saw 20 issues priced, raising USD 10.4 billion in proceeds. ^ High-yield funds reported estimated net flows of +USD 1.8 billion.^

Portfolio Review

The US Short Duration High Income Strategy remains an attractive and actively managed solution as investors adjust to higher rates without taking excessive credit risk or price volatility in passive fixed income strategies. In the current market environment, the US Short Duration High Income Strategy can purchase securities at discounts to par, or selectively invest in high coupon new issue producing yields well above management fees and hedging expenses.

Fundamental credit research, low duration, and liquidity are key tenants and goals for the US Short Duration High Income strategy that seeks to strike an attractive balance between risk, opportunity and expected return. The shorter maturity profile of the Fund should protect capital going forward as there are fewer years to repayment to close the average price discount. Goals of the strategy are unchanged to reinvest capital prudently to defend and evaluate credit risk and company fundamentals against a challenging global environment.

Since inception fifteen years ago, the US Short Duration High Income strategy remains US centric with coupons and repayment of principal in US dollars. The portfolio is services focused with non-domestic exposure and durable goods risk more limited versus the broader markets. The portfolio continued to stay up in quality while generally avoiding the lowest quality credits with average credit quality in the portfolio unchanged at B1/B+. Emphasis remains on credit selection, liquidity, and downside protection versus the broader market.

The US Short Duration High Income strategy is an actively managed solution with historically relatively high security turnover. This active approach to security selection should also allow the Fund to avoid some of the riskiest segments of the market further providing downside protection. Passive strategies may carry greater tail risk and show greater dispersion of investment returns. The US Short Duration High Income strategy selectively invests in opportunities that may present lower price volatility, risk-adjusted returns in line within the mandate, investment philosophy and Fund guidelines and importantly seeks to side-step and avoid many of the risks not appreciated by markets.

Performance in the period benefited from industry weightings and a consistent fundamental credit selection framework. Industries contributing the most to performance were Energy, Financial Services, and Media. Utilities was the only industry that detracted from performance.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities. New purchases included issues in Oil & Gas Storage & Transportation, Real Estate Operating Companies, and Gas Utilities. Sells consisted of issues in Specialized Finance, Consumer Finance, and Health Care Supplies.

Outlook and Strategy

The easing cycle has begun, with the Fed cutting interest rates by 75 basis points through November as inflation and the labor market continue to normalize.

Apart from an accommodative shift in monetary policy, potential economic tailwinds include pro-growth policies under the Trump administration, steady consumption, continued fiscal spending, the proliferation of artificial intelligence, and improving productivity, among others. Risk to the economy may increase if these trends weaken. Other potential headwinds include new tariffs, more restrictive immigration policies, geopolitical tensions, prolonged labor market softening, continued manufacturing contraction, and slower growth outside the US.

The US high-yield market, yielding over 7%[1], offers the potential for 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 prioritize debt reduction. Given these factors, the default rate has been below the long-term average with expectations for it to trend toward the historical average in 2025. Regarding credits spreads, they can stay tight for many years. This was the case in the mid-1990s and 2000s – periods like today when high-yield balance sheets were healthy and defaults were low, the economy was stable, and interest rates were elevated.

Longer-duration issues are the most likely to be impacted by rising interest 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.

The Short Duration High Income strategy remains an attractive fixed income solution without taking excess credit risk, the shorter maturity puts securities first in line to repayment at par, and the strategy lessens price volatility that may be highly amplified in passively managed strategies.

All data are sourced from Allianz Global Investors, S&P Dow Jones Indices and FactSet dated 30 November 2024 unless otherwise stated.

*Source: BofA Merrill Lynch, as at 30 November 2024.

^Source: J.P. Morgan, as at 30 November 2024.

[1]Source: ICE Data Services; data as at 30 November 2024.