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 January

January was a month of two halves for sovereign fixed income markets. In the first two weeks, sovereign bond yields rose as US labour market data underscored the optimism about the US economic outlook into 2025. However, as the month progressed, softer-than-expected US inflation data and a lack of immediate tariff action in the early days of the new Trump administration triggered a relief rally in bond markets. Having risen to 4.8% intra-month, 10-year US Treasury yields ended the month at 4.54%. The US 7s30s yield curve steepened to 35 basis points (bps), up 5 bps on the month. On the monetary policy front, as expected, the US Federal Reserve (Fed) kept policy rates on hold, leaving the fed funds target range unchanged at 4.25%-4.50%, while the European Central Bank (ECB) cut the deposit rate by 25 bps to 2.75%. In the UK, the pressure on the Gilt market receded as UK activity and inflation data highlighted a weakening UK growth outlook, while the government also signalled a tighter fiscal policy stance ahead. 10-year Gilt yields ended the month 3 bps lower at 4.54%.

On a trade-weighted basis, the USD started the year on a fractionally stronger footing, remaining around 2-year highs. The Canadian dollar was the worst performer within the G10 markets in January (1% lower versus the USD), as Trump initially signalled that tariffs would be applied to Canadian imports from February, while the JPY was the best performer (+1.4% versus the USD).

Portfolio Review and Strategy

The round trip in bond yields resulted in relatively muted contributions from duration exposure. Our tactical reduction in 7-10-year US Treasuries reversed some of its positive impact from December, but overall provided a useful portfolio ballast to the volatility seen over the US presidential inauguration event.

The reprieve in Gilts drove some recovery in the relative value (RV) risk in portfolios, in particular Gilt/Bund spread tightening was a positive contributor in January. The steepening in US and European curves was positive for performance. Although markets have shifted to reflect a less dovish Fed policy outlook in 2025, any term premia repricing in the US yield curve is set to benefit our 7s30s steepener. Meanwhile, markets price 3x rate cuts from the ECB this year, and with January's eurozone economic data generally weaker than expected, the steepening pressure on EUR yield curves was sufficient to meet our profit-take target for the German 5s30s trade. We exited the position at month-end. In Japan, the Bank of Japan (BoJ) followed through with an expected rate hike in January, as well as raising its inflation forecasts. The Fund benefitted from a strong flattening of the Japanese yield curve, with our targeted slope spread in 7s30s moving an impressive 15 bps over the month.

We continue to hold an allocation to 10-year US Treasury Inflation-Protected Securities (TIPS) which contributed well given the market's re-evaluation of potential inflationary pressures from Trump's trade and immigration policy ambitions. 10-year breakeven inflation rates widened circa 10 bps on the month.

Early in the month, we decided to close our long INR foreign exchange (FX) position, moving back to zero weight. INR did prove to be a lower volatility/higher carry FX choice through 2024, however, towards year-end INR struggled to keep pace with the USD moves, making the environment for carry harvesting more challenging. In addition, the recently appointed new Reserve Bank of India (RBI) Governor may prove to be relatively more pro-growth in future (ie, more comfort with pursuing policy easing measures). As a result of these risks, we opted to cover the position. Elsewhere, our Latin America FX exposure started 2025 on a positive footing, as immediate US tariffs for the region failed to materialise at the very start of President Trump's second term. Our long BRL versus euro, and long MXN versus USD both added to returns within the month.

In credit markets, global investment grade (IG) corporate spreads tightened 4 bps over the month, with EUR credit again outperforming the USD market. US sentiment was affected somewhat by the noisy backdrop around trade tariffs, and volatility in Tech names as news from China on "low cost" artificial intelligence (AI) tech made headlines. Spread risk (measured by weighted duration times spread (WDTS)) was maintained a modest long footprint benchmark via allocations to IG corporates (sector focus on Financials, with increasing rotation into USD names, EUR reverse-yankee bonds, and US-regulated Utilities). We also retained a position in Spanish 30-year sovereign spreads versus Germany – which positively contributed to performance.

From a strategy perspective, we currently prefer a tactical reduction in US duration position given escalating US tariff and inflation risks that reduce the likelihood of near-term Fed rate cuts. Active duration exposure is favoured in countries that offer a better risk/reward, in markets currently pricing a shallow interest rate cutting cycle and where real yields look relatively attractive, such as the UK, Australia and Norway. The UK macro outlook, pressure on the UK government on its fiscal policy stance, current Bank of England (BoE) policy pricing and Gilt valuations present an attractive outlook for Gilts both on an outright basis and cross market versus Bunds and Canadian rates, markets in which a lot of rate cuts are already in the price.

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All data are sourced from Bloomberg and Allianz Global Investors as of 31 January 2025 unless otherwise stated.