Allianz Global Diversified Credit

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth by investing in global bond markets in accordance with environmental and social characteristics.

What Happened in May

May was a strong month for credit with high yield spreads tightening 9 basis points (bps) and investment grade 2 bps while government bond curves steepened, with the 10-year US Treasury selling off around 25 bps as the market began to discount most headlines and focused on decent corporate and macro numbers that suggested that the world is so far untroubled by tariff pronouncements. Highlights included a technology company that designs graphics processing units saying that China does not appear to be slowing down, strong US consumer confidence, a lower-than-expected drop in US gross domestic product (GDP), and lower inflation which have reduced the consensus probability of a US recession from 50% to 35%. The expected trajectory for the US economy has flattened out - less of a V-shape to more of a saucer shape – which is better for cyclical business while interest rate sensitive sectors have longer to wait for relief. In Europe, the European Central Bank (ECB) remained expected to cut to 2% in June as growth/inflation forecasts were brought lower: further cuts will be a (much) tougher discussion with some sell-side commentators expecting a shift to a quarterly path for cuts after June.

Portfolio Review

The Fund returned positively, ahead of its cash benchmark (the Secured Overnight Financing Rate in USD). The Fund's return in May is a strong result compared to 36 bps for the 1-5 year US BBB index, given a similar average rating. We did not change the risk profile materially as we had conviction in the positions that had shown softness in April and this worked well.

On the margin, we have added a little US-domiciled credit which had cheapened on the back of a consensus negative view of US economic weakness which may be overdone. Our outlook on US corporates remains uncertain as the impact on tariffs is changing continually but currently companies appear to be able to handle them. Our European exposure is circa 30%, of which circa 19% is Financials where the investment case is more regulatory than growth. Circa 5% is asset-backed securities (ABS) and the residual 7% is corporate risk which is mostly non-cyclical BB, trading cheaper than US equivalent. We have a circa 19% in GBP risk split equally between ABS, Real Estate, Financials and Industrials, which offer an interesting relative value proposition in our view. Emerging Markets corporates remains constant at 22%, broadly spread across Latin America, Asia, Africa and CEEMEA (Central and Eastern Europe, Middle East, and Africa). Looking at the relative value across the market, US BBB and Euro BBB have similar spreads, while Euro BB are some 30bps cheaper which underlines a small bias towards Europe in this area.

Market Outlook

The fundamental outlook appears stronger than we had originally envisaged, although the drivers of uncertainty remain and could lead to rapid changes in sentiment. The strong performance in May has seen credit spreads return through long-term levels and while they can remain tight for a period, they offer limited compensation for any step up in defaults and thus we continue to be convicted in our up in quality positioning. We therefore will not chase the market and expect our portfolio structure to remain broadly similar with a focus on security selection and attractive carry and roll-down while keeping volatility under control.

All data are sourced from Bloomberg and Allianz Global Investors, as at 31 May 2025 unless otherwise stated.