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 June

Equity, convertible, and high yield markets advanced in June. Key macroeconomic and company reports were mixed over the period. On the positive, several inflation measures continued to show signs of cooling, Q1 gross domestic product (GDP) growth was revised upward, and monthly payrolls were above expectations. On the other hand, manufacturing remained in contractionary territory, home and retail sales missed estimates, the unemployment rate ticked up, and continuing claims reached their highest level in nearly three years. In addition, the US Federal Reserve (Fed) kept rates unchanged at June's Federal Open Market Committee (FOMC) meeting. The market's expectation for the first interest rate cut moved to September, with another expected by year-end.

Equities Market Environment

The S&P 500 Index returned +3.59% for the month.*

Technology, Consumer Discretionary, and Communication Services were the top performing sectors in the period, while Utilities, Materials, and Energy were the bottom performing sectors.

Equity volatility was lower month-to-month, finishing at 12.44.*

Convertible Securities Market Environment

The ICE BofA US Convertible Index returned +0.93% for the month.^

Convertible securities were positively impacted by rising stock prices.

Sector performance for the period was mixed with Consumer Discretionary, Health Care, and Technology outperforming, while Materials, Energy, and Utilities underperformed.

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

New issuance saw 13 issues priced, raising USD 7.4 billion in proceeds.^

High-Yield Bond Market Environment

The ICE BofA US High Yield Index returned +0.97% for the month.^

Credit-quality subsector returns for the month^:

- BB rated bonds: +1.07%
- B rated bonds: +0.94%
- CCC rated bonds: +0.58%

Spreads widened to 321 basis points (bps) from 320 bps, the average bond price rose to 92.98, and the market's yield fell to 8.10%.^

All industries finished higher with Food Producers, Cable, and Services outperforming, while Telecoms, Retail, and Chemicals underperformed.

Trailing 12-month default rates declined to 1.79% (par) and 1.80% (issues).**

New issuance saw 32 issues priced, raising USD 17.9 billion in proceeds.**

Portfolio Review

The portfolio was positively impacted by strength across risk assets.

Top contributors were primarily 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. Additionally, Apple gained after unveiling new AI capabilities. Eli Lilly advanced after an Alzheimer's drug received a positive opinion from the US Food and Drug Administration (FDA) and on favourable phase 2 trial data for a liver disease treatment. An electric vehicle manufacturer that obtained shareholder approval for its executive compensation package and noted that its autonomous driving technology is accelerating rapidly was another top contributor.

Top detractors included a utility operator that fell on a regulatory setback and an athletic apparel company that reported revenue below consensus estimates and offered weaker-than-expected guidance. Several aerospace issues consolidated after strong year-to-date gains, an automotive technology supplier reported slower sales due to macro headwinds, and a biotech company was negatively impacted by operating margin contraction. Other top detractors were holdings in property and casualty insurance, technology hardware, and a big-box retailer, among others.

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

Exposure increased the most in Technology, Financials, and Health Care, and decreased the most in Consumer Staples, Consumer Discretionary, and Real Estate. 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 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 June 2024 unless otherwise stated.

* Source: FactSet, as at 30 June 2024

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

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

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

Source: ICE Data Services, as at 31 December 2022

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