

# Allianz

## Income and Growth

Achieving income and growth with high yield bonds, convertible bonds, and equities. Setting in place the dual opportunities of potential income and growth.



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# 2024: US Economy Steady as She Goes

The US economy has been resilient during the first half of 2024. Consumer spending and overall business investment remained positive despite higher rates, stickier inflation and an uncertain economic outlook. The job market remains healthy which provides sustained income growth, supporting consumer spending and reducing the reliance on household savings.

**US Federal Reserve (Fed) cut imminent:** Stronger-than-expected US growth and higher-than-expected US inflation have pushed the timing of the first rate cut to later this year. As inflation starts to slow further, and growth starts to ease, the Fed seems to be ready to embark on a policy pivot finally.

**Move before the Fed:** With the Fed's interest rate cut on the horizon, it could be wise to move out of cash to lock in high rates in longer dated securities. A

non-recessionary rate cut may be conducive for risk assets and could lead to a broadening out in market leaders, encompassing the non mega-cap companies.

**US presidential election:** In recent months, the US election has been marked by some surprising developments including President Biden's last minute withdrawal from the race, and an assassination attempt on former President Trump. The outcome of the US election could just be as unpredictable, and volatility would not be unexpected. However, historical trends have shown that the economy and corporate health have been the more important drivers of investment returns over the long term.

**The Fed's rate path and the US election outcome will be difficult to predict with certainty. And with a myriad of geopolitical risks that may impact markets, this would mean investors should prepare for a bumpy ride. Yet, it is important for investors to capture market opportunity and continue to build a resilient portfolio by balancing risk and reward. A strategy with the potential for consistent income distribution, capital growth, and downside risk management would improve the resilience of a portfolio.**

# Three Approaches for Income and Growth

In the current market environment, investors with different levels of risk tolerance can consider three different approaches for income and growth.

1. High yield bonds – higher income opportunity and equity-like return with less volatility than stocks.
2. A combination of high yield bonds, convertible bonds and equities – steady flow of potential income, potential of upside market participation and downside risk management.
3. Equities with covered call options – enhanced income and upside potential when markets rise with higher volatility.

Risk/reward



Note: The above examples are for illustration only and does not represent actual results. There is no guarantee that these investment strategies and processes will be effective under all market conditions and investors should evaluate their ability to invest for the long term based on their individual risk profile especially during periods of downturn in the market.

# High Yield Bonds: High Income and Portfolio Diversifier

## What are high yield bonds?

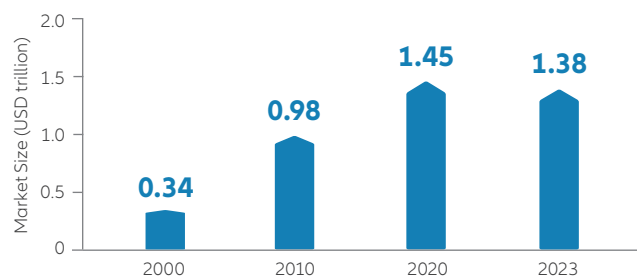
As the name implies, high yield bonds could offer a higher yield than other fixed income instruments.

**The credit ratings of high yield bonds are lower than BBB-. For this reason, the interest rates offered by such bonds are usually more favourable than issues with higher ratings such as US Treasuries and investment grade corporate bonds.** The past few

decades have seen strong growth in both the breadth and depth of the high yield market, and the asset class is now a globally popular investment instrument.

US high yield gross issuance was only USD 338 billion in 2000, but as of December 2023, the size of the market had grown to around USD 1.38 trillion<sup>1</sup>.

Growth of US high yield bond market<sup>1</sup>



Source

<sup>1</sup> ICE Data Indices, ICE BofA US High Yield Index, as at 31 December 2023.

The US dollar high yield bond market has continued to grow steadily. According to the ICE BofA US High Yield Index, the US dollar high yield market makes up about 60% of the global high yield universe<sup>2</sup>.

The US high yield bond universe is well diversified. It covers a wide range of sectors, allowing investors to allocate across a broad range of bond holdings.

## Info Corner: What is bond rating?

Bonds can be divided into two segments: investment grade and non-investment grade. Investment grade bonds have stronger creditworthiness but lower yields, while non-investment grade bonds are considered more risky due to the weaker credit profiles of their issuers. Issuers of non-investment grade bonds are more willing to offer higher interest rates to attract investors, and therefore these bonds are known as high yield bonds. It is worth mentioning that the creditworthiness of high yield bonds has greatly improved in recent years.

<sup>2</sup> Bloomberg, as at 31 December 2023.

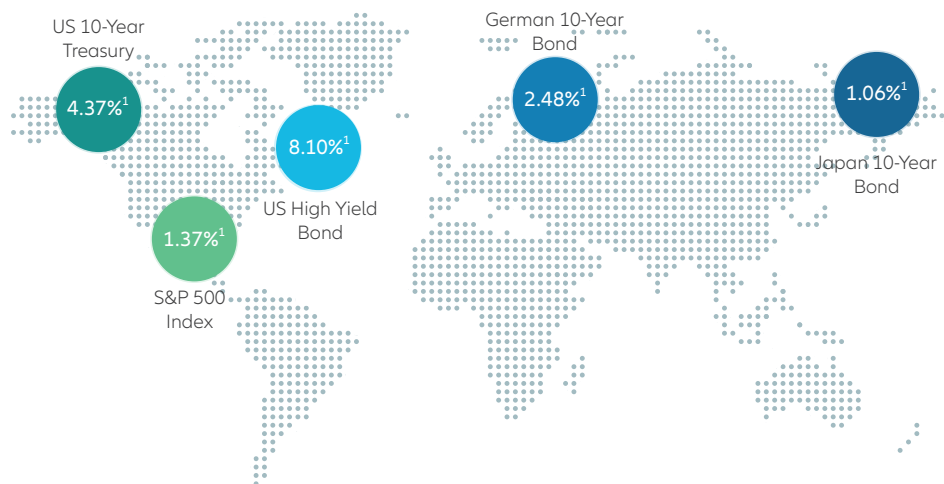
# Why Invest in High Yield Bonds?

## 1. Potential yields

US High yield bonds offer investors a competitive level of yield with lower interest rate sensitivity. As of 30 June 2024, the US 10-year Treasury bonds and US investment grade corporates offered yields of 4.37%<sup>1</sup> and 5.56%<sup>1</sup> respectively. US stocks have also delivered dividend yields, with the S&P 500 Index offering

1.37%<sup>1</sup>. Meanwhile, the US high yield market generated a yield of 8.10%<sup>1</sup>, making it a favourable opportunity for both international and domestic investors. Many people now include high yield bonds in their portfolios to enhance potential returns and hedge against inflation.

### Favourable yields from US high yield bonds



Source  
<sup>1</sup> Bloomberg as at 30 June 2024. US investment grade corporates represented by ICE BofA US Corporate Index and high yield bond represented by ICE BofA US High Yield Index, yield represented yield-to-maturity of the index, data as at 30 June 2024.

## 2. A proven track record

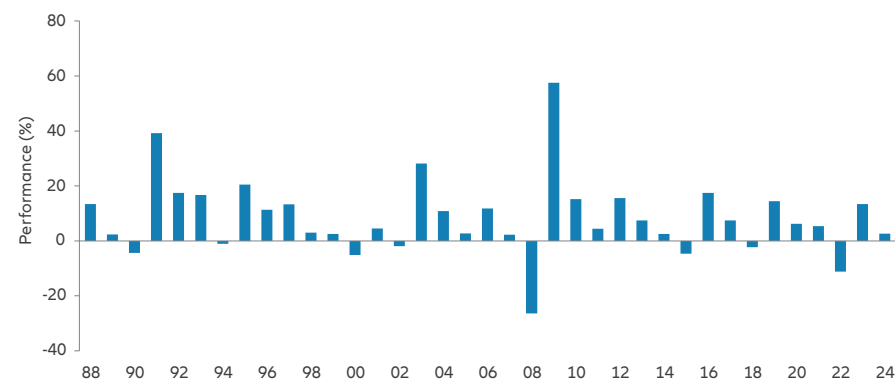
US high yield bonds have an outstanding past performance record, with an average annual return of 7.70%<sup>2</sup> in the past 36 years.

The US high yield market has posted negative returns in only 8 years between 1988 and 2023.

With 28 years of positive returns<sup>3</sup>, it is undoubtedly a front-runner in the global fixed income universe, which explains why it is appealing to investors.

It is also interesting to note that US high yield bonds have not declined in consecutive years.

### Performance of US high yield market in the past 36 years<sup>3</sup>



<sup>2</sup> Morningstar as at 30 June 2024. High yield bond represented by ICE BofA US High Yield Index, data from 1 January 1988 to 30 June 2024.

<sup>3</sup> Morningstar, ICE Data Services, Bloomberg, Allianz Global Investors, as at 30 June 2024. High yield bond performance is measured by ICE BofA US High Yield Index. Past performance, or any prediction, projection or forecast, is not indicative of future performance.

### 3. Fixed income diversification benefits

Historically, high yield bonds have delivered equity-like returns, with less volatility than stocks.

They also provide fixed income diversification benefits given their relatively low correlations with US Treasuries and other investment grade fixed income asset classes,

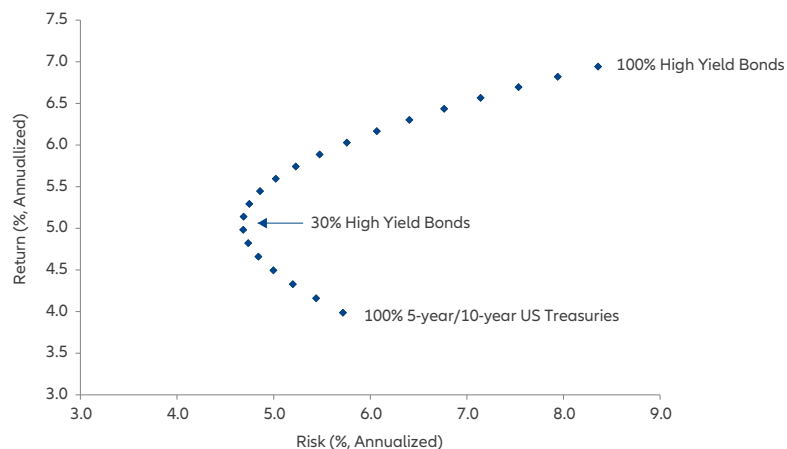
which means that adding high yield securities to a core fixed income portfolio may help enhance return while maintaining a similar level of risk exposure. Unlike US Treasury bonds which are very sensitive to changes in interest rates, high yield bonds are generally driven by the fundamentals of their issuers.

### High yield may benefit your portfolio

Over time, high yield bonds are well-positioned to deliver favourable potential total return. Low interest rate sensitivity, favourable yields and low dollar bond price are supporting factors of the asset class under a wide range of different economic scenarios.

#### Efficient Frontier - January 1993 to June 2024<sup>1</sup>

Adding high yield bonds to a fixed income allocation has been shown to reduce risk and increase returns over the long term.



Source  
<sup>1</sup> ICE Data Services, BofA, FactSet as at 30 June 2024. Past performance, or any prediction, projection or forecast, is not indicative of future performance. Data as of 30 June 2024. Efficient Frontier Chart Note: High Yield: ICE BofA US High Yield Index, 5- and 10-Year Treasuries: ICE BofA US Treasury Current 5 Year Index, ICE BofA US Treasury Current 10 Year Index. The information and charts above are provided for illustrative purposes only. The charts do not reflect future performance. This analysis has been distributed for informational purposes only, does not constitute investment advice and is not a recommendation or offer of any particular security, strategy or investment product.

# Risks of High Yield Bonds

## 1. Default risk

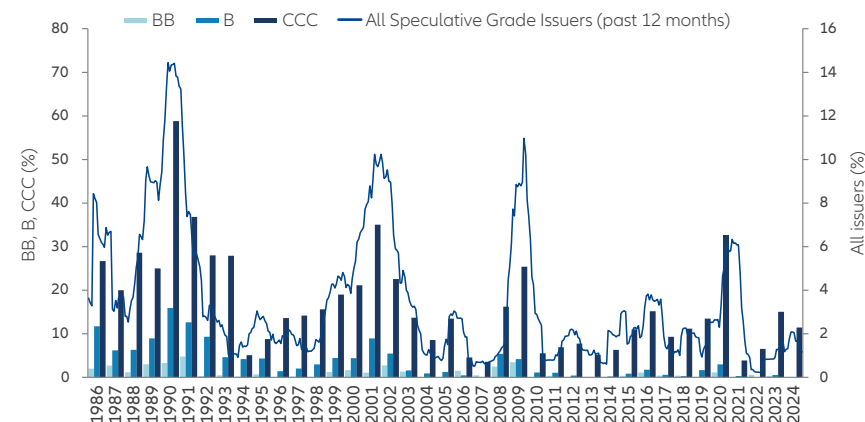
The main risk associated with high yield bonds is corporate default (also known as default risk). High yield defaults in June 2024 was at 1.17%<sup>2</sup> due to strong credit fundamentals, much lower than the long-term historical default rate of 3.5%<sup>2</sup>.

## 2. Beware of market fluctuations

The high yield market can be volatile, and investors need to be aware of market fluctuations.

**The path toward achieving positive results is hardly linear, and periods of heightened volatility should be expected.** The annualised volatility of US high yield bonds since 1988 amounted to 8.20%<sup>3</sup>, lower than that of S&P 500 Index (14.73%<sup>3</sup>) over the same period.

### Default rates at low level<sup>2</sup>



<sup>2</sup> BofA, JP Morgan, as at 30 June 2024. US high yield bonds are represented by the ICE BofA US High Yield Index.  
<sup>3</sup> Morningstar as at 30 June 2024. Data from 1 January 1988 to 30 June 2024. US high yield bonds are represented by the ICE BofA US High Yield Index.

# Convertible Bonds: Combining the Advantages of Bonds and Stocks

## What are convertible bonds?

Convertible bonds combine the features of both stocks and bonds, and are typically issued by a company.

Similar to other bonds, convertible bonds provide coupon income at a fixed rate. In addition, investors

may convert these bonds into stocks when the share price rises to capture the upside potential of the underlying stock.

The coupon rates of convertible bonds are usually lower than that of traditional corporate bonds but are higher than the typical dividend yields of stocks.

## Info Corner: How do convertible bondholders react to change in share price?

For example, in December 2016, company ABC issued five-year convertible bonds with a coupon rate of 3% p.a. and an exercise price of USD 5. Investors may exercise their right to convert the bonds into shares before December 2021.

### Scenario 1: The share price rises

Assuming the share price of company ABC rises to USD 6, holders of the convertible bonds may purchase the shares through conversion at a lower price and make a profit.

### Scenario 2: The share price declines

Assuming the share price of company ABC falls to USD 4, which is lower than the exercise price, the holder may continue to hold onto the bonds and receive coupon income.

Note: The above examples are for illustration only and does not represent actual results. Hypothetical example – not representative of any specific convertible bond. Convertibles involve the risk factors of both stocks and bonds. They fluctuate in value with the price changes of the underlying stock. If interest rates on the bonds rise, the value of the corresponding convertible bond will fall. Investors in convertibles may have to convert the securities before they would otherwise, which may have an adverse effect on their ability to achieve the investment objective.

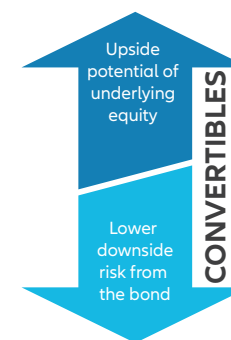
# Why Invest in Convertible Bonds?

## 1. Offensive yet defensive

Combining the advantages of bonds and stocks

Convertible bonds enjoy the advantages of both bonds and stocks. Most importantly, **they provide investors with the flexibility to cope with market volatility.**

For instance, when the stock market is doing well, investors can convert these bonds into shares in order to capture the potential market upside. When the stock market is doing poorly, investors may hold the convertible bonds and enjoy a stream of potential income.



## 2. Less volatile than stocks, lower interest rate risk than US Treasuries

correlation between convertible bonds and US Treasuries is relatively low, meaning their prices rarely move in tandem.

Historically, convertible bonds have exhibited a high correlation to equities, meaning their price movements are quite similar to the stock market. In contrast, the

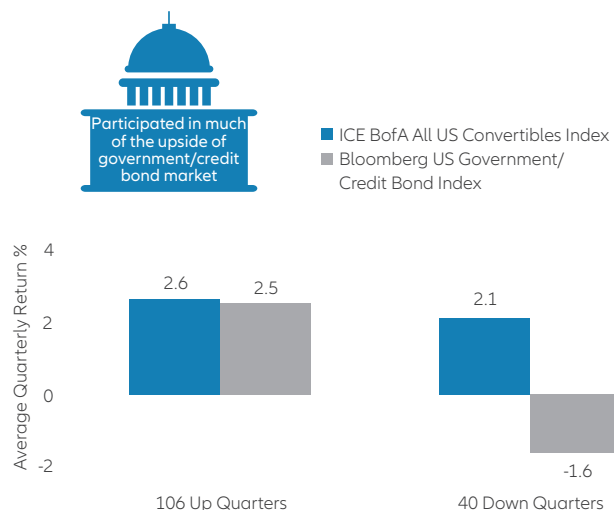
As convertible bonds share the same characteristics as stocks, they behave more like equities irrespective of the interest rate cycle.

Between January 1988 and June 2024, US government/ credit bonds rose in 106 quarters and fell in 40 quarters (by an average of -1.6% in each quarter). Convertible bonds managed to rise by an average of 2.1% in each of the quarters when US government/ credit bonds fell<sup>1</sup>.

### 3. Convertibles market outlook

During the first half of 2024, convertibles bond performance was modest as compared to the broad equity market. The absence of major mega cap companies, which drove S&P 500 performance, has weighed on the asset class.

Performance of convertible bonds between January 1988 and June 2024<sup>1</sup>



Source  
<sup>1</sup> FactSet, ICE Data Services, Morningstar as at June 2024. Data as of January 1988 to June 2024. US convertible bonds are represented by the ICE BofA All US Convertibles Index. US government credit bonds are represented by the Bloomberg US Government/Credit Bond Index. Past performance, or any prediction, projection or forecast, is not indicative of future performance.

Having said that, the US convertible market could continue to provide benefits to investors, including a favourable asymmetric return profile and potentially lower volatility relative to the equity market.

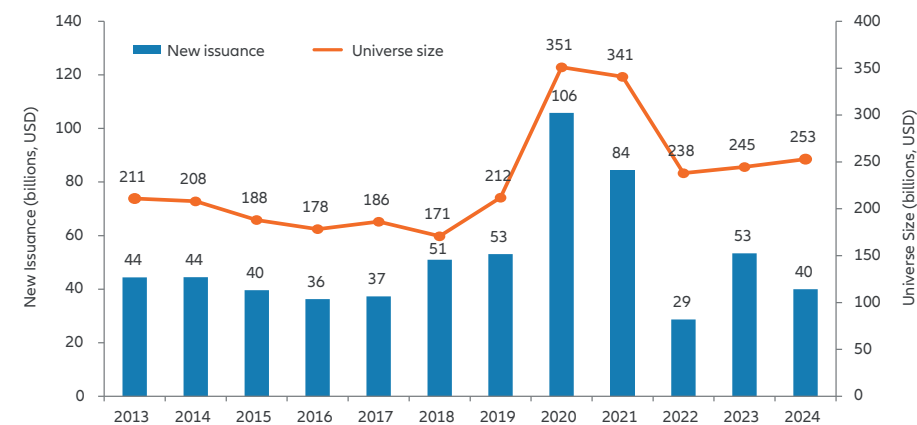
1. Bond-like characteristics: The convertible bond market consists of more yield opportunities after a challenging year in 2022. As the soft-landing outlook gains momentum, the lower delta in the convertible bond market is poised to provide better defensive characteristics with higher forward return potential.

2. Increased issuance: Convertible bond issuance staged a strong

first half, driven by refinancing activity. Increased new issuances continue to expand the investment universe and improve market breadth. According to BofA, Data Analytics, the US convertible bond issuance has already exceeded its expectation and led to it revising its forecast to rise 30%-40% to USD 60-80 billion in 2024.

3. Broadening out: While the spotlight has been on artificial intelligence (AI) related mega cap names, valuations outside of these companies are even more favourable. The broadening out of the equity rally beyond mega caps should help improve the upside capture of convertibles.

New issuance is expected to return<sup>2</sup>



<sup>2</sup> ICE Data Services, BofA as at 30 June 2024. Data as of 30 June 2024. US convertible bonds are represented by the ICE BofA All US Convertibles Index. Projections are based on assumptions with respect to future events. Actual future events may differ from the assumptions. Past performance, or any prediction, projection or forecast, is not indicative of future performance.



## Risks of Convertible Bonds

Convertible bonds are subject to the same risks associated with stocks and bonds. These bonds can fluctuate in value when interest rates rise and/or the price of the underlying stock changes.

**If interest rates rise, the value of convertible bonds may decline.**

Some of the companies that issue convertible bonds are below investment grade, which means **these bonds can be riskier than investment grade issues.**

Convertible bonds are often issued by smaller companies and may be more volatile than securities issued by larger companies. It is worth noting that the convertible bond market is relatively complicated and difficult for retail investors to access. A more practicable way of

investing in convertible bonds is to entrust the task to a professional management team.

In general, a fund management team analyses different aspects of each investment, such as:

- Financial condition
- Valuation
- Credit rating
- Bond spread

The team decides whether to buy a convertible bond only after reviewing the above fundamentals. As market conditions change, holdings are adjusted by selling, holding or converting the bonds into shares.

### Info Corner: Are convertible bonds subject to limitations?

Many companies issue convertible bonds with a call option that gives them the right to repurchase the convertible bond from the holder at a specified price (usually the par value of the bond). This call option can limit the opportunity to capture any potential upside from the underlying common stock. On the other hand, if the bond is structured with a put option, the holder has the right to sell the bond to the issuer on a specified date. This type of feature can limit risk should the underlying stock price drop sharply.

## US Equities: From Concentration to Dispersion

### 1. Solid earnings

Although the Fed delayed planned interest rate cuts, the US equity market continued to thrive. Q1 earnings results were better than expected, with most companies beating top- and bottom-line forecasts, which helped to further boost full-year 2024 and 2025 earnings growth estimates. For the second half of 2024, an easier monetary policy combined with strong US gross domestic product (GDP) should continue to provide a constructive backdrop for US equities.

### 2. Beyond AI

The AI-driven rally has boosted stock prices on a handful of companies, pushing the concentration of the market to multi-decade high. We could start to see a broadening out of the leaders to the rest of the market when valuations start to narrow.

# Covered Call Options: An Opportunistic Approach to Dampen Volatility

## What are covered call options?

This is an option strategy that pairs a long position with a short-call option on the same stock in exchange for an upfront premium paid by the buyer.

An option is the right to buy or sell a stock at a specified price on or before a specified date. There are two types of options: call options and put options.

If investors expect the stock market to remain flat, they may sell an option on a stock and use the premium to cover part of the potential volatility.

If investors expect the overall market to be increasingly volatile, they may sell an index option to obtain a premium to cover part of the market drop.

## Understanding how covered calls actually work

Let's look at a hypothetical example to understand how covered calls actually work.

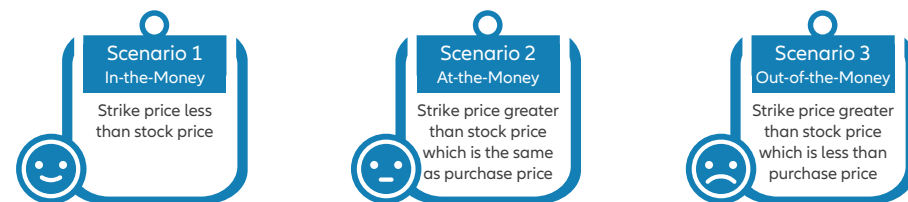
- An investor buys 100 shares of ABC Co. for USD 30 a share, the total cost being USD 3,000.
- At the same time, the investor sells a call option of ABC Co. The exercise price is USD 35.
- Option premium: USD 4 per contract (one contract per share).

**Scenario 1:** The investor benefits from additional cash flow and appreciation but does not participate in additional profits\*.

**Scenario 2:** The investor benefits from additional cash flow from premium.

**Scenario 3:** The additional cash flow from premium can only offset part of the stock depreciation.

## How covered calls work



**Market price of ABC Co.:** USD 37 per share; Stock up 23.3%

- Gain = USD 400 (premium)
- Realised gain of common stock = USD 500 [(USD 35 - USD 30) x 100 shares]
- Net portfolio effect = USD 900

**Market price of ABC Co.:** USD 30 per share; Stock flat

- Gain = USD 400 (premium)
- Net portfolio effect = USD 400

**Market price of ABC Co.:** USD 25 per share; Stock down 16.6%

- Gain = USD 400 (premium)
- Unrealised depreciation of common stock = USD 500 [(USD 25 - USD 30) x 100 shares]
- Net portfolio effect = -USD 100

## Why include a covered call strategy in a portfolio?

Selling covered call options on the stocks in a portfolio provide an additional source of potential income from the call premium received. Besides income, selling covered call option can help dampen downside volatility when the stock price declines. However, a covered call strategy also limits the upside potential of a stock when stock price rises.

Hence, it is also important to consider the coverage percentage, moneyness of the options and the

maturity of the option contracts when implementing a covered call strategy.



**BULL Market:** Portfolio return is likely to lag the market despite option premium received but upside is being capped.



**FLAT Market:** Portfolio return is likely to outperform the market from the option premium received.



**BEAR Market:** Portfolio return is likely to outperform the market from the option premium received, which helps offset some of the stock decline.

Note: The example above and on the next page is for illustration only and does not represent actual results.  
\* Additional profits = market price - exercise price.

# Allianz

## Income and Growth ("the Fund")

# Q&A

## Q1

### What was the performance of the Fund so far this year?

Year-to-date ending 30 June 2024, Allianz Income and Growth Class AT (USD) Accumulation returned +5.18% (offer-bid at -0.08%).<sup>1</sup> The Fund benefitted from the underlying strength across equities, convertible securities, and high yield bonds. For reference, the US Bloomberg US Aggregate Index and the S&P 500 Index returned -0.71% and +15.29% respectively.

For the first half of 2024, risky assets were mostly positive, with US stocks continuing to post strong gains while high yield and convertibles bonds posted modest returns. Q1 earnings results were better than expected, with most companies beating top- and bottom-line forecasts, which helped to further boost full-year 2024 and 2025 earnings growth estimates.

The US economy has proved to be more resilient as GDP growth surpassed forecasts but a higher-than-expected inflation has further pushed out rate cut expectation to September, with another expected by year-end.

<sup>1</sup> Source: Allianz Global Investors and IDS GmbH, as at 30 June 2024. Fund performance is based on Class AT Accumulation, calculated in USD on a bid-to-bid basis with net income and dividends reinvested. Investment returns are denominated in USD. SGD based investors are exposed to non-SGD foreign exchange fluctuations.

# Q2

## What is the outlook for the Fund in 2024?

2023's economic momentum should carry over into 2024, economic tailwinds include a healthy labour market, steady consumption, government spending, elevated household net worth, 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.

High yield credit and convertible securities should be better positioned to weather market volatility given current market dynamics, which in some respects are more favourable today than they were exiting 2022. US equity valuations reside near long-term averages. Visibility around 2024 and 2025 earnings, US dollar and Treasury market stabilisation, and an end to the rate hike cycle could be positive developments for stocks. Any equity market volatility will present opportunities for active managers to take advantage of better prices in investments.

Lastly, a covered call options strategy could also benefit from elevated or rising equity volatility by collecting premiums that translate into competitive annualised yields.

# Q3

## Why may investors consider investing in the Fund?

A multi-asset portfolio makes sense, being a great way for investors to potentially diversify their portfolios. It is clear that today's investing environment is characterised by high uncertainty, fears of both equity and rate volatility, and rising inflation which can erode wealth. The Fund consists of three sleeves – high yield, convertibles and equities, and is designed as a solution to address these risks. It aims to provide monthly income, the potential for capital appreciation, less volatility than an equity-only fund, and a low correlation to rate-sensitive investments.

For investors looking to supplement income in a portfolio, the high yield asset class provides coupon-like returns. Convertibles offer an asymmetric risk return, allowing investors to participate on the upside of the equity market while being cushioned from downside volatility. And equities provide the potential to grow the principal investment.

Collectively, these three asset classes may provide a source of potential income and a favourable return profile. The bottom line for investors is that they must not allow short-term market uncertainty to derail their long-term goals. Market timing is not easily achievable. Investors would be wise to "re-risk" their portfolios and consider a range of income-generating strategies that have historically held up well during down markets, and be able to capture market upside during bull market environments.

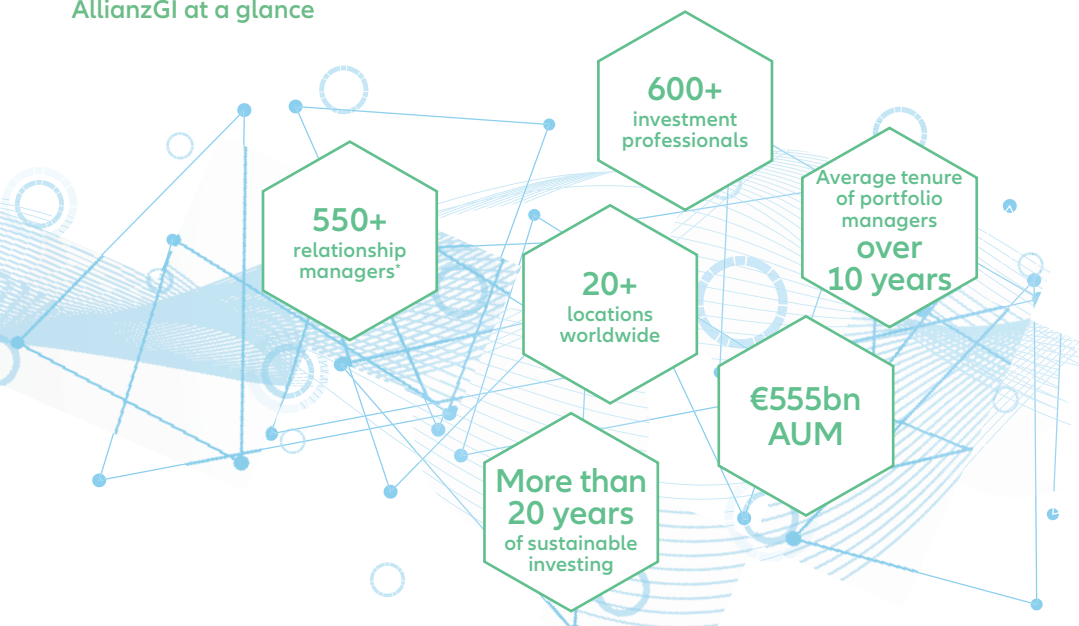
# About Allianz Global Investors

Allianz Global Investors is a leading active asset manager with over 600 investment professionals in over 20 offices worldwide and EUR 555 billion in assets under management.

We invest for the long term and seek to generate value for clients every step of the way. We do this by being active – in how we partner with clients and anticipate their changing needs, and build solutions based on capabilities across public and private markets.

As part of Allianz Group, we invest on behalf of one of the world's largest and most financially robust organisations, with more than 130 years of corporate history. Our goal is to elevate the investment experience for clients, whatever their location or objectives.

## AllianzGI at a glance



Updated as of June 2024. If not mentioned otherwise, data and information sources is Allianz Global Investors.

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

The information presented here is intended for general circulation and does not constitute a recommendation to anyone; it also has not taken into account the specific investment objectives, financial situation or particular needs of any particular person. Information herein is based on sources we believe to be accurate and reliable as at the date it was made. We reserve the right to revise any information herein at any time without notice. No offer or solicitation to buy or sell securities and no investment advice or recommendation is made herein. In making investment decisions, investors should not rely solely on this advertisement but should seek independent professional advice. However, if you choose not to seek professional advice, you should consider the suitability of the product for yourself. Past performance of the fund manager(s) and the fund is not indicative of future performance. Prices of units in the Fund and the income from them, if any, may fall as well as rise and cannot be guaranteed. Distribution payments of the Fund, where applicable, may at the sole discretion of the Manager, be made out of either income and/or net capital gains or capital of the Fund. As a result of the payment, the Fund's net asset value is expected to be immediately reduced. The dividend yields and payouts are not guaranteed and might change depending on the market conditions or at the Manager's discretion; past payout yields and payments do not represent future payout yields and payments. Investment involves risks including the possible loss of principal amount invested and risks associated with investment in emerging and less developed markets. The Fund may invest in financial derivative instruments and/or structured products and be subject to various risks (including counterparty, liquidity, credit and market risks etc.). Investing in fixed income instruments (if applicable) may expose investors to various risks, including but not limited to creditworthiness, interest rate, liquidity and restricted flexibility risks. Changes to the economic environment and market conditions may affect these risks, resulting in an adverse effect to the value of the investment. During periods of rising nominal interest rates, the values of fixed income instruments (including short positions with respect to fixed income instruments) are generally expected to decline. Conversely, during periods of declining interest rates, the values are generally expected to rise. Liquidity risk may possibly delay or prevent account withdrawals or redemptions. Past performance, or any prediction, projection or forecast, is not indicative of future performance. Investors should read the Prospectus obtainable from Allianz Global Investors Singapore Limited or any of its appointed distributors for further details including the risk factors, before investing. The duplication, publication, extraction, or transmission of the contents, irrespective of the form is not permitted, except for the case of explicit permission by Allianz Global Investors. This advertisement has not been reviewed by the Monetary Authority of Singapore (MAS). MAS authorization/recognition is not a recommendation or endorsement. The issuer of this advertisement is Allianz Global Investors Singapore Limited (79 Robinson Road, #09-03, Singapore 068897, Company Registration No. 199907169Z).

