Short Duration High Yield Bonds:
A solution for modern day fixed income investors

March 2021

Since the beginning of the year, there has been increasing concerns and interests around inflation. According to Google search data, searches on "inflation" have grown exponentially, reaching the previous peak in 2010-11 after the global financial crisis. Investors now see the return of inflation and an unruly rise in treasury yields as the key risk that could unsettle global markets.

With the vaccine rollout and the reopening of the economy gaining steam, together with the unprecedented monetary and fiscal stimulus, markets have become increasingly concerned about the risk of rising inflation. The recent spike in yields in the bond market was reminiscent of the 2013 taper tantrum when the prospect of the US Federal Reserve (Fed) withdrawing stimulus following the Global Financial Crisis prompted a severe selloff in bonds.

Arguably, the rates rise this time round is primarily "growth-driven" --- better growth expectations rather than "policy-driven". Despite the Fed's repeated reiteration of its dovish policy and playing down the impact of inflation risks, the bond market is clearly undergoing a pivotal shift from extraordinary monetary policy support to economic fundamentals taking the lead. Stronger fiscal stimulus in the US could also add fuel to the fire. Bond investors are already having a bad start this year. 10-year US Treasury yields rose to 1.72% from the low of 0.5% in August last year and the spread between 2-year and 10-year US Treasury yields also steepened sharply. For investors, the selloff in rates markets has important implications in their portfolios.

Since the beginning of 2021, major fixed income asset classes have posted negative performance.

So, what should bond investors do now?

A lot of the easy money has already been made in the bond market last year when the precipitous fall in rates made up a good portion of the return. Going forward, the traditional fixed income asset classes, i.e. government and corporate bonds, are likely to offer little income or inflation protection.

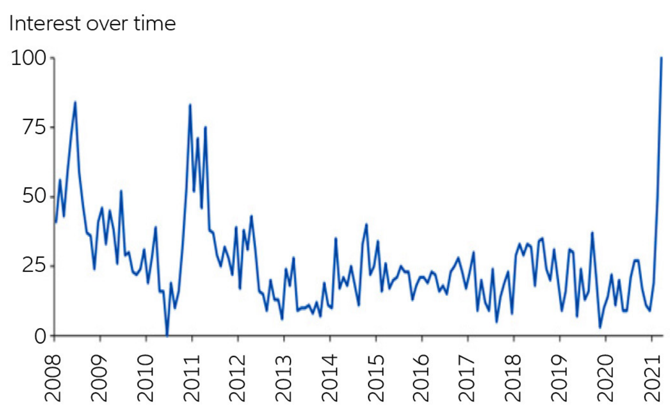
Most government and corporate bonds have low coupons and long maturities which provide little buffer to combat higher rates. Corporate bond spreads are also at cyclical low with limited room to compress further. Investors are generally taking more interest rate risks than the coupon could compensate them for.

When navigating the current bond market turbulence, fixed income investors who want to earn attractive income while avoiding interest rate volatility may want to consider an often-overlooked segment of the market: Short duration high yield bonds.

While the yield differential versus investment-grade fixed income is apparent, some investors may be surprised to learn that shorter maturity high yield bonds can offer similar yields to their full maturity counterparts. In fact, as of end February 2021, the Allianz US Short Duration High Income Bond offered a similar yield to that of the broad US High Yield market.

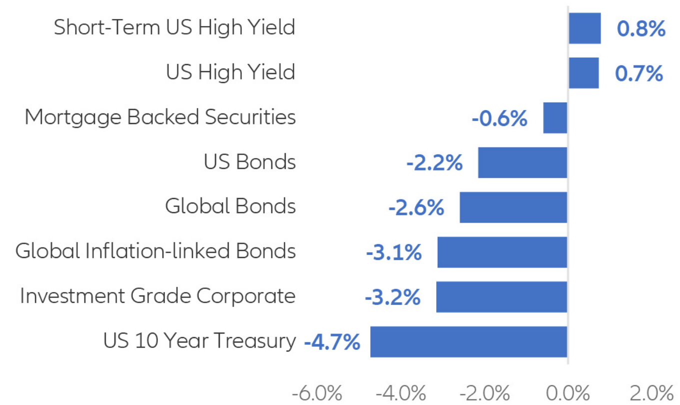
Currently, the yield-to-duration ratio for the aforementioned asset class surpasses those of other asset fixed income asset classes, especially investment grade corporate bonds which no longer deliver the risk/reward outcome investors have grown accustomed to. In today's market, high-quality short duration high yield bonds offer a defensive building block for a fixed income portfolio.

Google Trends: Inflation Topic in United States: News Search



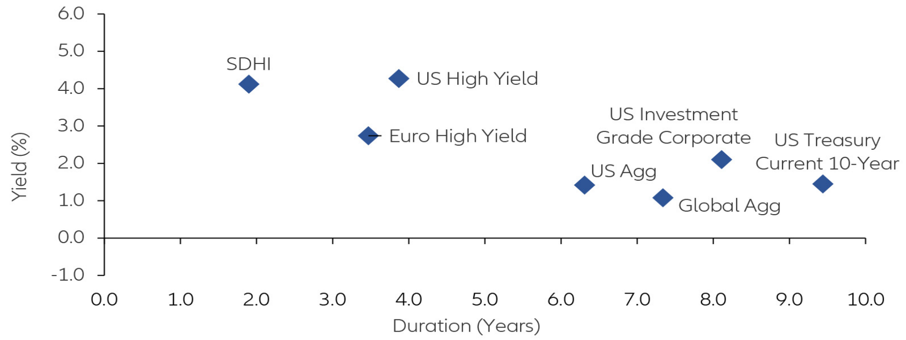
Source: Google Trends, as at 17 March 2021.
Note: Numbers represent search interest relative to the highest point on the chart for the given region and time. A value of 100 is the peak popularity for the term. A value of 50 means that the term is half as popular. A score of 0 means there was not enough data for this term.

Year-to-date Performance of Major Fixed Income Asset Class



Source: ICE Data Services, Bloomberg, as at 28 Feberary 2021.
Short-Term US High yield represent ICE BofA US High Yield Cash Pay 1-3Year Index: US High Yield represent ICE BofA US High Yield Index; Mortgage Backed Securities represent Bloomberg Barclays US Mortgage Backed Securities Index; US Bonds represent Bloomberg Barclays US Aggregate Index: Global Bonds represent Bloomberg Barclays Global Aggregate Index; Global Inflation-linked Bonds represent Bloomberg Barclays Global TIPS Index: Investment Grade Corporate represent ICE BofA US Corporate Index; US 10 Year Treasury represent Current US 10Year Treasury Bond.
Past performance is not indicative of future results.

Market Yields and Duration



Source: FactSet; ICE Data Services; Bloomberg, as at 28 February 2021.
Past performance is not indicative of future results. This statement reflects characteristics as of the time period shown, results over a different time period may have been more or less favorable. SDHI is the representative account of the Allianz US Short Duration High Income Fund; US High Yield represented by ICE BofA US High Yield Index; Euro High Yield represented by ICE BofA Euro High Yield Index; US Investment Grade Corporate represented by ICE BofA US Corporate Index; 10-Yr US Treasury represented by ICE BofA US Treasury Current 10 Year Index; US Agg represented by BBG Barclays US Aggregate Bond Index.

Why Allianz US Short Duration High Income Bond Strategy?

Allianz US Short Duration High Income Bond (the Fund) is a fixed income solution with a primary emphasis on capital preservation followed by income generation, while seeking to achieve risk-adjusted returns by identifying high-yield credits. High yield bonds tend to perform best when growth trends are favourable and defaults are low or falling.

Besides investing in bonds with short maturities, the strategy focuses on investing in high quality high yield bonds which mitigate credit risk, while low duration bonds help minimize the impact of interest rate movements.

The Fund is US centric and consumer focused with limited non-domestic exposure and trade risk versus the broader markets. This makes it well-positioned to capture the reacceleration of US corporate profits and economic recovery.

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