Allianz Income and Growth

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth and income by investing in United States of America ("US") and/or Canadian corporate debt securities and equities.

What Happened in April

Equity, convertible, and high yield markets declined in April, despite a solid start to Q1 earnings season. Thus far, the percentage of S&P 500 companies reporting a positive earnings surprise was above the longer-term average, as was the magnitude of the earnings surprises. In aggregate, S&P 500 companies are pacing to report year-over-year earnings growth for a third straight quarter. Key economic data points released during the month were mixed. The labour market remained healthy, the manufacturing sector moved into expansionary territory, joining the services sector, retail sales surpassed projections, and home price indices rose. On the other hand, US gross domestic product (GDP) missed growth forecasts, consumer confidence declined, and some inflation measures were higher than anticipated. As a result, market expectations for the first interest rate cut were pushed out further, driving Treasury yields higher and pressuring investor sentiment.

Equities Market Environment

The S&P 500 Index returned -4.08% for the month.*

Utilities was the only sector that advanced, while Energy and Consumer Staples also outperformed. The weakest performing sectors were Real Estate, Technology, and Health Care.

Equity volatility was higher month-to-month, finishing at 15.65.*

Convertible Securities Market Environment

The ICE BofA US Convertible Index returned -3.48% for the month.^

Convertible securities were negatively impacted by falling stock prices and credit spread widening.

All sectors finished lower with Utilities, Media, and Energy outperforming, while Consumer Discretionary, Industrials, and Technology underperformed.

Investment grade issues outperformed below-investment grade issues. Yield alternative (busted) issues outperformed total return (balanced) and equity sensitive issues.

New issuance saw 3 issues priced, raising USD 0.9 billion in proceeds.^

High-Yield Bond Market Environment

The ICE BofA US High Yield Index returned -1.00% for the month.^

Credit-quality subsector returns for the month^:

- BB rated bonds: -0.97%
- B rated bonds: -0.86%
- CCC rated bonds: -1.60%

Spreads widened to 318 basis points (bps) from 315 bps, the average bond price fell to 91.88, and the market's yield rose to 8.32%.^

All industries finished lower for the period. Health Care, Transportation, and Chemicals outperformed, whereas Cable, Telecoms, and Food Producers underperformed.

Trailing 12-month default rates fell to 2.33% (par) and 2.24% (issues).**

New issuance saw 38 issues priced, raising USD 26.4 billion in proceeds.**

Portfolio Review

The portfolio was negatively impacted by risk asset weakness.

Top contributors were led by Alphabet, which reported a beat-and-raise quarter on the back of strong cloud computing demand stemming from artificial intelligence (AI) adoption. Several holdings in aerospace and medical technology gained on strong organic sales growth, a restaurant chain reported above consensus margins, and an electric vehicle (EV) manufacturer advanced on better-than-feared results and reports of a new international revenue opportunity. Other top contributors were exposed to clean energy, satellite communications, and multimedia.

Top detractors included Microsoft and a social media company, both of which provided softer-than-expected guidance despite otherwise strong quarters. A home improvement retailer and a software company declined on acquisition-related headlines; a cosmetic retailer fell on competitive concerns; and an industrial coatings company missed sales estimates. Wells Fargo exceeded earnings expectations, but a position in a long duration convertible issue finished lower on higher interest rates. Other detractors included a specialty REIT despite raising 2024 guidance, and Mastercard.

All option positions expired below strike and the portfolio was able to retain the set premiums.

Exposure increased in Financials, Communication Services, and Health Care, and decreased the most in Consumer Discretionary, Industrials, and Materials. Covered call option positioning decreased month-over-month.

Market Outlook and Strategy

2023's economic momentum has carried over into 2024. Economic tailwinds include a healthy labour market, steady consumption, government spending, elevated household net worth, a stabilising 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.

US equity valuations reside near long-term averages. Visibility around 2024 and 2025 earnings, US dollar and Treasury market stabilisation, and an end to the rate hike cycle could be positive developments for stocks. Any equity market volatility will present opportunities for active managers to take advantage of better prices in attractive investments.

US convertible securities should continue to provide benefits to investors, including an attractive asymmetric return profile and potentially lower volatility relative to the equity market. The shift in the universe's composition exiting 2022 remains largely unchanged heading into 2024. Many securities offer attractive current yields and exhibit defensive characteristics given lower deltas and closer proximities to bond floors. This dynamic may allow for greater downside protection if equity volatility rises. If the prices of underlying stocks advance, convertible securities could be positioned to participate in the upside. Lastly, higher debt financing costs should draw issuers to the convertible market for coupon savings. As a result, new issuance is expected to increase materially year-over-year.

The US high yield market, yielding more than 8%^^, offers the potential for equity-like returns but with less volatility. Credit fundamentals are stable, near-term refinancing obligations remain low, and management teams continue to prioritise 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 discount to face value and higher 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 the seven cases[#], and forward 12- and 24-month return projections based on the current market yield have been consistent with mid to high single digits[##].

A covered call options strategy can be utilised to generate premium income. In periods of elevated or rising equity volatility, premiums collected may translate into more attractive annualised yields.

Collectively, these three asset classes can provide a steady source of income and a compelling "participate-and-protect" return profile.

The Fund is a client solution designed to provide high monthly income, the potential for capital appreciation, and less volatility than an equity-only fund.

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All data are sourced from Allianz Global Investors dated 30 April 2024 unless otherwise stated.

* Source: FactSet, as at 30 April 2024

^ Source: BofA Merrill Lynch, as at 30 April 2024

** Source: J.P. Morgan, as at 30 April 2024

^^ Source: ICE Data Services, as at 30 April 2024

Source: ICE Data Services, as at 31 December 2022

Source: J.P. Morgan, as at 31 October 2022