Allianz Global Investors

Allianz US Short Duration High Income Bond

Monthly commentary

Investment Objective

The Fund aims at long-term income and lower volatility by investing in short duration high yield rated corporate debt securities of US bond markets in accordance with environmental and social characteristics.

What Happened in April

The high yield bond market was flat in April. Early in the month, markets sold off after President Trump announced sweeping tariffs as well as subsequent retaliatory measures. However, over the remainder of the month, markets rallied. Several factors contributed to the positive shift in market tone, including a softened stance on tariffs, stabilisation in the US dollar and 10-year US Treasury yield, trade deal optimism, and a better-than-feared start to Q1 earnings season. On the other hand, corporate outlooks were cautious with many companies pulling full-year guidance and warning of price hikes. Economic reports released during the month were generally balanced, although most strategists expect trade policy and uncertainty to begin dragging on growth mid-year.

The ICE BofA US High Yield Index was flat for the month.*

Credit-quality subsector returns for the month*:

- BB rated bonds: +0.17%.
- B rated bonds: -0.06%.
- CCC rated bonds: -0.62%.

Spreads widened to 394 basis points (bps) from 355 bps, the average bond price fell to 94.44, and the market's yield rose to 8.05%.*

Industry performance skewed positive with Health Care, Cable, and Utilities outperforming, while Energy, Retail, and Transportation underperformed.

Trailing 12-month default rates finished the period at 1.25% (par) and 0.68% (issues).^ The upgrade/downgrade ratio fell to 0.4.^

Monthly new issuance saw 8 issues priced, raising USD 8.6 billion in proceeds.^ High yield funds reported estimated net flows of -USD 9.5 billion.^

Portfolio Review

The portfolio (net of fees) provided a negative return over the period but continued to serve as a fixed income diversifier with the goals of preserving capital, generating high income, and providing liquidity. Opportunity exists for new capital to invest at a discount to par.

The Fund remains an attractive and actively managed solution as investors adjust to high for longer rates without taking excessive credit risk or price volatility in passive fixed income strategies. In the current market environment, the Fund can purchase securities at discounts to par, or selectively invest in high coupon new issue producing yields well above money market accounts, management fees, and hedging expenses.

Fundamental research, credit analysis, low duration, and liquidity are key tenets and goals for the Fund that seeks to strike an attractive balance between risk, opportunity and expected return. The shorter maturity profile of the Fund should protect capital going forward as there are fewer years to repayment to close the average price discount. Goals of the Fund are unchanged to reinvest capital prudently to defend and evaluate credit risk and company fundamentals against a challenging global environment.

Since inception over 15 years ago, the Fund remains US centric with coupons and repayment of principal in US dollars. The portfolio is focused on energy, transportation leasing and infrastructure. The portfolio continued to stay up in quality while generally avoiding the lowest quality credits with average credit quality in the portfolio unchanged at B1/B+. Emphasis remains on credit selection, liquidity, and downside risk mitigation versus the broader market.

The Fund is an actively managed solution with historically relatively high security turnover. This active approach to security selection and portfolio construction should also allow the Fund to avoid some of the riskiest segments of the market further mitigating downside volatility. Passive strategies may carry greater tail risk and show greater dispersion of investment returns. The Fund selectively invests in opportunities that may present lower price volatility, risk-adjusted returns in line within the mandate, investment philosophy and Fund guidelines and importantly seeks to side-step and avoid many of the risks not appreciated by markets.

Industries contributing the most to performance were Health Care, Support-Services, and Media. There were no individual issues that had an outsized positive impact on performance. Energy, Retail, and Utilities were the industries detracting the most from performance in the period. An issue in the Energy space specialising in liquefied natural gas infrastructure, that was a meaningful contributor in 2024, was again a detractor to performance as the high yield Energy sector dragged on performance in the month of April. Underperformance in Retail was driven by an ultra-luxury department store operator that provided a company update including identifying additional cost synergies, although commentary on inventory flow-through and possible new sources of liquidity appeared overshadowed by concern of tariffs and consumer demand. Within Utilities, a residential solar provider elected to defer a coupon payment on 1 April, which further pressured the bonds. The issuer also appointed an interim chief financial officer and later announced the appointment of two new independent directors. The issuer subsequently filed an 8k to enter into a forbearance agreement with creditors as the company is engaged in discussions with stakeholders.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities. Transactions in the period consisted of a new purchase in Oil & Gas Storage & Transportation, and complete sells in Automotive Parts & Equipment, Health Care Services, and Casinos/Gaming.

Market Outlook

The US economy could expand in 2025, but tariffs have become a bigger headwind than previously thought, with most strategists expecting trade policy and uncertainty to begin dragging on growth mid-year. When clarity improves, uncertainty should lessen, and spending, investment, hiring, and mergers and acquisitions (M&A) activity can resume. In addition, tailwinds such as deregulation and taxation measures still exist with productivity gains and demand tied to reindustrialisation, onshoring, and the private sector acting as other potential growth drivers.

The US high yield market, yielding more than 8%**, could deliver a coupon-like return in 2025. 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. In this environment, new issuance is expected to remain steady, and the default rate should stay below the historical average of 3-4%.

Longer-duration issues are the most likely to be impacted by high and volatile rates, but the overall high yield market should have a dampened response due to its larger coupon relative to other fixed income alternatives. As a result, US high yield bonds contribute from both a diversification and a relative performance perspective, offering a very compelling yield opportunity.

The Fund remains an attractive fixed income solution without taking excess credit risk, the shorter maturity puts securities first in line to repayment at par, and the Fund lessens price volatility that may be highly amplified in passively managed strategies.

All data are sourced from Allianz Global Investors, S&P Dow Jones Indices and FactSet, dated 30 April 2025 unless otherwise stated.

* Source: BofA Merrill Lynch, as at 30 April 2025

^ Source: J.P. Morgan, as at 30 April 2025

** Source: ICE Data Services, as at 30 April 2025

Allianz Global Investors and Voya Investment Management entered into a long-term strategic partnership on 25 July 2022, upon which the investment team transferred to Voya Investment Management. This did not materially change the composition of the team, the investment philosophy nor the investment process. Management Company: Allianz Global Investors GmbH. Delegated Manager: Voya Investment Management Co. LLC ("Voya IM").