Allianz Global Investors

Allianz

Flexi Asia Bond

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth and income by investing in debt securities of Asian bond markets denominated in EUR, USD, GBP, JPY, AUD, NZD or any Asian currency in accordance with the Sustainability Key Performance Indicator Strategy (Relative). In this context, the aim is to outperform the sub-fund's Sustainability KPI compared to sub-fund's benchmark to achieve the investment objective.

What Happened in July

Asian credits enjoyed another strong month in July, delivering 1.3% as measured by the JACI composite index. Asian high yield (HY) returned 1.5%, supported by high carry and strong returns from US Treasuries. Investment grade (IG) credits also delivered attractive returns of 1.3%, predominantly from US Treasuries. Year-to-date, Asian credits returned 4.2% as 54 basis points (bps) of spread tightening delivered 2.7% of spread returns. As the direction of policy rates in the US became clearer, US Treasury yields decreased more decisively and interest rate return also rose to 1.5% on a year-to-date basis. While Asian IG bonds delivered a decent 2.9%, ahead of US IG, Asian HY stood out with a stellar 12.1% return, strongly ahead of other HY markets and asset classes. The new issue market remained fairly active with USD 16 billion printed, bringing year-to-date Asia ex Japan G3 currency bond issuance to USD 104 billion.

Asian IG spreads were stable on a month-to-month basis, but US Treasuries staged an aggressive rally with the 10-year benchmark yield dropping by 37 bps to a 6-month low of 4.03%. The move was driven by tamer-than-expected inflation data and clearer US Federal Reserve (Fed) guidance for a rate cut in September. The Macau Gaming sector saw slowing gross gaming revenue (GGR) growth although encouragingly, the deleveraging trend for the sector continued. In the Asian Technology sector, bellwethers released strong Q2 results. In the new issue market, Financials and China were the major contributors to supply. Debut performance for the new issues were driven by supportive US Treasury returns as the credit spreads largely remained sideways.

Asian HY continued its uptrend since bottoming out in August 2023. For July, HY spreads were flat to slightly higher for some sectors, but returns were supported by high interest accrual and strong returns from US Treasuries. In China, the Third Plenum, which focuses on long-term economic policies, was a non-event even though expectations for decisive policies were low. However, this did not stop the China HY sector from being one of the top contributors for the month as the successful debt extension by a property developer supported sentiment across the sector.

The strongest movers for the month were driven by idiosyncratic drivers such as a Hong Kong-based developer that was able to demonstrate strong refinancing abilities despite ongoing challenges to the commercial rental market in Hong Kong. Risk seeking appetite remained strong and investors were increasingly going down the credit curve to pursue alpha opportunities, so perpetual bonds performed well in July. Frontier sovereigns were not strong contributors in July, as Pakistan consolidated amidst the weaker global macro risk appetite despite having its credit rating upgraded by Fitch, and Sri Lanka saw profit taking despite making progress on its debt restructuring. There were a few HY new issuances from Indian and Southeast Asian issuers for the month and most were well subscribed and traded well in the secondary market. This bodes well for the asset class as the market normalises as a funding channel.

Portfolio Review

The Fund returned positively for the month.

Fund performance was driven by our overweight allocation to HY over IG. Within HY, the portfolio was mostly overweight in BB-rated and B-rated bonds, avoiding most of the riskiest CCC-rated bonds. Most of the returns came from interest rate duration, as US Treasury yields declined while credit spreads tightened modestly.

Over the month, we traded tactically on duration from the short side but remained largely flat on duration. We added some BB-rated HY to beef up carry in the portfolio, given our positive view on Asian HY's total return potential as default rate is expected to come down.

Market Outlook

Given the numerous key central bank decisions and upcoming elections, we could see heightened volatility in markets over the near term. However, Asian credits are likely to be supported by resilient credit fundamentals and supportive negative net bond supply. For Asian IG bonds, credit spreads are generally at the tighter end of the range, but the absolute yield remains attractive for carry. We continue to favour the Asian HY space despite strong outperformance for the whole year. Many sectors are at a favourable point in the credit cycle and credit spreads in general still have room to compress. That said, as certain sectors and corporates are navigating the downcycle, credit selection in those sectors is key to outperformance.

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All data are sourced from Bloomberg and Allianz Global Investors, as at 31 July 2024 unless otherwise stated.