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 February

Markets advanced in February as investors digested better-than-expected corporate earnings, mixed economic data, and a shift in rate cut expectations. A strong finish to the earnings season drove Q4's earnings growth to 4.0% (compared to -0.3% at the end of January) and helped lift 2024 and 2025 earnings estimates. Monthly payroll figures and the unemployment rate topped forecasts and manufacturing and services sector surveys improved. On the other hand, some inflation measures came in higher than expected. As a result, market expectations for the first interest rate cut were pushed out to June's Federal Open Market Committee (FOMC) meeting, aligning with the US Federal Reserve (Fed)'s most recent full-year forecast. Against this backdrop, Treasury yields rose, and investment grade bonds fell.

Equities Market Environment

The S&P 500 Index returned 5.34% for the month, closing the period at an all-time high.*

Gains were broad-based with all 11 sectors finishing higher in February. Consumer Discretionary was the best performing sector, followed by Industrials and Materials. Utilities was the worst performer, followed by Consumer Staples and Real Estate.

Equity volatility was lower month-to-month, finishing below 14.*

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Convertible Securities Market Environment

The ICE BofA US Convertible Index returned 1.20% for the month.^

Convertible securities were positively impacted by rising stock prices and credit spread tightening. Most sectors finished higher in February. Consumer Staples, Telecom, and Industrials outperformed, while Media, Utilities, and Health Care underperformed.

Below-investment grade issues outperformed investment grade issues. Equity sensitive issues outperformed yield oriented and total return issues.

US new issuance increased month-over-month with nine issues priced, raising USD 7.9 billion in proceeds.^ February's monthly volume was the largest in more than two years.

High-Yield Bond Market Environment

The ICE BofA US High Yield Index returned 0.30% for the month.^

Credit-quality subsector returns for the month^:

- BB rated bonds: -0.24%
- B rated bonds: +0.37%
- CCC rated bonds: +2.33%

Spreads narrowed to 329 basis points (bps) from 359 bps, the average bond price fell to 92.44, and the market's yield rose to 8.02%.^

Industry performance skewed positive. Telecom, Autos, and Retail outperformed, whereas Media, Utilities, and Food Producers underperformed.

Trailing 12-month default rates remained low at 2.53% (par) and 2.45% (issues).** The upgrade/downgrade ratio increased to 1.1.**

US new issuance decreased month-over-month with 38 issues priced, raising USD 27.7 billion in proceeds. High-yield funds reported estimated net flows of USD 10 million.**

Portfolio Review

The portfolio was positively impacted by strength across markets.

Top contributors included companies capitalising on artificial intelligence (AI) adoption and cloud migration such as Nvidia, Amazon, Microsoft and Salesforce.com. A social media holding advanced after reporting accelerating advertising growth and instituting a dividend, and a pharmaceutical position continued to gain on research and development (R&D) scalability and revenue opportunity potential. Other top contributors were Tesla, a major US bank, a power management company, and Home Depot on signs the housing market may be stabilising.

Top detractors included a cyber security company that lowered guidance and a wireless services provider that reported a data breach. Substitution fears weighed on a software company, and competitive concerns adversely impacted television broadcasting exposure. Slowing demand and soft user trends pressured residential solar and social media companies, respectively. Other top detractors were in Technology, Health Care, and Clean Energy.

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

Exposure increased the most in Industrials, Consumer Discretionary, and Real Estate, and decreased the most in Information Technology, Energy, and Health Care. Covered call option positioning modestly increased month-over-month.

Market Outlook and Strategy

2023's economic momentum should carry over into 2024. Economic tailwinds include low unemployment, steady consumption, government spending, waning inflation, a stabilising manufacturing sector, an end to the rate hike cycle, and inflecting earnings. Economic headwinds include continued restrictive monetary policy and quantitative tightening, less savings, and US/international political risks, among others.

High-yield credit and convertible securities should be better positioned to weather any market volatility given current asset class dynamics, which in some respects are more favourable today than they were exiting 2022. Consequently, today's market outlook resembles 2023's with mid to high single-digit returns possible by year-end 2024 for high-yield credit, convertible securities, and equities.

The US high-yield market, currently yielding 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[##].

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.

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.

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

All data are sourced from Allianz Global Investors dated 29 February 2024 unless otherwise stated.

* Source: FactSet, as at 29 February 2024

^ Source: BofA Merrill Lynch, as at 29 February 2024

** Source: J.P. Morgan, as at 29 February 2024

Source: ICE Data Services, as at 31 December 2022

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

Allianz Global Investors and Voya Investment Management (Voya IM) have entered into a long-term strategic partnership, and as such, as of 25 July 2022, the investment team transferred to Voya IM and Voya IM became the delegated manager for this fund. AllianzGI continues to provide information and services to Voya IM for this investment through a transitional service agreement.