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 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 May

The high-yield bond market advanced in May. With the first quarter earnings season nearly complete, most companies surpassed consensus estimates helped by strong sales, cost cut, and share repurchases. Full-year 2024 and 2025 earnings estimates moved higher over the month despite mixed company management outlooks. Key economic reports were neutral in aggregate. The labor market remained healthy, consumer confidence improved, and inflation showed signs of slowly ebbing. On the other hand, manufacturing fell back into contractionary territory and home and retail sales missed expectations. Finally, the US Federal Reserve (Fed) kept rates unchanged at May's Federal Open Market Committee (FOMC) meeting with Chair Powell pushing back against potential rate hikes at the press conference.

The ICE BofA US High Yield Index returned +1.13% for the month.* BB, B, and CCC rated bonds returned +1.23%, +0.96%, and +1.23%, respectively.*

Spreads widened to 320bp from 318bp, the average bond price rose to 92.54, and the market's yield fell to 8.18%.*

Most industries finished higher for the period. Healthcare, food producers, and utilities outperformed, whereas media, telecoms, and cable underperformed.

Trailing 12-month default rates fell to 2.02% (par) and 1.90% (issues).^ The upgrade/downgrade ratio decreased to 1.1.^

New issuance saw 54 issues priced, raising USD 33.6 billion in proceeds. ^High-yield funds reported estimated net flows of + USD 4.9 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 nearly 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 Utilities, Healthcare, and Energy. Media and Telecommunications were the sole detractors 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 Refining & Marketing, Commercial & Residential Mortgage Finance, and Internet Services & Infrastructure. Sells consisted of issues in Passenger Ground Transportation, Advertising, and Health Care Facilities. Additionally, there were both purchases and sells in Oil & Gas Storage & Transportation.

Outlook and Strategy

2023's economic momentum has carried over into 2024. Economic tailwinds include a healthy labor market, steady consumption, government spending, elevated household net worth, a stabilizing manufacturing sector, an end to the rate hike cycle, and accelerating earnings. Economic headwinds include persistent inflation, restrictive monetary policy, prolonged yield curve inversion, less personal savings, and US/international political risks, among others.

The US high-yield market, currently yielding nearly 8%[1], offers the potential for equity-like returns but with much lower volatility. Credit fundamentals are stable, near-term refinancing obligations remain low, and management teams continue to prioritize debt reduction. Given these factors, defaults should remain well below historical cycle peaks. The market's attractive total return potential is a function of its deep discount to face value and increased coupon, which also serves to cushion downside volatility. Notably, after recording an annual decline, the high-yield market has historically delivered two consecutive years of positive returns in six of seven cases[2], and forward 12- and 24-month return projections based on the current market yield have been consistent with mid to high single digits[3].

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 31 May 2024 unless otherwise stated.
*Source: BofA Merrill Lynch, as at 31 May 2024.
^Source: J.P. Morgan, as at 31 May 2024.
[1]Source: ICE Data Services; data as at 31 May 2024
[2] Source: ICE Data Services; data as of December 2022
[3]Source: JP Morgan; data as of October 2022