

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 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 further out, aligning with the US Federal Reserve (Fed)'s most recent full-year forecast. Against this backdrop, Treasury yields rose, and investment grade bonds fell.

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 (net of fees) provided a positive monthly return, outperformed the high-yield market and continued to serve as a fixed income diversifier with the goal of preserving capital and generating consistent and high income. Positive returns of the Fund in the month compared to negative returns for other fixed income asset classes.

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 credit selection framework. Industries contributing the most to performance were Health Care, Energy, and Support-Services. Media, Utilities, and Media Content 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 Construction Machinery & Heavy Transportation Equipment, Oil & Gas Storage & Transportation, and Automotive Parts & Equipment.

Market Outlook

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.

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#.

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 strategy 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 29 February 2024 unless otherwise stated.

* 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.

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