Fund Commentary

Allianz Income and Growth

02/2014

Investment Objective

The Fund's investments are concentrated in a combination of common stocks and other equity securities, debt securities and convertible securities.

What Happened in January

The high yield, convertible and equity markets were mixed for January 2014. The BofA Merrill Lynch All US Convertibles Index and the Russell 1000 Growth Index returned 1.7% and -2.9%, respectively. The BofA Merrill Lynch US High Yield Master II Index increased 0.7%. By way of comparison, the 10-year Treasury rose 3.2% and the S&P 500 declined 3.5%.

Overall, credit-market strength and a quick drop in Treasury yields helped high-yield bonds and convertibles weather a decline in both sentiment and the equity markets. Investors were confronted with economic data indicating slower growth and emerging-market headwinds. The Federal Reserve (Fed) announced additional asset-purchase reductions for February, but continued to reinforce expectations for ongoing accommodative central-bank policies. Regarding Q4 2013 earnings, corporations have delivered healthy results thus far. Separately, the high-yield bonds and convertibles provided diversification benefits in the face of equity market weakness.

In convertible market environment, non-investment-grade issuers outperformed investment-grade issuers. Bond-like or busted convertibles outperformed total-return convertibles. Healthcare, technology and transportation sectors were outperformers. On the contrary, sectors such as consumer staples, energy, materials and media were underperformers. New issuance of convertibles was light in January 2014 with four new deals pricing for USD 0.8 billion in proceeds.

In the high-yield bond market environment, spreads widened by approximately 20 basis points month over month. The stronger-performing industries were paper, airlines and healthcare. The weaker-performing industries were super retail, apparel or textiles and environmental. Sixty new issues priced in the month, raising USD 33.2 billion in proceeds. No issuers defaulted in the month. The trailing 12-month (TTM) default rate by issuer is 1.86%. By dollar volume, the default rate is 0.63%.

All but two sectors closed negative for the month. HealthCare and Utilities were the only sectors to record gains. In contrast, consumer discretionary, consumer staples and materials underperformed by the greatest magnitude. The Chicago Board Options Exchange Volatility Index (VIX) spiked concurrent with equity market weakness. The VIX ended the reporting period at 18.41 after starting the month at 13.72.

Allianz Global Investors

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Market Outlook and Strategy

The outlook for the equity, the convertible and the high-yield markets are unchanged and constructive. Q4 2013 earnings so far have been better than expected. Corporate balance sheets remain strong, with leverage ratios and interest-coverage ratios consistent with, or better than, levels seen in the past 20 years. In addition, corporate-balance-sheet cash levels remain high.

Forecasts of economic statistics point to moderate economic growth for 2014. Weather appears to be creating a headwind early Q1 2014, but we have seen an uptick in capital expenditures and acquisition activity is ongoing. Lower-coupon new issues have produced a lower semi-annual interest expense burden, and the widespread availability of new capital has eliminated near-term amortisation risk for most issuers. The Federal Reserve reiterated its long-term commitment to keep short rates low.

Companies are expected to use both the high cash levels on their balance sheets and future free cash flow to boost shareholder value. Share buybacks, dividends, and merger and acquisition activity are possible uses of excess cash. These factors would benefit equity and convertible investors. Security selection will be the key to performance.

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