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 March

High-yield bonds finished lower in March. Concerns around the pace and magnitude of tariff and government reform measures pressured markets due to their potential impact on consumer and corporate spending, economic growth, earnings, employment, and inflation. Economic reports released during the period were balanced with durable goods and factory orders, industrial production, and a key services survey all topping expectations. Conversely, consumer confidence declined, Atlanta Fed GDPNow estimates remained subdued due to imports, and a major manufacturing survey missed projections. Inflation, housing, and labor gauges were mixed. The Federal Reserve kept interest rates steady, slowed its balance sheet drawdown, and updated its economic projections to show a decrease in 2025 gross domestic product (GDP) growth estimates and an increase in 2025 inflation estimates. Against this backdrop, the 10-year US Treasury yield was largely unchanged month over month.

The ICE BofA US High Yield Index returned +0.95% for the period. *BB rated bonds returned +1.45%, outperforming B and CCC rated bonds, which returned +0.70% and -0.67%, respectively.*

Spreads widened to 355bp from 292bp, the average bond price fell to 94.97, and the market's yield rose to 7.88%.*

Industry performance was mostly higher for the period. Food producers, cable, and capital goods outperformed whereas packaging/paper, autos, and transportation underperformed.

Trailing 12-month default rates finished the period at 1.20% (par) and 0.68% (issues). ^ The upgrade/downgrade ratio rose to 1.4.^

New issuance saw 90 issues priced, raising USD 68.3 billion in proceeds.^ High-yield funds reported estimated net flows of +USD 2.1 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 over 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.

Industries detracting the most to performance included Energy, Utilities, and Retail. An issue in the Energy space specializing in liquefied natural gas infrastructure, that was a meaningful contributor in 2024, received a credit downgrade prior to announcing an asset sale later in the month with use of proceeds expected to later pay down debt. Within Utilities, a residential solar provider reported quarterly results that missed expectations, subject to a credit downgrade and bonds trading down to distressed levels. Underperformance in Retail was primarily driven by a luxury department store operator despite the issuer having strong liquidity, as retail overall has underperformed on reduced consumer confidence and escalating tariff concerns. There were no industries that had a material positive impact on performance.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities. New purchases included issues in Diversified Chemicals and Data Processing & Outsourced Services, while complete sales consisted of an issue in Oil & Gas Storage & Transportation.

Outlook and Strategy

In our 2025 outlook, we wrote that the equity market's path would not be linear, with bouts of volatility throughout the year. We also noted convertible securities and high-yield bonds – given their defensive characteristics – could mitigate equity market weakness. This scenario materialized in the first quarter. The portfolio is well positioned if volatility persists without sacrificing upside participation and income-generation potential.

Tariff, government reform, and immigration measures are becoming a bigger headwind than previously thought. However, tailwinds such as deregulation and taxation measures still exist. As trade and budgetary clarity improves, uncertainty should lessen, and spending, investment, hiring, M&A, etc. can resume. Productivity gains, industrialization, onshoring, and private sector demand are additional potential growth drivers.

The US high-yield market, yielding over 8%[1], could 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 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 March 2025 unless otherwise stated.

*Source: BofA Merrill Lynch, as at 31 March 2025.

^Source: J.P. Morgan, as at 31 March 2025.

[1]Source: ICE Data Services; data as at 31 March 2025.