Allianz Global Investors

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 August

Equity, convertible, and high yield markets finished higher despite a volatile August, which saw intra month declines as large as -6%, driven by a strong finish to earnings season, balanced economic data, a dovish US Federal Reserve (Fed), and anticipated monetary policy easing. On the earnings front, blended growth for Q2 exceeded expectations by nearly 3%, helped by above-trend margin expansion. August saw another month of mixed economic data. Lower-than-expected monthly employment and contracting manufacturing data contrasted favourable consumer spending and additional evidence of decelerating inflation. Investor confidence broadened following dovish comments from the Fed Chair Jerome Powell, stating that "the time has come for policy to adjust" at the annual Jackson Hole Economic Symposium. As such, markets are firmly anticipating a rate cut of at least 25 basis points (bps) at September's Federal Open Market Committee (FOMC) meeting.

Equities Market Environment

The S&P 500 Index returned +2.43% for the month and logged its highest monthly close ever.*

Most sectors were higher in August. Consumer Staples, Real Estate, and Health Care were the top performing sectors, while Energy, Consumer Discretionary, and Communication Services were the bottom performing sectors in the period.

Equity volatility was higher month-to-month, finishing at 15.00.*

Convertible Securities Market Environment

The ICE BofA US Convertible Index returned +1.31% for the month.^

Convertible securities were positively impacted by rising stock prices and credit spread tightening.

Most sectors closed higher with Utilities, Health Care, and Financials outperforming, while Energy, Materials, and Media underperformed.

Investment grade issues outperformed below-investment grade issues. Equity sensitive issues outperformed total return (balanced) and yield-oriented (busted) issues.

New issuance saw 9 issues priced, raising USD 2.4 billion in proceeds.^

High-Yield Bond Market Environment

The ICE BofA US High Yield Index returned +1.59% for the month.^

Credit-quality subsector returns for the month^:

- BB rated bonds: +1.55%
- B rated bonds: +1.52%
- CCC rated bonds: +1.96%

Spreads narrowed to 317 bps from 325 bps, the average bond price rose to 95.47, and the market's yield fell to 7.55%.^

All industries advanced with Telecoms, Food Producers, and Technology outperforming, while Autos, Travel, and Media underperformed.

Trailing 12-month default rates finished the period at 1.73% (par) and 1.46% (issues).**

New issuance saw 23 issues priced, raising USD 18.1 billion in proceeds.**

Portfolio Review

The portfolio was positively impacted by strength across risk assets.

Top contributors in the period were led by Eli Lilly, which rallied after beating top- and bottom-line estimates by double digits and boosting full-year guidance. Meta and Apple also gained following strong earnings reports, both of which showcased the companies' respective plans for artificial intelligence (AI) monetisation. A property and casualty insurance provider rose on well-received asset sale headlines, a medical device manufacturer moved higher in tandem with the broader industry, and a residential solar provider gained after reiterating its focus on cash generation. Other top contributors in the period included Global Payments, a surgical robotics company, and a specialty online retailer.

Top detractors included Technology companies capitalising on secular trends around AI and cloud migration, including Amazon and a mega-cap internet services provider, as well as several semiconductor companies. A major electric vehicle (EV) manufacturer declined on competitive concerns, an industrial technology company was lower after reporting softer orders growth, and an asset manager fell on disappointing earnings that stemmed from an underperforming insurance subsidiary. Other top detractors in the period were holdings in Oil & Gas, Banking, and Health Care Services.

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

Exposure increased the most in Consumer Staples, Materials, and Technology, and decreased the most in Consumer Discretionary, Industrials, and Financials. Covered call option positioning decreased month-over-month.

Market Outlook and Strategy

The US economy has been resilient, continuing to expand above historical average growth rates despite restrictive monetary policy. Going forward, growth may be more moderate and inflation should decelerate further, allowing the Fed to begin reducing interest rates.

Apart from an accommodative shift in monetary policy, economic tailwinds include steady consumption and government spending, elevated household net worth, and accelerating earnings, as well as the proliferation of AI. Risk to the economy may increase if these trends weaken. Other potential headwinds could include prolonged labour market softening or manufacturing sector contraction. In addition, US equity volatility could increase pre- and post-election, but any such volatility should 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 nearly 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 31 August 2024 unless otherwise stated.

* Source: FactSet, as at 31 August 2024

^ Source: BofA Merrill Lynch, as at 31 August 2024

** Source: J.P. Morgan, as at 31 August 2024

^^ Source: ICE Data Services, as at 31 August 2024

Source: ICE Data Services, as at 31 December 2022

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