

# 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 October

High yield bonds finished lower in October. The Q3 earnings season got off to a strong start. Management commentary has been focused on positive credit conditions, strong artificial intelligence (AI) demand, favourable advertising traction, mixed consumer demand, China headwinds, and industrials/auto-related softness. On the economic front, Q3 gross domestic product (GDP) growth was above trend, consumer confidence rose, employment data was balanced, and core inflation increased modestly. Against this backdrop, futures markets pared back rate cut expectations to 25 basis points (bps) for the November Federal Open Market Committee (FOMC) meeting, driving Treasury yields higher.

The ICE BofA US High Yield Index returned -0.55% for the month.\*

Credit-quality subsector returns for the month\*:

- BB rated bonds: -0.89%.
- B rated bonds: -0.45%.
- CCC rated bonds: +0.62%.

Spreads narrowed to 288 bps from 303 bps, the average bond price fell to 95.72, and the market's yield rose to 7.51%.\*

Most industries were lower with Telecoms, Cable, and Transportation outperforming, while Packaging/Paper, Health Care, and Real Estate underperformed.

Trailing 12-month default rates finished the period at 1.39% (par) and 0.79% (issues).^ The upgrade/downgrade ratio decreased to 1.1.^

New issuance saw 39 issues priced, raising USD 27.2 billion in proceeds.<sup>^</sup> High yield funds reported estimated net flows of +USD 1.1 billion.<sup>^</sup>

### Portfolio Review

The portfolio 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 for the Fund 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 of the Fund are unchanged to reinvest capital prudently to defend and evaluate credit risk and company fundamentals against a challenging global environment.

Since inception coming up on 15 years, the Fund remains US centric with coupons and repayment of principal in US dollars. The portfolio is focused on Energy, Transportation Leasing and Infrastructure. It 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 it 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 Energy, Support-Services, and Media. Utilities, Health Care, and Retail were the largest detractors from performance.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities. New purchases included issues in Internet Services & Infrastructure, Passenger Ground Transportation, and Food Distributors. Sells consisted of an issue in Restaurants.

### Market Outlook

The easing cycle has begun, with the US Federal Reserve (Fed) cutting interest rates by 50 bps in September as inflation normalises and the labour market softens.

Apart from an accommodative shift in monetary policy, potential economic tailwinds include steady consumption, continued government spending, improving productivity, increasing capital expenditures, and the proliferation of AI. Risk to the economy may increase if these trends weaken. Other potential headwinds include escalating geopolitical

tensions, prolonged labour market softening, deteriorating consumer sentiment, and continued manufacturing contraction.

The US high yield market, yielding over 7%\*\* , offers the potential for equity-like returns but with less volatility. 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. Credit fundamentals are stable, near-term refinancing obligations remain low, and management teams continue to exercise balance sheet discipline. Given these factors, the default rate has been below the long-term average with expectations for it to trend towards the historical average in 2025. Regarding credit spreads, they can stay tight for many years. This was the case in the mid-1990s and 2000s – periods like today when high yield balance sheets were healthy and defaults were low, the economy was stable, and interest rates were elevated.

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 31 October 2024 unless otherwise stated.

\* Source: BofA Merrill Lynch, as at 31 October 2024

^ Source: J.P. Morgan, as at 31 October 2024

\*\* Source: ICE Data Services, as at 31 October 2024

Allianz Global Investors and Voya Investment Management have entered into a long-term strategic partnership, and as such, as of 25 July 2022, the investment team transferred to Voya Investment Management. This did not materially change the composition of the team, the investment philosophy nor the investment process. Management Company: Allianz Global Investors GmbH. Delegated Manager: Voya Investment Management Co. LLC ("Voya IM").

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