Allianz Multi Asset Long / Short

Fund manager commentary

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Summary

- Global equities and global bonds rallied over the first quarter. Central banks' dovish statements provided some support for both. In currencies, dovish comments from the USD Fed and ECB also served to support the Japanese Yen (JPY), while volatility in the British Pound (GBP) reflected the constantly changing expectations around the Brexit. Oil prices rallied, with Brent crude reaching a peak on worries over the impact of US sanctions on Venezuela and Iran also helped to buoy prices.
- The fund's performance was moderately negative (in EUR terms). Positive drivers were our long positions in bond futures. Main detractors were within commodities, currencies as well as short positions in global equities.

Market environment

Global equities rallied strongly over the first quarter of 2019, rebounding from their sharp sell-off at the end of 2018 as many markets recorded their strongest quarterly gains since 2010. Sentiment was lifted by hopes of improved trade relations between the US and China and a dovish tone from major central banks. However, the rally slowed as the quarter progressed amid growing concerns over the outlook for global growth.

Global bonds rallied. Yields moved decisively lower to touch multi-month lows, boosted by monetary policy U-turns from the US Federal Reserve and European Central Bank. The 10-year US Treasury yield slipped below 2.4%, touching its lowest level since December 2017, while the yield on the 10-year German Bund traded below zero for the first time since late 2016. With 10-year Japanese government bond yields moving back below zero, the total amount of global bonds trading on negative yields rose above USD 10 trillion for the first time since September 2017. Corporate bonds outperformed government bonds as credit spreads narrowed. With economic data indicating that global growth was weakening and inflation easing, central banks became increasingly dovish. In March, the US Federal Reserve signalled that it would refrain from raising rates throughout the rest of 2019 and slowed the pace of its monthly reductions of the bond holdings it had amassed as part of its quantitative easing policies. In the same month, the European Central Bank pledged to hold rates until the end of 2020 and reinstated its policy of offering cheap long-term loans to banks. During the quarter, the People's Bank of China also injected a record amount of liquidity into China's economy and cut the reserve requirement ratio for banks, while the Chinese authorities announced further stimulus measures.

Oil prices rallied, with Brent crude reaching a peak of just above USD 68 a barrel. OPEC and Russia pledged to cut oil production and worries over the impact of US sanctions on Venezuela and Iran also helped to buoy prices.

The pound advanced, buoyed by speculation that Brexit would be delayed and that the UK would achieve a softer outcome rather than leave the EU without a deal. In contrast, with the US Federal Reserve and European Central Bank becoming more dovish, both the USD and Euro declined against the Sterling. The Japanese yen also closed the quarter lower, despite strengthening modestly amid rising demand for safe haven assets in March.

Performance analysis and strategy

In this market environment, the fund's performance was moderately negative (in EUR terms). The strategy retreated sharply during the risk-on market of January, but increased strongly in the month of March. Primary positive drivers of performance during the reporting period were our long positions in bond futures, especially in the US, Europe, Canada and Australia. In contrast, the main detractors were our exposure to metals and the energy sector. In addition, the positioning in currencies (Japanese Yen, Canadian Dollar and Great Britain Pound) as well as our short positions in global equities hurt the fund's performance during the first quarter of 2019.

From an asset allocation perspective, our net exposure to equities started the quarter at about –34% and was progressively reduced to a short position of approximately –13% by the end of January. During the month of February, we switched to a net long position, ending at about +10% by the end of the month. As per end of the quarter, the net long position has been increased to about +18% as risky assets continued to rally. Additionally, we started the first quarter with a long position in VIX futures and went short during the second part of the quarter by ending the month of March with a small short position of approximately 1%.

In contrast, global bond exposure began the quarter with a net long positon of roughly 140%, fluctuated in January and February, but ended the reporting period at a higher level of about 150% due to a strong bull market in duration. In credits, the short position in US high yields was eliminated during the month of January, turning into a long position of approximately 7% by the end of February, while it was further increased to about 11% by the end of March. Similarly, we went long in emerging market credits at about 8% by the end of January and increased the position to 13% in February and further in March, ending the month with a net long position of about 15%. Within currencies, we began the new year with a approximately 50% short position in international currencies versus the US Dollar. While the positions were rather volatile during the first two months, the overall position was reduced to about 30% by the end of March. From an commodities perspective, we began the quarter with significant short exposure to the oil and the industrial metals sectors at about -3% and -8% respectively. However, during February these positions were reduced considerably to an approximately neutral position where they stayed until March as oil prices rose together with the risk-on rally. Natural gas was however long during the reporting period, starting at about 2%. After reductions during the months of January and February, the exposure was raised again in March, ending the month at about 1%. For precious metals, we began the reporting period with a net short position of about -6% which was eliminated by the end of January. By the end of February, the exposure was raised to about 5% again, ending the month of March at a rather neutral level.

Overall, the performance of the fund during the reporting period was mainly based on the systematic trend-based component according to scores we retrieved from our Market Cycle Analysis. Therefore, as scores for global equities improved at the beginning of the year and continued to advance, their market cycle scores strengthened over February and March across the board. Consequently, we ended the quarter with a moderate long position in global equities. In commodities, oil's short term advance led the score to increase from a negative reading during the first two months of the quarter to a neutral one in March which was also displayed in our portfolio positioning. Gold started in positive territory, while its price decline in the last month contributed to a reduction in scores from positive to neutral. Therefore, the portfolio also ended the quarter at a neutral level. In the fixed income part, declining yields led their market cycle scores to strengthen across the quarter. In credits, scores for high yielding bonds and emerging market bonds also improved and remained strongly positive at the end of March. In currencies, the scores for the US Dollar remained generally favourable, as scores for the USD/EUR and the USD/JPY pairs remained unchanged, while the USD/JPY moved further in support of the dollar. Therefore, our short positioning in international currencies against the USD was moderately reduced during the period, but is still in place.

From a fundamental view, in the light of continued macro and political uncertainty, we are neutral on most global equity indices. Against a backdrop of relatively weak fundamentals, markets are supported by dovish central banks and lower interest rates. For global fixed income, it is still too early to diverge from our neutral fundamental view in light of markets being driven by monetary policy rather than economic data. Risky assets including credit continued well, which intensifies our focus on risks related to valuations across credit segments. Although we maintain neutral fundamental view on US and Euro sovereigns, we are positive on emerging markets debt (both local and hard currency) while closely monitoring possible spillover effects from Turkey. We have maintained a neutral profile on commodities with the exception of a brief overweight in gold. Our positive view on gold was motivated by tailwinds of an accommodative Fed policy, expectation of lower rates and our cautious stance on the USD. An underweight to the USD is driven by our midterm outlook, dominated by valuation and structural components like the large U.S. current account deficit. Albeit, the USD gained momentum again last month. Despite dovish statements by the Fed and a higher recession probability, the USD appreciated against most G10 currencies. The JPY was supported by risk aversion but economic indicators continue to disappoint. All in all, the outlook is rather balanced for the months to come.

Opportunities

+ Prospect for attractive risk-adjusted return throughout the market cycle
+ Flexible use of different high-opportunity asset classes
+ Potential exploitation of rising and falling asset prices through combination of long and short positions

Risks

– Positive return or capital preservation not guaranteed. The fund unit price may be subject to strongly increased volatility.
– Above-average fluctuations and risk of loss particularly in high-opportunity asset-classes
– Above-average risk of loss in alternative investment strategies employing derivatives and long/short strategies

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