Allianz Global Investors

Allianz Global High Yield

Monthly commentary

Investment Objective

The Fund aims at long- term capital growth by investing in high yield rated debt securities of 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 re-assessment 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 (HY) index returned -86 basis points (bps), with the US underperforming at -107 bps, Europe retuned -84 bps, and emerging markets (EM) the winner at -12 bps. By rating, it was a typical risk-off month with BBs returning -45 bps, Bs -117 bps, and CCC -238 bps. While the VIX “fear index” ended the month at similar levels to where it ended (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 HY spreads increased 55 bps 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 have 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 EM being offset by small increases in Europe. For a prolonged period, global 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 circa 8% we remain hopeful that a new level is not far away.

Portfolio Review

The Fund returned negatively on a gross basis in March, ahead of its benchmark (ICE BofA Global High Yield Constrained Index USD Hedged – HW0CUSDH). Over the month, we increased our allocation to EM and reduced US Consumer names. We reduced headline risk versus the benchmark. Our small overweight to Europe and EM and our CCC underweight added value, offsetting our underweight to BB. The positive portfolio construction contribution was offset by single name losses mostly in the US Packaging and Retail sector.

Going into early April, the portfolio had been running a beta just below 1, with most of the underweight coming from the CCC sector that is the mostly likely to see equity cushions eroded and business models called into question in a recessionary scenario. We have had a slight underweight position in the US which we maintain although the relative value versus Europe is beginning to become interesting. We have invested in idiosyncratic opportunities in EM, such as meat exporters, towers, and renewables businesses, which haven't been impacted by the announcements. Within European HY, UK names look interesting given attractive valuations and the fact that the UK has emerged relatively unscathed from the announcements.

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 EM 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.

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

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