Allianz Global Investors

Allianz Income and Growth

Monthly commentary

Investment Objective

The Fund aims at long-term capital growth and income by investing in United States of America ("US") and/or Canadian corporate debt securities and equities.

What Happened in January

Equity, convertible, and high yield markets finished higher in January. The Q4 earnings season got off to a strong start, with approximately three quarters of reporting companies topping bottom-line consensus estimates, although forward guidance has been mixed. Corporate managements are balancing potentially easier financial and regulatory conditions, improving business sentiment, stable employment, and a resilient consumer, against stricter trade and immigration policies, as well as global growth uncertainties. Key economic data points released in January were largely positive. Manufacturing and services surveys surpassed estimates, inflation measures were in line with expectations, and the labour markets remained solid. On the other hand, retail sales, durable goods orders, and consumer confidence were weaker. As widely expected, the US Federal Reserve (Fed) left interest rates unchanged. Against this backdrop, the 10-year US Treasury yield fell, and risk assets and core fixed income advanced.

Equities Market Environment

The S&P 500 Index returned +2.78% for the month.*

Sector performance was mostly positive in January. Communication Services, Health Care, and Financials were the top performing sectors, while Technology, Real Estate, and Consumer Staples were the bottom performing sectors in the period.

Equity volatility was modestly lower month-to-month with the VIX finishing at 16.43.*

Convertible Securities Market Environment

The ICE BofA US Convertible Index returned +2.66% for the month.^

Most sectors finished higher in January. Materials, Health Care, and Industrials outperformed, whereas Energy, Transportation, and Utilities underperformed.

Below-investment grade issues outperformed investment grade issues. Equity sensitive issues outperformed total return (balanced) and yield-oriented (busted) issues.

Monthly new issuance saw 5 issues priced, raising USD 1.9 billion in proceeds.^

High-Yield Bond Market Environment

The ICE BofA US High Yield Index returned +1.38% for the month.^

Credit-quality subsector returns for the month^:

- BB rated bonds: +1.29%
- B rated bonds: +1.42%
- CCC rated bonds: +1.64%

Spreads narrowed to 268 basis points (bps) from 292 bps, the average bond price rose to 96.34, and the market's yield fell to 7.42%.^

Industry performance was broadly higher with Cable, Energy, and Real Estate outperforming, while Utilities, Packaging/Paper, and Telecoms underperformed.

Trailing 12-month default rates finished the period at 1.43% (par) and 0.91% (issues).**

Monthly new issuance saw 27 issues priced, raising USD 23.0 billion in proceeds.**

Portfolio Review

The portfolio moved higher in the month.

Top contributors in the period were led by Meta following a strong top- and bottom-line beat for Q4, and Amazon on optimism around core business efficiency and margin expansion. Several major US banks, including JP Morgan, advanced after reporting net interest income ahead of expectations. In addition, an aerospace manufacturer gained on strong free cash flow guidance. An industrial conglomerate outperformed on broad organic revenue growth, and a utility operator rallied on mergers and acquisitions (M&A) headlines. Other top contributors were Alphabet and several medical technology holdings.

Top detractors in the period were led by multiple semiconductor companies, including Nvidia, which declined as investors re-evaluated future growth potential. Apple lagged on uncertainty over tariffs and currency headwinds, but finished off lows following a strong quarterly report, while Microsoft and travel services companies were both negatively impacted by competitive concerns. The other top detractors were companies in utilities, residential solar, satellite television, and software.

Most option positions expired below strike and the portfolio was able to retain the set premiums.

Exposure increased the most in Consumer Discretionary, Materials, and Industrials, and decreased the most in Energy, Utilities, and Communication Services. Covered call option positioning decreased month-over-month.

Market Outlook and Strategy

The US economy should continue to expand in 2025, supported by earnings growth, further Fed easing as inflation and the labour market continue to normalise, and the new administration's pro-US growth policies.

Apart from these factors, steady consumer spending, ongoing services sector expansion, continued fiscal spending, and improving productivity aided by the proliferation of artificial intelligence (AI) are growth tailwinds. Risk to the economy may increase if these trends weaken. Other considerations include tariff and immigration policies, geopolitical tensions, prolonged labour market softening, continued manufacturing contraction, and economic weakness outside of the US.

Against this backdrop, mid- to high-single-digit returns in 2025 are possible for large-cap equities, convertible securities, and high yield bonds. The equity market's path will not be linear, with bouts of volatility probable throughout the year. Given their defensive characteristics, high yield bonds and convertible securities can mitigate market volatility better than equities.

The expected range of annual returns for large-cap equities is 5-10%. The market could benefit from continued Fed easing, economic growth, and accelerating or inflecting earnings from more companies. Secular growth themes, such as AI, lower taxes, increased M&A activity, deregulation, productivity gains, and share buybacks are also catalysts. If either economic growth or earnings growth fall short of expectations, the equity market could be challenged. Valuations will continue to be debated.

US convertible securities have an attractive asymmetric return profile, providing upside participation potential when stock prices rise and downside mitigation when stock prices fall. The asset class may outperform the broad equity market if leadership broadens, and new issuance remains steady. USD 60-65 billion[#] of new issuance is expected in 2025 due to coupon savings demand, elevated refinancing needs, and a positive outlook for price appreciation among small- and mid-cap companies. Aside from diversification benefits, new issuance expands the opportunity set of investments with attractive terms and the desired risk/reward characteristics.

The US high yield market, yielding over 7%^^, is expected to deliver a coupon-like return in 2025 with upside possible. As a result, the asset class continues to offer equity-like returns but with less volatility. The market's attractive total return potential is a function of its discount to face value and higher coupon, which also serves to cushion downside volatility. Credit fundamentals are stable, near-term refinancing obligations remain low, and management teams continue to exercise balance sheet discipline. Increased M&A activity and deregulation could also have a positive market impact. In this environment, new issuance is expected to remain elevated, the default rate should stay below the historical average of 3-4%, and spreads can remain tight.

A covered call options strategy can be utilised to generate premium income. In periods of elevated or rising equity volatility, premiums collected may translate into more attractive annualised yields.

Collectively, these three asset classes can provide a steady source of income and a compelling "participate-and-protect" return profile.

The Fund is a client solution designed to provide high monthly income, the potential for capital appreciation, and less volatility than an equity-only fund.

All data are sourced from Allianz Global Investors dated 31 January 2025 unless otherwise stated.

* Source: FactSet, as at 31 January 2025

^ Source: BofA Merrill Lynch, as at 31 January 2025

** Source: J.P. Morgan, as at 31 January 2025

^^ Source: ICE Data Services, as at 31 January 2025

Source: BofA Research, as at 31 January 2025