The impact of Liberation Day on trade finance

The Allianz Working Capital ("ALWOCA") strategy was set up to be a **global diversified strategy with the ability to adapt to changes in the geopolitical landscape**. We believe that there should be minimal impact to the portfolio from the "Liberation Day" announcements through its inherent diversification across various regions and sectors, although we **continuously review all positions and are conducting increased due diligence** in the limited areas where we believe risk may have become more elevated.

What is the direct impact of tariffs?

To put this in context; around 45% of the strategy has payables/receivables that are cross-border globally. Specifically, cross-border into the United States is c10%.

Of the US cross-border business, we do not expect an immediate change in the buyer/supplier relationships as any changes will take time and will be nuanced to specific sectors and countries and the level of tariff vs the cost of changing supply chains. Where the US business is supply-chain finance, it is possible that any new supplier may need financing, and the buyer credit risk remains the same. Nevertheless, this is an area of ongoing diligence.

Turning to corporate fundamentals, the consensus view is that it is likely that technology, auto suppliers and retail will be most impacted by tariffs. However, the risk of tariffs wasn't an unknown and a lot of our exposure in these sectors was BB or investment grade. Our B-rated exposure across these sectors is below 10% without undue single name concentration. By virtue of their rating, these credits were already subject to close due diligence. Within the B-sector we include the You Lend, Sports & Media Finance all of which should not be impacted by tariffs, so the remaining corporate B exposure is not excessive and well-diversified.

Key takeaways

- With a structural imbalance in the demand for and the supply of trade finance, we do not see our ability to source assets as being impaired.
- ALWOCA should get tail winds from front end movements versus cash due to the lag effect of c110 days across the portfolio.
- Longer term we do not see a dislocation in the relative value of the asset class versus BB high yield.

Navigating Rates

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What is the indirect impact of tariffs?

Consensus global growth estimates have been shaved by approximately 1% annually (assuming no negotiations to lower the impact) and recession probabilities have risen to 25-35% (Source: JP Morgan, Goldman Sachs). However, we do not see this as a watershed moment of pain as the starting point is one of relative strength. Corporate fundamentals are reasonable, interest rates are not excessive, and unemployment rates are low. With a structural imbalance in the demand for and the supply of trade finance, we do not see our ability to source assets as being impaired. The insurance market and bank providers of trade finance is often pro-cyclical with desks reducing exposure if economies are seen as slowing. Potentially this could provide new opportunities for us in terms of pricing and new credits to review.

Relative attractiveness of the asset class

Compared to 1 month ago, US front end cash rates are broadly unchanged; but the 10yr Treasury has fallen c30bp - so the current relative value of front-end rates is more attractive again but this is probably only short term. Forward market expects US cash rates to fall 70bp over the next 12months, while expectations for the 5yr and 10yr are virtually unchanged (Source: Bloomberg). To put this in context, in a year's time the market expects cash rates slightly below the 5yr and 10yr levels, but not much. In the meantime, Allianz Working Capital strategy should get tail winds from front end movements versus cash due to the lag effect of c110 days across the portfolio.

Credit spreads have widened: but only to c240bp for global BB corporates with 3.6yrs duration (Source: ICE HW10 index) vs 110 days for ALWOCA. Most strategists expect further widening of high yield spreads. While the relative value of the Allianz Working Capital strategy spreads may suffer in the short term as public markets adjust more rapidly, we would expect wider available spreads in trade finance with a roughly six-month delay if we do see a deterioration in the economy. If, there is a reversion to "normality", public spreads would of course tighten. Thus, longer term we do not see a dislocation in the relative value of the asset class versus BB high yield. If one takes a bearish view and believe a recession is imminent, we believe that higher expected recovery rates in trade finance, are another reason to refer the asset class versus public credit.

We believe that as volatility is likely to continue, this supports a conservative positioning in a short spread and rates duration portfolio such as the Allianz Working Capital strategy.

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