Allianz Global Investors

Allianz Dynamic Asian High Yield Bond

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth and income by investing in high yield rated debt securities of Asian bond markets.

What Happened in December

In December, market activities for Asian credit slowed down as we entered the holiday season. US Treasury rates remained volatile with the 10-year yield rising to 4.6%, a level which was last seen in May 2024. During the month, the Federal Open Market Committee (FOMC) cut rates by 25 basis points (bps) as expected, but the latest dot projections indicated only two cuts in 2025, and the long-run neutral rate was revised up to 3.0%. Investors were surprised by the hawkish projections. Markets are now pricing in less than 40 bps of rate cut in 2025 versus more than 60 bps previously.

For Asian credit, the JP Morgan Asia Credit Index (JACI) composite reported negative return of -0.8% in December. High yield (HY) credits did slightly better, delivering -0.6% with -0.3% coming from credit spread and -0.3% from US Treasury. Year-to-date, Asian credit delivered 5.7% in total return, driven by a mix of spread return (3.8%) and Treasury return (1.8%). Asian HY continued to report outstanding return of 15.2%, significantly outperforming other HY markets.

In Asian HY, negative spread return was mainly driven by idiosyncrasies, rather than beta moves. In fact, most of the major sectors delivered positive spread return except for Hong Kong Real Estate and Sri Lanka sovereign. Company-specific negative headline news in the Hong Kong Real Estate sector was the largest detractor, with news reporting that a leading Hong Kong property developer was in discussion with banks to extend some bilateral loans and had asked for a waiver of a debt ratio covenant. Bonds were priced down significantly as the development contradicts with the common perception that the company continues to have access to bank loan funding at competitive levels. For Sri Lanka, the underperformance was due to technical reasons with retail accounts taking profit ahead of the bond exchange deadline. The bond exchange was well accepted with a high participation rate.

It was a quiet month for the new issue market in Asia with only USD 6.9 billion printed, bringing year-to-date Asia ex-Japan USD bond issuance to USD 202 billion. Net supply remains negative as Asian corporates and sovereigns have ample financing optionality.

Portfolio Review

The Fund returned positively, outperforming its benchmark.

Fund performance was driven by carry and our positioning in sovereigns while our exposure to Hong Kong property was a drag. We continue to maintain a portfolio beta of slightly above 1 and look for pullbacks to increase our market exposure further. While we have overweights in core sectors such as Macau Gaming and Indian Renewables, selection remains key for this portfolio.

Market Outlook

Going into January, primary activities should pick up after the holiday season and may put pressure on credit spread in the near term given the tight valuation. We expect supply to increase in 2025, but net supply should still be negative or close to zero. We are still comfortable with the corporate fundamental in Asian credits and expect limited impact from the potential trade war in 2025 as most of the Asian issuers do not have large direct exposures to the US market. That said, given current tight valuation and the less supportive technicals, we do not see much room for investment grade (IG) credit spreads to tighten and expect most of the return to come from carry moving forward.

In Asia HY, although valuation is not as attractive as a year ago, we continue to favour HY as valuations look less stretched compared to IG. We also take comfort from the stable to improving fundamental outlook for most of the HY issuers. Nevertheless, prudent credit selection remains the key for outperformance given the idiosyncrasies of Asian HY.

Overall, the all-in yield of Asian credit remains attractive and the stable-to-improving credit fundamentals should keep spread volatility in check. Trump 2.0 may bring volatility to the market, but we are not worried about default risk in Asian credit given the favourable credit cycle. We will continue to take market corrections, if any, as opportunities to buy into credits that we have high conviction on.

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All data are sourced from Bloomberg and Allianz Global Investors as at 31 December 2024 unless otherwise stated.