Allianz Global Investors

Allianz Global Opportunistic Bond

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth and income by investing in global bond markets.

What Happened in September

Market focus in September turned to the US Federal Reserve (Fed) and expectations of a start to the US rate cutting cycle, in line with the policy easing that began in other G10 markets in recent months. In the event, the Fed started its easing cycle with a 50 basis point (bps) cut, lowering the fed funds target range to 4.75-5.0%. The Fed affirmed market expectations of a front-loaded rate cutting cycle, highlighting greater sensitivity to any weakening in the labour market ahead. Even though the Fed's real gross domestic product (GDP) growth projections for 2024 and 2025 were little changed from the previous meeting, at 2%, projections for the unemployment rate were edged up to 4.4% for both years. In its dot plot projections, the committee signalled two further 25-bps rate cuts by year-end. Government bond yield curves continued their steepening trend that began in the summer, with the US 7s30s curve ending the month at 47 bps – around its highest levels since early 2022. 10-year US Treasury yields ended the month 12 bps lower at 3.78%. Risk assets were buoyed by the Fed decision as it raised hopes that the Fed could engineer a soft landing for the economy. The trade-weighted US dollar ended the month around year-to-date lows, with the AUD, JPY and GBP the best performers versus the USD in the G10 space.

In contrast to the US, the economic woes of the euro area came back into focus as survey data pointed to an anaemic growth outlook for the region, especially in Germany and France. As expected, the European Central Bank (ECB) cut the deposit rate by a further 25 bps to 3.5% in September, with market pricing increasingly shifting towards further front-loaded rate cuts. The German 5s30s curve ended the month at 51 bps – its highest level since mid-2022. German 10-year yields ended the month 18 bps lower at 2.12%, while concerns about the stability of the French government and fiscal dynamics saw 10-year French/German spreads re-test the June highs at 80 bps. In the UK, the Bank of England (BoE) held rates steady at 5%, as expected, but communicated a more gradual easing path ahead, citing still elevated services inflation. 10-year Gilt yields ended the month 12 bps lower at 3.78%.

In Asia, there was a renewed sense of urgency amongst Chinese policymakers as they tried to stem the downside growth risks for the Chinese economy. The Chinese central bank announced a broad package of policy measures to support domestic demand, focussed on the troubled real estate sector and the equity market. 10-year Chinese government bond yields ended the month fractionally higher at 2.21% – although they remain around historic lows.

Portfolio Review and Strategy

The Fed's decision to front-load its easing cycle with a 50 bps rate reduction, as well as further scope for ECB cuts, drove yield curves steeper in the US and Europe. Throughout the month, we continued to phase out of steepening risk in the Fund by cutting in two clips circa 50% in the US 7s30s risk, as well as closing the DE 10s30s steepening stance. We do remain engaged in the more policy-sensitive 5s30s expression on the German yield curve.

The global move lower in yields over the month helped our moderate long duration stance, with contributions from our exposures in the US, New Zealand and in Norwegian government bonds where, following the outsized repricing higher in NOK yields after the hawkish guidance by the Norges Bank, we engaged via a tap at the 10-year auction.

Early in the month, we added a new cross-market relative value (RV) trade, buying UK 10-year Gilts against German Bunds. We think that the improvement in the UK growth outlook is now sufficiently priced, while inflationary pressures are set to moderate further and the UK fiscal stance risks becoming a drag on growth. Against this backdrop, we think markets are under-pricing the extent of BoE rate cuts in comparison to the ECB and the Fed. The downbeat data from the eurozone and the continued emphasis on a gradual easing path by the BoE worked against the position in September, but we remain confident in the potential for Gilt outperformance in the next 3 to 6 months as valuations remain attractive.

Our active foreign exchange (FX) allocations added value over the month, with our Latin American FX exposure in BRL and MXN, as well as our FX RV trade to be long AUD versus NZD contributing. Our short EUR/INR position meanwhile modestly detracted in September as the EUR leg edged higher amid US Dollar weakness in September. In line with our allocation to UK Gilts, and consistent with the belief that interest rate markets are insufficiently pricing the potential for BoE rate cuts relative to the ECB and the Fed, we decided to take profit on our tactical short in EUR/GBP which had performed well since inception in August.

In credit markets, global investment grade (IG) corporate spreads tightened -1 bps in September, with US corporates outperforming (5 bps tighter) their European peers (unchanged) as generally firm US data was contrasted by weak data in Europe. Spread risk (measured by weighted duration times spread (WDTS)) was maintained with a moderate long bias, with a focus on IG corporates (mainly Financials, EUR-credit, and US-regulated Utilities), as well as a position in Spanish 30-year sovereign spreads versus Germany (4 bps tighter). The selection preference towards Financials (4 bps tighter) benefitted the Fund in September.

Looking ahead, the outlook for sovereign bond returns remains constructive given the current global macro and policy backdrop, although bond market volatility may well be elevated as market attention turns to the US elections in November and as Middle Eastern tension rises. We favour a long interest rate duration stance in several sovereign bond markets (Australia, New Zealand, Norway, and the UK) and we continue to have a preference to be positioned for steeper yield curves in the US and euro area versus a curve flattener expression in Japan. We favour UK Gilts on a relative value, cross-market basis against German Bunds from both a fundamental and valuation perspective. In addition, we favour owning inflation protection given the reflation risks stemming from the policy easing currently being priced and given renewed upside risks for oil prices.

All data are sourced from Bloomberg and Allianz Global Investors as of 30 September 2024 unless otherwise stated.