

Allianz

Flexi Asia Bond

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth and income by investing in debt securities of Asian bond markets denominated in EUR, USD, GBP, JPY, AUD, NZD or any Asian currency in accordance with the Sustainability Key Performance Indicator Strategy (Relative). In this context, the aim is to outperform the sub-fund's Sustainability KPI compared to sub-fund's benchmark to achieve the investment objective.

What Happened in September

September was a strong month as risk assets outperformed on the back of US Federal Reserve's (Fed's) front-loaded easing cycle that began with a 50 basis points (50 bps) policy rate cut. In Asia, the market rally continued to gather pace, following positive headlines around China policy stimulus and subsequent monetary policy easing from the People's Bank of China (PBoC). Asian credit (JACI composite) delivered 1.2% return in September. Year-to-date, Asian credit delivered 7.1% in total return, driven by a good mix of tighter credit spreads (3.2%), as well as positive contribution for and Treasury return (3.8%). Asian investment grade (IG) delivered 5.9% in total return, ahead of JP Morgan US Liquid Index's (JULI's) 5.6% total return slightly. Asian high yield (HY) continued to report outstanding returns of 14.8%, significantly outperforming other HY markets.

In China, policymakers announced significant market supportive measures to boost market sentiments. The government first announced its intention to recapitalise the six state-owned Chinese banks, with an estimated RMB 1 trillion of capital injections. If confirmed, this would mark the first time since the global financial crisis (GFC) that China's largest state-owned banks will be re-capitalised. Policymakers also announced various stimulus measures for the Real Estate sector, with a comprehensive package of policy measures and stimulus that exceeded market expectations. Outside of China, the Australian Prudential Regulation Authority (APRA) released a proposal that would see additional Tier 1 (AT1) phased out such that regulatory capital requirements will be met with common equity and Tier 2. This measure would be supportive of the Australian AT1 sector.

Asian IG spreads tightened over September, on the back of the sentiment boost from the Fed and Chinese policymakers. For top gainers, China Technology was the strongest outperformer. IG sovereigns in Philippines and Indonesia, and Malaysia quasi-sovereigns also outperformed given their long duration profile.

In a similar note, Asian HY also delivered strong returns of 1.8% for September, with both Treasury and credit spread movements driving gains. Within HY, China and China Real Estate led gains, followed by Sri Lanka and Pakistan Sovereigns, which was driven by their respective idiosyncratic situations. China HY Industrials also benefitted from the optimism in Real Estate, rallying in tandem.

In the Sovereign HY space, election noise in Sri Lanka drove market volatility higher, though the bond market subsequently ended the month in positive territory. Sri Lanka authorities had secured an Agreement in Principle (AIP) with the international and local bondholders' group. This reduced concerns about the need to re-negotiate the structure of the current proposal. Newly-elected President Anura Kumara Dissanayake (AKD) had also signalled his willingness to be pragmatic and not abandon the International Monetary Fund (IMF) deal. Over in Pakistan, the IMF announced that they have approved a USD 7 billion loan for Pakistan under the Extended Fund Facility to support its economy. The initial USD 1 billion will be disbursed immediately, with the remaining amount to be released over the next three years.

Portfolio Review

The Fund returned positively.

The Fund had reduced its allocation to HY from the previous month, retaining a small overweight that supported higher carry contribution. Over the month, we traded tactically on duration from the short side but remained largely neutral on overall portfolio duration. We picked up some HY during the volatile periods and this contributed as these bonds rebounded.

Market Outlook

As the Fed begins its rate cutting cycle, the positive sentiment would flow into the bond markets. Although the Fed easing cycle is widely anticipated, the more aggressive Fed cut suggests that the policymakers are determined to ensure a soft landing and avoid any hard landing scenario. With this soft-landing backdrop, it should be overall positive for credits. One potential source of volatility would be the upcoming US elections. As we proceed closer to the election, rhetoric from both US presidential candidates could possibly lead to knee-jerk reaction to the financial markets. Therefore, we must remain vigilant on this front.

Within Asia, we remain sanguine about Asia credit with all the positive headlines from China. As market sentiment continues to be buoyant and excited by the new policy support from China, we think that credit spreads can continue to grind tighter. However, we do feel that most of the returns from Asia credits would likely come from lower rates and yield carry, which would still be decent.

In the Asian IG space, credit spreads should continue to benefit from strong demand despite lower yields. Improving IG credit quality reflected in continued positive rating actions, is also supportive, despite regional growth risks. For these reasons, we continue to expect IG spreads to remain relatively resilient going into year end. We would also focus on risk optimisation in anticipation of higher volatility due to uncertainty on political noises and risk averse behaviour going into year end. We maintain a long-spread bias and position in the shorter end.

We continue to favour Asian HY given the wider credit spreads and stable to improving fundamental outlook. Given the strong performance of the asset class, prudent credit selection is increasingly important for outperformance.

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