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 March

High-yield bonds finished lower in March. Concerns around the pace and magnitude of tariff and government reform measures pressured markets due to their potential impact on consumer and corporate spending, economic growth, earnings, employment, and inflation. Economic reports released during the period were balanced with durable goods and factory orders, industrial production, and a key services survey all topping expectations. Conversely, consumer confidence declined, Atlanta Fed GDPNow estimates remained subdued due to imports, and a major manufacturing survey missed projections. Inflation, housing, and labour gauges were mixed. The Federal Reserve kept interest rates steady, slowed its balance sheet drawdown, and updated its economic projections to show a decrease in 2025 GDP growth estimates and an increase in 2025 inflation estimates. Against this backdrop, the 10-year US Treasury yield was largely unchanged month over month.

The ICE BofA US High Yield Index returned -1.07% for the month.*

Credit-quality subsector returns for the month*:

- BB rated bonds: -0.56%.
- B rated bonds: -1.31%.
- CCC rated bonds: -2.72%.

Spreads widened to 355 basis points (bps) from 287 bps, the average bond price fell to 94.97, and the market's yield rose to 7.88%.*

Industry performance was broadly lower with Food Producers, Utilities, and Capital Goods outperforming, while Autos, Packaging/Paper, and Real Estate underperformed.

Trailing 12-month default rates finished the period at 1.20% (par) and 0.68% (issues).^ The upgrade/downgrade ratio rose to 1.4.^

Monthly new issuance saw 37 issues priced, raising USD 26.6 billion in proceeds.^ High yield funds reported estimated net flows of +USD 2.1 billion.^

Portfolio Review

The portfolio 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 a favourable 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 a favourable 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 fifteen 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. 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 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 detracting the most to performance included Energy, Utilities, and Retail. An issue in the Energy space specialising in liquefied natural gas infrastructure, that was a meaningful contributor in 2024, received a credit downgrade prior to announcing an asset sale later in the month with use of proceeds expected to later pay down debt.

Within Utilities, a residential solar provider reported quarterly results that missed expectations, subject to a credit downgrade and bonds trading down to distressed levels. Underperformance in Retail was primarily driven by a luxury department store operator despite the issuer having strong liquidity, as retail overall has underperformed on reduced consumer confidence and escalating tariff concerns. There were no industries that had a material positive impact on performance.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities.

New purchases included issues in Diversified Chemicals and Data Processing & Outsourced Services, while complete sells consisted of an issue in Oil & Gas Storage & Transportation.

Market Outlook

In our 2025 outlook, we wrote that the equity market's path would not be linear, with bouts of volatility throughout the year. We also noted convertible securities and high yield bonds – given their defensive characteristics – could mitigate equity market weakness. This scenario materialised in Q1. The portfolio is well positioned if volatility persists without sacrificing upside participation and income-generation potential.

Tariff, government reform, and immigration measures are becoming a bigger headwind than previously thought. However, tailwinds such as deregulation and taxation measures still exist. As trade and budgetary clarity improves, uncertainty should lessen, and spending, investment, hiring, mergers and acquisitions (M&A), etc. can resume. Productivity gains, industrialisation, onshoring, and private sector demand are additional potential growth drivers.

The US high yield market, yielding nearly 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 favourable 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 favourable yield opportunity.

The Fund remains a favourable 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 31 March 2025 unless otherwise stated.

* Source: BofA Merrill Lynch, as at 31 March 2025

^ Source: J.P. Morgan, as at 31 March 2025

** Source: ICE Data Services, as at 31 March 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").