

Allianz US High Yield

Fund manager
commentary

July 2017



Doug Forsyth
Fund manager

Summary

- US high-yield market advanced for the month of July.
- Allianz US High Yield ended the month higher (in USD terms) but behind its market segment.
- The US economy is expected to expand at a moderate pace in 2017 with the stock market's strength and the Treasury's yield curve confirming this notion. The Fed path, earnings trends, commodity prices and global growth will all influence the outlook.

Market environment

The high-yield market advanced for the month. The BofA Merrill Lynch High Yield Master II Index returned 1.15% and the BofA Merrill Lynch BB-B U.S. High-Yield Constrained Index underperformed the Master II because higher-quality credits lagged the lowest-quality credits. Credit-quality subsector returns for the month were: BB rated bonds returned 1.01% as B rated bonds returned 1.08% and CCC rated bonds returned 1.83%. Spreads tightened 16 basis points to 361. The rally in high-yield bonds accelerated in July alongside record highs in stocks. Industry strength was broad-based although commodity-related issuers were notable outperformers. A weaker dollar and favorable supply/demand dynamics helped lift select base metal and crude oil prices, which supported these issuers. A strong start to the second-quarter earnings season and a benign FOMC statement positively influenced investor sentiment and appetite for risk assets. Outperformance of CCC rated bonds was a function of this development. Slower new issuance for the month helped support secondary market activity. Leading indicators and weekly jobless claims along with other data releases signaled continued economic expansion. The stronger-performing industries were Metals/Mining Ex Steel, Steel Producers/Products and Energy as weaker-performing industries were Food & Drug Retailers, Trucking & Delivery and Theaters & Entertainment. Thirty-three new issues priced in the month, raising \$15.7 billion in proceeds and mutual-fund net flows were \$0.5 billion. There were no defaults in the month. The trailing 12-month (TTM) default rate by issuer was 3.15%. By dollar volume, the default rate was 1.21%. Finally the upgrade-to-downgrade ratio decreased to 0.9 with 16 up to 18 down.

Performance analysis

The fund posted a positive return lagging its market segment. Industry performance was predominantly positive with most issues trading higher during the month. An underweight in CCC rated bonds was a headwind as the lowest-quality credits outperformed. Industry exposure that helped: Chemicals, Financial Services and Telecom - Wireless. In Chemicals, issue selection was the driver of outperformance. All portfolio holdings closed higher, but an upside outlier was a chemical producer that reported above-consensus revenues and earnings due to favorable pricing trends and strengthening end-market demand. In Financial Services, gains were broad-based in the portfolio and contributed to positive issue selection. A student loan servicer with stable underlying fundamentals topped earnings expectations.

Allianz 
Global Investors

**INFORMATION FOR FUND DISTRIBUTORS
AND INSTITUTIONAL INVESTORS ONLY.**

In Telecom - Wireless, the portfolio's return was higher than the peer group and an underweight was additive also. A wireless carrier that reported a better-than-expected profit was a top contributor. Industry exposure that lagged: Telecommunications, Support-Services and Healthcare. In all three industries, the portfolio's return was higher on an absolute basis, but trailed the respective peer group. In Telecommunications, a voice and data network services provider traded lower; quarterly results were generally in line with consensus expectations, however. In Support-Services, there were no outliers with all portfolio holdings closing higher for the month. In Healthcare, an acute care facilities operator was under pressure due to proposed payment structure changes.

Portfolio strategy and activity

Buys/sells: Purchases and sales were limited. A semiconductor company was purchased. Sales included issues that were called.

Outlook

From a fundamental standpoint, as well as the observed condition of the economy, defaults in 2017 and 2018 are expected to remain below their long-term historical average. Spreads ended the month at 361 basis points over comparable Treasuries - narrowing in the month, but not materially. This stage of the market cycle can be compared to the mid-1990s and mid-2000s - market environments that exhibited economic stability, low defaults and healthy balance sheets.

Stress in select industries of the market has waned, and overall, balance sheets, leverage ratios and interest-coverage ratios continue to support an investment in the asset class. Furthermore, less than 13% of the market matures before 2020. This amount is well below the average annual new issuance over the past five years.

The US economy is expected to expand at a moderate pace in 2017 with the stock market's strength and the Treasury's yield curve confirming this notion. Moreover, positive tax reform, decreased regulation and / or increased fiscal spending could result in even stronger economic growth. After bottoming in the second quarter of 2016, corporate profits have accelerated through the first quarter of 2017. Based on bottom-up estimates, they are poised to trend higher throughout year.

US monetary policy continues to be modestly accommodative with the Fed expected to take a gradual approach toward policy adjustments. Additional interest rate hikes and balance sheet reduction efforts would signal confidence in the US economy's ability to grow. The purpose of these adjustments would be to achieve a normalized environment after an extended period of extreme accommodation. Until the Fed either moves aggressively or is well into the tightening cycle, monetary policy should not be expected to drive an extended sell-off and spread-widening in high yield. Notably, in the past 30 years, the US has not fallen into recession, nor have high-yield spreads moved substantially higher, without being preceded by an inverted yield curve. The difference between the three-month Treasury bill and the 10-year Treasury note remains accommodative for growth. Outside of the US, global monetary policy continues to be constructive.

Relative value within the rating categories can be viewed as the composite of all of the factors expected to affect the market. B-rated issuers offer the most attractive balance between return and risk without sacrificing the benefits of interest-rate diversification. It is worth noting that higher interest rates are likely to have the greatest impact on the more narrow-spread and generally higher-rated issues in the high-yield market. CCC-rated bonds are the least compelling of the three credit-quality buckets due to their elevated exposure to default risk in conjunction with a tighter-than-average spread. It is prudent to be highly selective when choosing to invest within this subcategory. From an asset-class perspective, the relative value proposition of US high-yield bonds is clear. With US Treasuries and US investment-grade corporates yielding 2.3% and 3.2%, respectively at month-end, and trillions worth of debt globally yielding even less, the 6.0% yield of the US high-yield market is a compelling opportunity for both international and domestic investors alike.

Among fixed-income alternatives, high-yield bonds should contribute from both a diversification and a relative-performance perspective. In 2017, a coupon-like return can be achieved. Interest rates should not have a significant impact on the high-yield market given the relative average spread and dollar market price today. The Fed path, earnings trends, commodity prices and global growth will all influence the outlook.

Opportunities

- + Particular yield potential of high-yielding corporate bonds
- + Capital gains opportunities on declining market yields
- + Currency gains against investor currency possible in unhedged unit classes
- + Broad diversification across individual securities
- + 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 sharply increased volatility.
- Currency losses against investor currency possible in unhedged unit classes
- Limited participation in the potential of individual securities
- No guarantee that single security analysis and active management will be successful

Important notes:

A performance of the strategy is not guaranteed and losses remain possible. A security mentioned as example above will not necessarily be comprised in the portfolio by the time this document is disclosed or at any other subsequent date. This is no recommendation or solicitation to buy or sell any particular security. Data gross of fees; calculation at the net asset value (BVI method) based on the assumption that distributions are reinvested and excludes initial charges. Individual costs such as fees, commissions and other charges have not been taken into consideration and would have a negative impact on the performance if they were included. Past performance is not a reliable indicator of future results. **Calculation based on the most expensive share class.** The statements contained herein may include statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. We assume no obligation to update any forward-looking statement.

Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors may not get back the full amount invested.

Investment in fixed-income securities may entail various risks for investors including, but not limited to, credit status risk, interest-rate risk, liquidity risks and the risk of limited flexibility. Changes in the business environment and market conditions may affect these risks, with a negative impact on the value of the investments. In periods of rising nominal interest rates, the value of fixed-income securities (including short positions on fixed-income securities) is generally expected to fall. Conversely, in periods of falling nominal interest rates, the value of fixed-income securities is generally expected to rise. Liquidity risks may result in account pay-outs or pay-backs being delayed or prevented. Allianz US High Yield is a sub-fund of Allianz Global Investors Fund SICAV, an open-ended investment company with variable share capital organised under the laws of Luxembourg. The value of the shares which belong to the Share Classes of the Sub-Fund that are denominated in the base currency may be subject to an increased volatility. The volatility of other Share Classes may be different and possibly higher. Past performance is not a reliable indicator of future results. If the currency in which the past performance is displayed differs from the currency of the country in which the investor resides, then the investor should be aware that due to the exchange rate fluctuations the performance shown may be higher or lower if converted into the investor's local currency. This is for information only and not to be construed as a solicitation or an invitation to make an offer, to conclude a contract, or to buy or sell any securities. The products or securities described herein may not be available for sale in all jurisdictions or to certain categories of investors. This is for distribution only as permitted by applicable law and in particular not available to residents and/or nationals of the USA. The investment opportunities described herein do not take into account the specific investment objectives, financial situation, knowledge, experience or specific needs of any particular person and are not guaranteed. The views and opinions expressed herein, which are subject to change without notice, are those of the issuer companies at the time of publication. The data used is derived from various sources, and assumed to be correct and reliable, but it has not been independently verified; its accuracy or completeness is not guaranteed and no liability is assumed for any direct or consequential losses arising from its use, unless caused by gross negligence or wilful misconduct. The conditions of any underlying offer or contract that may have been, or will be, made or concluded, shall prevail. For a free copy of the sales prospectus, incorporation documents, daily fund prices, key investor information, latest annual and semi-annual financial reports, contact the management company Allianz Global Investors GmbH in the fund's country of domicile, Luxembourg, or the issuer at the address indicated below or www.allianzgi-regulatory.eu. Please read these documents, which are solely binding, carefully before investing. This is a marketing communication issued by Allianz Global Investors GmbH, www.allianzgi.com, an investment company with limited liability, incorporated in Germany, with its registered office at Bockenheimer Landstrasse 42-44, 60323 Frankfurt/M, registered with the local court Frankfurt/M under HRB 9340, authorised by Bundesanstalt für Finanzdienstleistungsaufsicht (www.bafin.de). The duplication, publication, or transmission of the contents, irrespective of the form, is not permitted.