

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 May

High yield bonds finished higher in May. Momentum from April's mid-month rally persisted, as tariff tensions eased following announcements of de-escalation measures with both China and the UK. The earnings season wound down over the month with most of the remaining high profile companies surpassing analyst expectations. Q1 top- and bottom-line growth rates exceeded consensus estimates although many companies pulled or reduced full-year guidance on trade-related uncertainty. Economic reports released during the month were generally positive. Inflation measures decelerated, consumer confidence increased, the services sector rebounded, unemployment remained low, and Q2 estimates for real gross domestic product (GDP) growth neared 4%. Conversely, continuing jobless claims trended higher, retail sales underwhelmed, and select housing statistics remained weak. Against this backdrop, the US Federal Reserve (Fed) held interest rates steady at May's Federal Open Market Committee (FOMC) meeting, taking a "wait-and-see" approach, and the 10-year US Treasury yield increased to 4.39% but finished well off the intramonth high of 4.63%.

The ICE BofA US High Yield Index returned +1.68% for the month, bringing year-to-date performance to +2.65%.*

Credit-quality subsector returns for the month*:

- BB rated bonds: +1.52%.
- B rated bonds: +1.44%.
- CCC rated bonds: +3.17%.

Spreads narrowed to 332 basis points (bps) from 394 bps, the average bond price rose to 95.65, and the market's yield fell to 7.75%.*

Industry performance was broadly higher with Media, Energy, and Telecoms outperforming, while Cable, Food Producers, and Metals underperformed.

Trailing 12-month default rates finished the period at 1.33% (par) and 1.03% (issues).[^] The upgrade/downgrade ratio rose to 1.1.[^]

Monthly new issuance saw 35 issues priced, raising USD 32.0 billion in proceeds.[^] High yield funds reported estimated net flows of +USD 5.6 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 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 Air Transportation, Financial Services, and Technology & Electronics. A commercial airliner that announced a partnership aided outperformance in Air Transportation. Outperformance in Financial Services was broad-based, with issues in heavy equipment leasing, mortgage services, and payments having the largest impact. A trading platform operator drove performance in Technology & Electronics.

Industries detracting the most from performance were Energy, Retail, and Steel Producers/Products. An issuer in Energy specialising in liquefied natural gas infrastructure remained under pressure after missing Q1 earnings expectations. An ultra-luxury department store operator weighed on Retail but finished off intra-month lows after announcing new financing commitments. There were no notable detractors in Steel Products/Producers, an industry that could potentially benefit from steel tariffs.

Liquidity remained in focus to pay distributions, meet redemptions and to take advantage of reinvestment opportunities. Transactions in the period consisted of new purchases in Passenger Ground Transportation, Gas Utilities, and Tires/Rubber, and complete sells in Passenger Airlines, Hotels/Resorts/Cruise Lines, and Oil & Gas Storage & Transportation.

Market Outlook

Despite May's notable strength in risk assets, the macro outlook remains uncertain.

The US economy is still expected to expand in 2025 with widespread effects from tariffs hampering growth. Clarity around trade policy is unlikely to improve in the near term, but as the range of outcomes continue to narrow, uncertainty should lessen, and spending, investment, hiring, and mergers and acquisitions (M&A) activity can resume. Further out, fiscal stimulus, deregulation measures, productivity gains, and a reindustrialisation movement are potential growth drivers.

The Fed likely remains on hold as officials continue to assess the effect of tariffs on inflation, employment, and the potential for stagflation. Inflation has slowed but concerns of a second wave have risen due to tariffs. Steady employment is possible if less hiring is met with less layoffs. A resumption of monetary policy easing – currently, the market is pricing in two 25-bps interest rate cuts in 2025 – would closer align the Fed with accommodation by central banks overseas.

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, 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.

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All data are sourced from Allianz Global Investors, S&P Dow Jones Indices and FactSet, dated 31 May 2025 unless otherwise stated.

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

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

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