

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 March

March was a weak month for global credit driven primarily by headlines out of the US and a reassessment of whether the “Trump put” and US exceptionalism remained valid scenarios and what this all meant for Europe and markets globally. The global high yield index returned -86 basis points (bp), with the US underperforming at -107bp, Europe returned -84bp and EM the winner at -12bp. By rating, it was a typical risk-off month with BBs returning -45bp, Bs -117bp and CCC -238bp. While the Chicago Board Options Exchange's (CBOE's) Volatility Index (VIX) “fear index” ended the month at similar levels to where it started (22), it traded in a range of 17 to 29 demonstrating how hard the market found interpreting the news flow, whether it be tariffs, stagflation, or European defence budgets. We often look at VIX as historically it has explained around two thirds of spread movements and over the month, global high yield spreads increased 55bp reflecting more uncertainty.

It has been widely expected that tariffs would be announced and as such, there has been no material changes to our headline positioning since the reciprocal tariff announcement in early April. What is new is the scale of the tariffs, especially for Southeast Asia. Markets are weaker but have so far digested the news in a relatively orderly fashion. Overall, we think that much of this news is in the price, but retaliations have already started which could change the landscape further. We hope that cooler heads will prevail and that these tariffs become a basis for negotiation. The consumer will ultimately be impacted the most and the lowest parts of this sector have already repriced considerably. Our credit research team has recently updated our internal default forecasts for the next 12 months and despite the geopolitical headlines believe that default rates will be like 2024's at below 2% with a drop in Emerging Markets (EM) being offset by small increases in Europe. For a prolonged period, Global High Yield (HY) spreads have looked a little tight and we see the latest price action as a move from complacency to normality. Markets might overshoot until there is

more certainty and the VIX returns to normal levels, so it may be a little early to buy the dip but with HY yields at approximately 8%, we remain hopeful that a new level is not far away.

Portfolio Review

The Fund delivered a negative return in March, behind its cash benchmark (the Secured Overnight Financing Rate in USD). The Fund generated positive returns primarily from the rates component of US investments offset by losses in European names. The bulk of negative returns were in non-investment grade rated Industrials and Financials. Single name performance remained solid with no name costing more than 3bp over the month.

Going into early April, we had reduced risk in the portfolios by reducing some high yield and subordinated Financials although core exposures to short-dated high yield have not been unscathed by the recent volatility. With uncertainties remaining on the risk of escalation length and the ultimate impact on economic growth, our focus remains on sectorial and idiosyncratic opportunities, where we see winners and losers from the announcements before a material change in risk profile.

Market Outlook

The outlook for the remainder of 2025 is tough to call and will be driven by geopolitical forces. While the base case remains for reasonable growth in the US, the possibility of stagflation or recession is increasing. In Europe, there are conflicting forces – the impact of tariffs versus increased spending and potential support for impacted sectors. While some parts of Latin America are at the epicentre of the tariff discussions, other parts of Emerging markets such as India and China have large domestic markets that could be safe havens from some international ripples. Fundamentally the picture is a little clearer as we start 2025 with decent credit metrics and a limited refinancing wall, especially in the US, and an expectation that default rates should remain low.

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