

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 December

High yield markets finished lower in December. The US Federal Reserve (Fed) cut its benchmark interest rate by 25 basis points (bps) to a range of 4.25-4.50%. However, the central bank also updated its summary of economic projections for 2025, decreasing its forecast for interest rate cuts and employment, while increasing its forecast for real gross domestic product (GDP) growth and inflation. On the economic front, nonfarm payrolls, small business optimism, and consumer sentiment rose, and inflation measures were generally in line with estimates. On the other hand, regional manufacturing gauges missed expectations. Against this backdrop, the 10-year US Treasury yield rose, steepening the yield curve and pressuring risk assets and core fixed income.

The ICE BofA US High Yield Index returned -0.43% for the month.*

Credit-quality subsector returns for the month*:

- BB rated bonds: -0.65%.
- B rated bonds: -0.32%.
- CCC rated bonds: +0.19%.

Spreads widened to 292 bps from 274 bps, the average bond price fell to 95.48, and the market's yield rose to 7.65%.*

Industry performance skewed lower with Telecoms, Transportation, and Media outperforming, while Cable, Real Estate, and Energy underperformed.

Trailing 12-month default rates finished the period at 1.47% (par) and 1.02% (issues).^ The upgrade/downgrade ratio increased to 1.0.^

New issuance saw 17 issues priced, raising USD 11.5 billion in proceeds.^ High yield funds reported estimated net flows of -USD 3.7 billion.^

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 tenants 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 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 Energy, Media, and Technology & Electronics. Utilities, Automotive, and Retail 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 Commercial & Residential Mortgage Finance, Trading Companies/Distributors, and Automobile Manufacturers. There were no complete sells in the period.

Market Outlook

The US economy should continue to expand in 2025, supported by earnings growth, further 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%** , 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 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. 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 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 strategy 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 December 2024 unless otherwise stated.

* Source: BofA Merrill Lynch, as at 31 December 2024

^ Source: J.P. Morgan, as at 31 December 2024

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