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 May

In May, bonds market started off strong largely driven by the dovish statement from the latest Federal Open Market Committee (FOMC) meeting and the softer-than-expected nonfarm payroll (NFP). In addition, US Federal Reserve (Fed) Chair Powell indicated policy rates are sufficiently restrictive and that the Fed's next move is unlikely to be a hike. All these reversed the rise in US Treasury yields, which had weakened market sentiments in the prior weeks.

Middle of the month, China's regulators announced a slew of policy measures to boast the Real Estate sector. China's Politburo meeting in April had earlier pledged to study how to digest the exiting housing inventory. All these boosted markets sentiments, and both investment grade (IG) and high yield (HY) markets displayed strong performance. The JP Morgan Asia Credit Index (JACI) composite rose by 1.3%, led by JACI HY which rose 2.8% while JACI IG increased by 1.1%.

In Asia IG, credit spreads traded around a wide 19 basis points (bps) range but ended the month relatively flat at 84 bps. Most of the performance came from the interest rate duration return as US Treasury yields declined, given spread return was largely flat. Within Asia IG, Indonesia IG outperformed while Korea IG lagged. Indonesia IG benefited from the rally in US Treasury as they are duration proxies and thus were sensitive to interest rates movement.

In China, it was reported that the US government could potentially unveil new tariffs on Chinese goods, but it was mostly shrugged off by investors. Instead, China Technology saw credit spreads tightened modestly on the back of their Q1 earnings announcement, which saw most still recording topline growth. Moreover, several Technology-related companies issued convertible bonds during the month, likely reducing potential supply of straight bonds.

In the last week of May, S&P moved India's sovereign's outlook to positive, while affirming its BBB- rating. This benefitted credits whose ratings are tied to sovereign ratings. In addition, India concluded its general elections on 1 June with exit polls out and predicting a landslide victory for the Bharatiya Janata Party-led (BJP-led) National Democratic Alliance (NDA) party. All these elevated the positive sentiments on India's IG bonds. The credit primary market picked up in May, taking the year-to-date (YTD) total to USD 60 billion, about 9% higher than the same period last year. Most of the new issues performed well on debut, reflecting investor demand for bonds to deploy cash.

In Asia HY, the market delivered 2.8% returns in May, significantly outperforming global HY (+1.2%) and US HY (+1.2%). Among the countries, China HY led the returns while Macau HY lagged.

China Real Estate bonds rallied strongly on the back of revived optimism in the sector. The Chinese authorities a slew of measures to accelerate the destocking of existing housing inventory and were looking at proposed plans for local governments to acquire unsold homes. Following these announcements, several provinces scrapped home purchase restrictions and lowered down payment for home purchases. All these measures lifted China Real Estate bond prices. China Industrial bonds also rallied, driven by the positive sentiments to the Chinese HY bond market.

Macau Gaming companies showed resilience in earnings before interest, taxes, depreciation and amortisation (EBITDA) growth while their gross gaming revenue (GGR) continued to increase, beating market expectations. Although there were some divergences in earnings momentum between the operators, most of them were in deleveraging mode. There, we expect most operators to continue to see improved credit metrics.

Portfolio Review

The Fund returned positively (gross, USD) for the month.

The Fund's performance has been driven by our overweight allocation to HY. Our HY positioning was mostly overweighted in BB-rated bonds, avoiding most of the riskiest CCC-rated bonds. We also took profits on our long duration position and remained largely flat on duration. However, we increased our 5-year versus 30-year curve steepener position. We added more 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

Asia investors should stay invested in Asia credits as current conditions remain benign with credit fundamentals improving and corporates deleveraging their balance sheets. All-in yield remains attractive providing high carry. Although credit spreads have continued to tighten YTD, we expect credit spreads to stay at their current tight levels, given the strong demand/supply technicals and attractive credit cycle. Corporate earnings out of most Asia companies had generally been positive. In China, the Tech sector is still in an upswing, with the consumption sector being a developing bright spot. India's corporates credit and fundamentals backdrop remain strong, and their latest results did not disappoint. Most of the Southeast Asia credits which have reported earnings show stable fundamentals.

The activity in the credit primary market has picked up, compared to April. The overall tone remains positive on both the supply and demand sides, with issuers achieving small new issue concessions. We have been active in the new issuance market, taking the opportunity to switch out of bonds which have tightened beyond fair valuation, and into new issuance with attractive valuation. We do seek a careful balance between quality and carry from a positioning perspective while at the same time, minimise spread duration risk. Interest rate volatility remains a key risk, and our strategy is to maintain a highly diversified portfolio with high portfolio yield and carry.

In the Asia IG credit space, we anticipate continued sideways trading of credit spreads due to low supply of bonds. Although spread levels are tight, but the overall yield is high, which is positive for quality carry. We have a preference for BBB Indonesia Utilities credits, which is supported by stable earnings. At the same time, we also like Hong Kong A-rated Real Estate companies – fundamentals seem to be bottoming out and lower rates into 2025 should support valuations and reduce costs of debt.

On Asia HY credits, we hold a constructive view, expecting modest spread compression. Current spread levels still imply a higher probability of defaults than estimated, which mean there is a potential for further spread compression. We do advocate increasing allocations to HY credits, and we believe credit selection remains key to finding alpha opportunities. Within this segment, we like BB-rated India Renewables which have shown steady interim results, improvements in working capital cycles, and strong access to onshore and offshore funding. We also like the Macau Gaming sector which has shown continued recovery and all issuers have turned EBITDA positive with continued debt reduction.

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