

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 July

Amid resilient economic data from both sides of the Pacific, no further escalation in the Iranian conflict, and trade deals being reached across Asia towards the end of the month, sentiment was positive for the month of July. In the US, non-farm payrolls continue to be stronger than expected at 147,000 against expectations of 106,000, while the University of Michigan Consumer Sentiment Index rose to 61.8 despite a slight uptick in the consumer price index (CPI) to 2.7% year-over-year. In Asia, China's Q2 gross domestic product (GDP) rose by a better-than-expected 5.2% against consensus expectations of 5.1%. Both the National Bureau of Statistics (NBS) and Caixin manufacturing purchasing managers' indices (PMIs) for June were also stronger than forecast due to the short-term de-escalation in the US-China tariff war. The market was also looking for further large stimulus measures to be announced at the China Politburo meeting at the end of July but was disappointed when nothing specific was announced. With the positive macroeconomic backdrop, Asian credit markets were in a risk-seeking mode. While credit spreads are fairly valued, absolute yields are still attractive. Asian credits were further supported by resilient fundamentals, a positive credit rating upgrade/downgrade trajectory, decreasing default rates, and bond supply that was lower than maturities. With stable to compressing credit spreads, most of the market volatility was driven by US Treasuries.

Asian credit (JACI Composite) was up 0.6% in July. Investment grade (IG) credits returned 0.5%, with spread and interest rate contributing 0.6% and -0.1% respectively. High yield (HY) credits were up 1.4% with most of the return coming from spread return.

New issuance was very active again in July with a total issue size of USD 39 billion, similar to the previous month. With close to USD 44 billion of maturities, we had a negative net supply in July. Most of the new issuances were rated IG, while

Japan stood out with a few jumbo-sized new issues. On a year-to-date basis, the cumulative supply from new issuances is close to maturities.

Asian HY had another strong month of performance where returns were driven by both spread compression and carry. Given the supportive macro backdrop, sovereigns led by Pakistan and Sri Lanka performed well. The non-IG Macau Gaming sector also performed well with the strongest gross gaming revenue achieved since COVID in July. At the issuer level, a Chinese cement producer rose strongly as it recorded stronger-than-expected profits and outlined plans to refinance a maturing bond, while a BB-rated Hong Kong supply chain manager announced a partial tender on their perpetuals and issued an attractively priced new HY bond that performed well in the secondary. There were no meaningful negative contributors at the country/sector level for the month of July.

Portfolio Review

Both allocation and selection contributed positively to active performance. Our underweight in China Financials, together with our overweight in China Diversified credits were the main drivers for positive allocation, while our selection within Macau Gaming and higher quality China Real Estate issuers were the primary contributors for selection. We continue to have higher interest carry in the Fund compared to the benchmark and expect security selection to be the key long-term positive contributor.

Market Outlook

There has been a slew of trade deals being struck with the US towards the end of July. This has reduced tariffs for most countries to within 15-20%, which is a level that markets feel consumers, companies, and the economy can absorb. With less meaningful differences in tariffs between the export-dependent Asian economies, there would not be a material change in the comparative advantage of production for each country. Although tariffs are disruptive to global trade, this outcome is less disruptive than initially feared. The resolution of tariffs has removed a key risk weighing on financial markets since the start of the year, and credit markets are likely to continue grinding higher as focus shifts towards the impending policy rate cuts in the US. Together with robust fundamentals, high absolute yields, and low new bond supply, we remain constructive on Asian credit markets.

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