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 July

Equity, convertible, and high yield markets finished higher in July despite a tangible increase in volatility. The Q2 earnings season got off to a solid start with most companies exceeding top- and bottom-line estimates and year-over-year earnings growth approaching double digits. Cost controls, operating efficiencies, increasing capital expenditures and steady consumption factored into better-than-expected results. Corporate management outlooks varied, however. Economic reports were also mixed. Q2 gross domestic product (GDP) growth, retail sales, and monthly payrolls surpassed forecasts, and inflation gauges continued to ease. Conversely, manufacturing remained in contractionary territory, home sales missed estimates, and weekly jobless claims moved higher. Against this backdrop, the US Federal Reserve (Fed) kept interest rates unchanged at the July Federal Open Market Committee (FOMC) meeting, but Chair Jerome Powell noted if economic data continues on its current path, "a reduction in our policy rate could be on the table as soon as the next meeting in September".

Equities Market Environment

The S&P 500 Index returned +1.22% for the month.*

July saw a rotation in sector leadership, with Real Estate, Utilities, and Financials the top performing sectors in the period, while Communication Services, Technology, and Consumer Discretionary were the bottom performing sectors.

Equity volatility was higher month-to-month, finishing at 16.36.*

Convertible Securities Market Environment

The ICE BofA US Convertible Index returned +1.93% for the month.^

Convertible securities were positively impacted by rising stock prices.

Most sectors closed higher with Materials, Energy, and Utilities outperforming, while Consumer Staples, Technology, and Transportation underperformed.

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

New issuance saw 5 issues priced, raising USD 2.0 billion in proceeds.^

High-Yield Bond Market Environment

The ICE BofA US High Yield Index returned +1.96% for the month.^

Credit-quality subsector returns for the month^:

- BB rated bonds: +1.59%
- B rated bonds: +1.78%
- CCC rated bonds: +4.00%

Spreads widened to 321 basis points (bps) from 325 bps, the average bond price rose to 94.37, and the market's yield fell to 7.79%.^

All industries advanced with Telecoms, Cable, and Media outperforming, while Packaging/Paper, Transportation, and Retail underperformed.

Trailing 12-month default rates were flat at 1.78% (par) and 1.80% (issues).**

New issuance saw 31 issues priced, raising USD 19.5 billion in proceeds.**

Portfolio Review

The portfolio was positively impacted by strength across risk assets.

Top contributors in the period were led by Tesla and Apple, both of which rallied after providing better-than-expected read-throughs on production and demand. An aerospace company reported a beat-and-raise quarter driven by strong free cash flow, an industrial conglomerate outperformed across all business segments and appointed a well-received new CEO, and a cellular tower REIT boosted its outlook for organic growth in several key end markets. Holdings in biotech, network infrastructure, and consumer finance all gained after reporting earnings growth that exceeded expectations. A utility operator and a pharmaceutical company also outperformed.

Top detractors included technology companies capitalising on secular trends around artificial intelligence (AI) and cloud migration, including Microsoft and Amazon, as well as several semiconductor companies led by Nvidia. A medical device manufacturer sold off on declining procedure volumes, competitive concerns pressured a pharmaceutical company, and a global outage weighed on a cyber security position. The other detractors in the period were a restaurant chain and a design software holding company.

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

Exposure increased the most in Real Estate, Industrials, and Energy, and decreased the most in Materials, Communication Services, and Health Care. Covered call option positioning increased 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, 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 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.

All data are sourced from Allianz Global Investors dated 31 July 2024 unless otherwise stated.

* Source: FactSet, as at 31 July 2024

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

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

^^ Source: ICE Data Services, as at 31 July 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.