Allianz Global Investors

Allianz Select Income and Growth

Monthly commentary

Investment Objective

The Fund aims at long term capital growth and income by investing in investment grade corporate Debt Securities and Equities of US and/or Canadian Equity and Bond markets.

What Happened in August

Equity, convertible, and investment grade markets finished higher despite a volatile August, which saw intramonth declines as large as -6%, driven by a strong finish to earnings season, balanced economic data, a dovish 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 US Federal Reserve (Fed) Chair 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.^

Investment Grade Corporate Market Environment

The ICE BofA US Corporate Index returned +1.53%, outperforming the shorter-dated ICE BofA 1-10 Year US Corporate Index which returned +1.27%.**

Credit-quality subsector returns for the month**:

- AAA rated bonds: +1.83%
- AA rated bonds: +1.61%
- A rated bonds: +1.51%
- BBB rated bonds: +1.54%

Spreads narrowed to 96 bps from 97 bps, the average bond price rose to 94.77, and the market's yield fell to 5.02%.**

Gross new issuance for the period was USD 107.6 billion.^

The 10-year US Treasury returned +1.38%.^ The note's yield fell to 3.92%, compared to 4.05% the prior month.^

Portfolio Review

The portfolio was positively impacted by strength across risk assets.

Top contributors in the period were led by several pharmaceutical holdings, one of which rallied after beating top- and bottom-line estimates by double digits and boosting full-year guidance, and another that beat-and-raised on strong volumes and successful partnerships. A social media company gained following a strong earnings report, which showcased the company's plans for AI monetisation. A property & 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 a consumer finance issuer, a surgical robotics company, and a ratings agency.

Top detractors included technology companies capitalising on secular trends around artificial intelligence (AI) and cloud migration, including Amazon and a mega-cap internet services provider, as well as several semiconductor companies. A major electric vehicle 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 social media, banking, and healthcare services.

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

Exposure increased the most in Industrials, Materials, and Consumer Staples, and decreased the most in Consumer Discretionary, Technology, 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.

US investment grade corporate bond's risk/reward opportunity is also compelling. Rising interest rates are a risk for high grade corporates however the investment opportunity remains attractive given higher coupons and yields, and a positive fundamental outlook with limited default risk. The asset class trades at a discount to par, offering compelling total return potential and downside cushioning.

A covered call options strategy can be utilised to help 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 help 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: ICE Data Services, as at 31 August 2024