

Allianz US Short Duration High Income Bond

Monthly commentary

Investment Objective

The Fund aims at long-term income and lower volatility by investing in short duration high yield rated corporate debt securities of US bond markets.

What Happened in April

High yield markets declined in April, despite a solid start to the Q1 earnings season. Thus far, the percentage of S&P 500 companies reporting a positive earnings surprise was above the longer-term average, as was the magnitude of the earnings surprises. In aggregate, S&P 500 companies are pacing to report year-over-year earnings growth for a third straight quarter. Key economic data points released during the month were mixed. The labour market remained healthy, the manufacturing sector moved into expansionary territory, joining the services sector, retail sales surpassed projections, and home price indices rose. On the other hand, US gross domestic product (GDP) missed growth forecasts, consumer confidence declined, and some inflation measures were higher than anticipated. As a result, market expectations for the first interest rate cut were pushed out further, driving Treasury yields higher and pressuring investor sentiment.

The ICE BofA US High Yield Index returned -1.00% for the month.*

Credit-quality subsector returns for the month*:

- BB rated bonds: -0.97%.
- B rated bonds: -0.86%.
- CCC rated bonds: -1.60%.

Spreads widened to 318 basis points (bps) from 315 bps, the average bond price fell to 91.88, and the market's yield rose to 8.32%.*

All industries finished lower for the period. Health Care, Transportation, and Chemicals outperformed, whereas Cable, Telecoms, and Food Producers underperformed.

Trailing 12-month default rates fell to 2.33% (par) and 2.24% (issues).[^] The upgrade/downgrade ratio increased to 1.8.[^]

New issuance saw 38 issues priced, raising USD 26.4 billion in proceeds.[^] High yield funds reported estimated net flows of -USD 4.6 billion.[^]

Portfolio Review

The portfolio (net of fees) provided a negative monthly return but continued to serve as a fixed income diversifier with the goals of preserving capital, generating high income, and providing liquidity.

The Fund remains an attractive and actively managed solution as investors adjust to high for longer rates without taking excessive credit risk or price volatility in passive fixed income strategies. In the current market environment, the Fund can purchase securities at discounts to par, or selectively invest in high coupon new issue producing yields well above money market accounts, management fees, and hedging expenses.

Fundamental research, credit analysis, low duration, and liquidity are key tenants and goals that seeks to strike an attractive balance between risk, opportunity and expected return. The shorter maturity profile of the Fund should protect capital going forward as there are fewer years to repayment to close the average price discount. Goals are unchanged to reinvest capital prudently to defend and evaluate credit risk and company fundamentals against a challenging global environment.

Since inception nearly 15 years ago, the Fund remains US centric with coupons and repayment of principal in US dollars. The portfolio is focused on energy, transportation leasing and infrastructure. The portfolio continued to stay up in quality while generally avoiding the lowest quality credits with average credit quality in the portfolio unchanged at B1/B+. Emphasis remains on credit selection, liquidity, and downside risk mitigation versus the broader market.

The Fund is an actively managed solution with historically relatively high security turnover. This active approach to security selection and portfolio construction should also allow the Fund to avoid some of the riskiest segments of the market further mitigating downside volatility. Passive strategies may carry greater tail risk and show greater dispersion of investment returns. The Fund selectively invests in opportunities that may present lower price volatility, risk-adjusted returns in line within the mandate, investment philosophy and Fund guidelines and importantly seeks to side-step and avoid many of the risks not appreciated by markets.

Performance in the period benefitted from industry weightings and a consistent fundamental credit selection framework. Industries contributing the most to performance were Air Transportation, Support-Services, and Energy. Utilities, Financial Services, and Health Care were the largest detractors from performance.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities. New purchases were issues in Commercial & Residential Mortgage Finance and Food Distributors. Sells consisted of issues in Specialty Chemicals and Automotive Parts & Equipment.

Market Outlook

2023's economic momentum has carried over into 2024. Economic tailwinds include a healthy labour market, steady consumption, government spending, elevated household net worth, a stabilising manufacturing sector, 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.

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^{##}.

Longer-duration issues are the most likely to be impacted by high and volatile rates, but the overall high yield market should have a dampened response due to its larger coupon relative to other fixed income alternatives. As a result, US high yield bonds contribute from both a diversification and a relative performance perspective, offering a very compelling yield opportunity.

The Fund remains an attractive fixed income solution without taking excess credit risk, the shorter maturity puts securities first in line to repayment at par, and the Fund lessens price volatility that may be highly amplified in passively managed strategies.

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All data are sourced from Allianz Global Investors, S&P Dow Jones Indices and FactSet, dated 30 April 2024 unless otherwise stated.

* Source: BofA Merrill Lynch, as at 30 April 2024

^ Source: J.P. Morgan, as at 30 April 2024

** Source: ICE Data Services, as at 30 April 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.

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