

# 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.

### What Happened in September

The high yield market finished higher in September, driven by a dovish shift in monetary policy that stemmed from an array of new economic data. Multiple inflation measures continued to ease, consumer spending surprised to the upside, and the service sector remained in expansionary territory. However, some labour market measures were weaker, the manufacturing sector continued to contract, and consumer confidence declined. The simultaneous deceleration of inflation and jobs growth proved to be the catalyst for the first monetary easing campaign in four years, as the US Federal Reserve (Fed) cut interest rates by 50 basis points (bps) at the September Federal Open Market Committee (FOMC) meeting. Markets responded favourably, with risk assets moving broadly higher into the end of the month to solidify monthly gains.

The ICE BofA US High Yield Index returned +1.63% for the month.\*

Credit-quality subsector returns for the month\*:

- BB rated bonds: +1.09%.
- B rated bonds: +1.18%.
- CCC rated bonds: +5.20%.

Spreads narrowed to 303 basis points (bps) from 317 bps, the average bond price rose to 96.72, and the market's yield fell to 7.21%.\*

All industries advanced with Cable, Telecoms, and Media outperforming, while Energy, Autos, and Capital Goods underperformed.

Trailing 12-month default rates finished the period at 1.64% (par) and 1.35% (issues).<sup>^</sup> The upgrade/downgrade ratio increased to 1.9.<sup>^</sup>

New issuance saw 56 issues priced, raising USD 36.7 billion in proceeds.<sup>^</sup> High yield funds reported estimated net flows of +USD 3.0 billion.<sup>^</sup>

### Portfolio Review

The portfolio (net of fees) provided a positive monthly return and continued to serve as a fixed income diversifier with the goals of preserving capital, generating high income, and providing liquidity.

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 coming up on 15 years, the Fund remains US centric with coupons and repayment of principal in US dollars. The portfolio is focused on Energy, Transportation Leasing, and Infrastructure. It 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 it 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.

Performance in the period benefitted from industry weightings and a consistent fundamental credit selection framework. Industries contributing the most to performance were Air Transportation, Financial Services, and Health Care. Energy, Technology, and Cable & Satellite TV were the largest detractors from performance.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities. New purchases included issues in Casinos & Gaming, Commercial & Residential Mortgage Finance, and Other Specialty Retail. Sells consisted of issues in Integrated Telecommunication Services, Alternative Carriers, and Hotels/Resorts/Cruise Lines.

### Market Outlook

The easing cycle has begun, with the Fed cutting interest rates by 50 bps in September as inflation normalises and the labour market softens.

Apart from an accommodative shift in monetary policy, potential economic tailwinds include steady consumption, continued government spending, improving productivity, increasing capital expenditures, and the proliferation of artificial intelligence (AI). Risk to the economy may increase if these trends weaken. Other potential headwinds include escalating geopolitical tensions, prolonged labour market softening, deteriorating consumer sentiment, and continued manufacturing contraction.

The US high yield market, yielding over 7%\*\* , offers the potential for 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 prioritise debt reduction. Given these factors, the default rate has been below the long-term average with expectations for it to trend towards the historical average in 2025. Regarding credits spreads, they can stay tight for many years. This was the case in the mid-1990s and 2000s – periods like today when high yield balance sheets were healthy and defaults were low, the economy was stable, and interest rates were elevated.

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.

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All data are sourced from Allianz Global Investors, S&P Dow Jones Indices and FactSet, dated 30 September 2024 unless otherwise stated.

\* Source: BofA Merrill Lynch, as at 30 September 2024

^ Source: J.P. Morgan, as at 30 September 2024

\*\* Source: ICE Data Services, as at 30 September 2024

Allianz Global Investors and Voya Investment Management have entered into a long-term strategic partnership, and as such, as of 25 July 2022, 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").

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