

# 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 February

Markets were mixed in February. Q4 earnings momentum persisted, with approximately three-quarters of companies topping bottom-line consensus estimates, while corporate guidance remained mixed as managements await clarity around the new administration's policies. Except for a key manufacturing survey and unemployment, both of which were better than expected, economic data generally underwhelmed. Services, retail sales, consumer confidence, and select inflation measures missed estimates. Against this backdrop, the 10-year US Treasury yield fell sharply.

The ICE BofA US High Yield Index returned +0.65% for the month.\*

Credit-quality subsector returns for the month\*:

- BB rated bonds: +0.72%.
- B rated bonds: +0.61%.
- CCC rated bonds: +0.46%.

Spreads widened to 287 basis points (bps) from 268 bps, the average bond price rose modestly to 96.52, and the market's yield fell to 7.39%.\*

Industry performance was broadly higher with Food Producers, Health Care, and Utilities outperforming, while Autos, Retail, and Chemicals underperformed.

Trailing 12-month default rates finished the period at 1.25% (par) and 0.68% (issues).^ The upgrade/downgrade ratio rose to 1.1.^

Monthly new issuance saw 26 issues priced, raising USD 18.7 billion in proceeds.^ High yield funds reported estimated net flows of +USD 2.9 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.

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 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.

Performance in the period benefitted from industry weightings and a consistent fundamental credit selection framework. Industries contributing the most to performance included Financial Services, Basic Industry & Real Estate, and Support-Services. Industries detracting the most from performance were Energy, Utilities, and Media.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities. New purchases included issues in Cable & Satellite, Broadcasting, and Trading Companies/Distributors, while complete sells consisted of issues in Oil & Gas Refining & Marketing, and Oil & Gas Storage & Transportation.

## Market Outlook

Macro factors, including newly implemented tariffs and government efficiency initiatives, could weigh on consumer spending and delay corporate investment in the near term as households and companies await clarity around current and future policies. A growth slowdown would not be unexpected if these headwinds materialise. The recent increase in equity volatility likely reflects the possibility of downward revisions to short-term earnings growth estimates.

The US economy should continue to expand in 2025, supported by earnings growth, further US Federal Reserve (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.

The US high yield market, yielding over 7%\*\*<sup>1</sup>, 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 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. Increased mergers and acquisitions (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.

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.

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All data are sourced from Allianz Global Investors, S&P Dow Jones Indices and FactSet, dated 28 February 2025 unless otherwise stated.

\* Source: BofA Merrill Lynch, as at 28 February 2025

^ Source: J.P. Morgan, as at 28 February 2025

\*\* Source: ICE Data Services, as at 28 February 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").

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