Allianz Global Investors

Allianz Euro High Yield Defensive

Monthly commentary

Summary

- The Euro High Yield market posted a strong performance for a 4th month in a row (+0.31% for the ICE BofAML BB-B Euro Non-Financial High Yield Constrained Index / HEC5);
- The fund slightly underperformed its benchmark (ICE BofA BB-B Euro Non-Financial High Yield Constrained Index – HEC5) on a gross basis, with a beta slightly below 1;
- If disinflation sticks to its current path and a soft (or no) landing scenario remains valid, the appetite for risk assets should remain and volatility suppressed; in this context, we are maintaining a decent risk position to benefit from the carry while keeping an adequate credit selection to avoid negative specific credit stories.

Market environment

European bonds weakened as hopes faded that the European Central Bank may cut rates in March. The yield on the 10-year German Bund touched a three-month high of 2.5% mid-month, before closing February around 2.40%, some 25 basis points higher than its level at the end of January. Peripheral euro-zone bonds outperformed core bonds, particularly Italian debt (source all data points: Trading Economics).

The flash estimate of the HCOB euro-zone composite purchasing managers' index (PMI) improved further in February, rising to an eight-month high of 48.9. Service sector activity jumped to 50.0, the highest level in seven months. While manufacturing activity deteriorated to 46.1, it indicated activity had improved from last year's late-summer slump. The European Commission revised down its growth and inflation projections, saying it expected the euro-zone economy to grow by 0.8% in 2024, down from a prior estimate of 1.2%, while inflation is now forecast to fall to 2.7%, from a previous estimate of 3.2% (source all data points: Detstatis).

February posted a quite positive tone for the European High Yield markets. Market consensus is still focusing on the downward trend of inflation in Europe and still robust US macroeconomic data have supported risk assets, including equities. To illustrate this, the negative news coming from New York Community Bank in the US and its commercial real-estate exposure related impairments did not ignite any sustainable episode of volatility, as the event remained contained to this specific credit story. Consequently the market kept on performing, leaning on last months' positive momentum and despite an upward pressure on interest rates, mainly driven by the strong economic metrics published in the USA. The European High Yield market has also been supported by decent positive flows into the asset class, and still quite positive quarterly results released by corporates globally. This translated into a tightening in spreads across the investment universe, combined with compression between low and high rated issuers. Primary market was also active, with corporates and financial issuers catching the opportunity to issue bonds at tighter spread levels, mostly for refinancing purposes. Similarly to last month, market has been constructive about these new issues. Liquidity is still well supported.

The Euro High Yield market posted a strong performance for a 4th month in a row (+0.31% for the ICE BofAML BB-B Euro Non-Financial High Yield Constrained Index / HEC5).

By rating, higher rated BBs (+0.17%) underperformed lower quality Bs debt (+0.66%). By sector, real estate (+1.5%), retail (+1.1%) and leisure (+0.9%) outperformed, while technology (-1.4%), energy (0.0%) and basic industry (+0.1%) underperformed in relative terms. The ICE BofAML BB-B Euro Non-Financial High Yield Constrained index tightened from 344 to 303 bp during the month (spread-to-worst vs Government, source Bloomberg).

Performance, activity, positioning

The fund slightly underperformed its benchmark (ICE BofA BB-B Euro Non-Financial High Yield Constrained Index – HEC5) on a gross basis, with a beta slightly below 1.

During the month, the fund has been notably positively impacted by its underexposure – or lack of exposure - to Atos, Bayer hybrids, and its overexposure to Teva and United Group. It has been negatively impacted by its overexposure to Forvia and its underexposure to Catalent or British American Tobacco hybrids.

The fund was active on the secondary market during the month and added exposure notably to issuers such as Altice France, Elia hybrid, Air France, Telecom Italia. It reduced its positions to issuers such as VodafoneZiggo, Séché Environnement, Boels and Consolidated Energy. The fund participated to new issues from Forvia, Citycon (Senior) and TUI.

Outlook

Central banks seem to keep their cautious stance regarding their monetary policies, as uncertainty about macroeconomic figures keep on giving contradictory directions. However, if disinflation sticks to its current path and soft - or no - landing scenario remains valid, the appetite for risk assets should remain and volatility suppressed. Concerning spreads, valuations are still fair to slightly rich in particular for some well rated corporates, in line with the low volatility environment in both rates and equities. In this context, we are maintaining a decent risk position to benefit from the carry while keeping an adequate credit selection to avoid negative specific credit stories. Primary market should remain active in the weeks to come, with corporates still benefiting from decent environment and demand to refinance their short-dated debt.

Opportunities

+ Particular yield potential of high-yielding corporate bonds
+ Capital gains opportunities on declining market yields
+ Minimum rating requirements foster overall credit quality
+ Attractive profile through active sector selection
+ Broad diversification across numerous securities and single issuers
+ Possible extra returns through single security analysis and active management

Risks

– Bonds suffer price declines on rising interest rates
– High-yielding corporate bonds entail above-average risk of volatility, illiquid markets and capital loss. The fund unit price may be subject to increased volatility.
– Minimum rating limits yield potential
– Sector profile may prove disadvantageous at times
– Limited participation in the yield potential of single securities and issuers
– Success of single security analysis and active management not guaranteed