

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 August

High yield bonds finished higher in August. Q2 earnings reports for S&P 500 companies continued to surpass top- and bottom-line estimates, with quarterly earnings growth pacing for low-double-digits (versus projections for mid-single-digits) with most constituents having reported. Economic data was mixed. The Federal Reserve Bank of Atlanta's Q3 gross domestic product (GDP) estimate moved higher, the consumer price index (CPI) was below consensus, and initial claims remained subdued, while manufacturing and services surveys missed estimates, the unemployment rate ticked higher, and retail sales decelerated. Global trade remains in focus with many companies citing tariff pressures, while the Trump administration indicated that most major deals will be finalised in the next few months. The US Federal Reserve (Fed) was a focal point in August with Chair Powell's Jackson Hole speech marking a significant shift in stance, further increasing market expectations for a rate cut in September. Against this backdrop, the 10-year Treasury yield fell 14 basis points (bps) to 4.22%.

The ICE BofA US High Yield Index returned +1.22% for the month.*

Credit-quality subsector returns for the month*:

- BB rated bonds: +1.20%.
- B rated bonds: +1.15%.
- CCC rated bonds: +1.51%.

Spreads narrowed to 284 bps from 286 bps, the average bond price rose to 97.79, and the market's yield fell to 7.13%.*

Almost all industries finished higher with Energy, Health Care, and Real Estate outperforming, while Packaging/Paper, Chemicals, and Transportation underperformed.

Trailing 12-month default rates finished the period at 1.45% (par) and 1.14% (issues).[^] The upgrade/downgrade ratio fell to 0.3.[^]

Monthly new issuance saw 31 issues priced, raising USD 25.7 billion in proceeds.[^] High yield funds reported estimated net flows of +USD 1.1 billion.[^]

Portfolio Review

The Fund remains focused on offering fixed income diversification 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 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. The portfolio continued to stay up in quality while generally avoiding the lowest quality credits with average credit quality in the portfolio slightly higher at B1/BB-. 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 Energy, Financial Services, and Support-Services. Strength in Energy was broad, driven primarily by holdings in natural gas and petroleum refining that rallied. Within Financial Services, several mortgage services companies had the largest impact. Issues in building products, equipment rental, and professional services were sources of strength in Support-Services.

Retail was the only industry that detracted from performance in the period. Weakness stemmed from a luxury department store operator.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities. Transactions in the period included new purchases in Cable & Satellite, Transaction & Payment Processing Services, and Electric Utilities, and complete sells in Homebuilding and Commercial & Residential Mortgage Finance.

Market Outlook

Despite a strong recovery in risk assets, the macroeconomic outlook remains clouded given uncertainty around trade and monetary policy. On the other hand, economic data has been resilient, trade tensions while elevated have stabilised, earnings estimates appear to have inflected, the Fed's stance has shifted significantly, capital markets have been active, and government spending has emerged as a tailwind.

The US economy should expand in 2025, even with tariffs potentially hampering growth. Trade policy clarity could begin to improve and as the range of outcomes narrow, uncertainty should lessen, and spending, investment, hiring, and mergers and acquisitions (M&A) activity can resume. Further out, fiscal stimulus, deregulation measures, capital expenditure (capex) tailwinds, productivity gains, and a reindustrialisation movement are potential growth drivers.

A resumption of monetary policy easing – currently, the market is pricing in three 25-bps interest rate cuts in 2025 – would closer align the Fed with accommodation by central banks overseas. Early signs of labour market softening or minimal tariff price pass through could pull forward rate cuts, while steady employment or higher inflation could cause the Fed to move later.

The US high yield market, yielding more than 7%**, 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, spreads can stay tight, and the default rate should continue to reside below the historical average.

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 31 August 2025 unless otherwise stated.

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

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

** Source: ICE Data Services, as at 31 August 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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