Asian Fixed Income
"EM Light" for Global Investors

First Sentier Investors

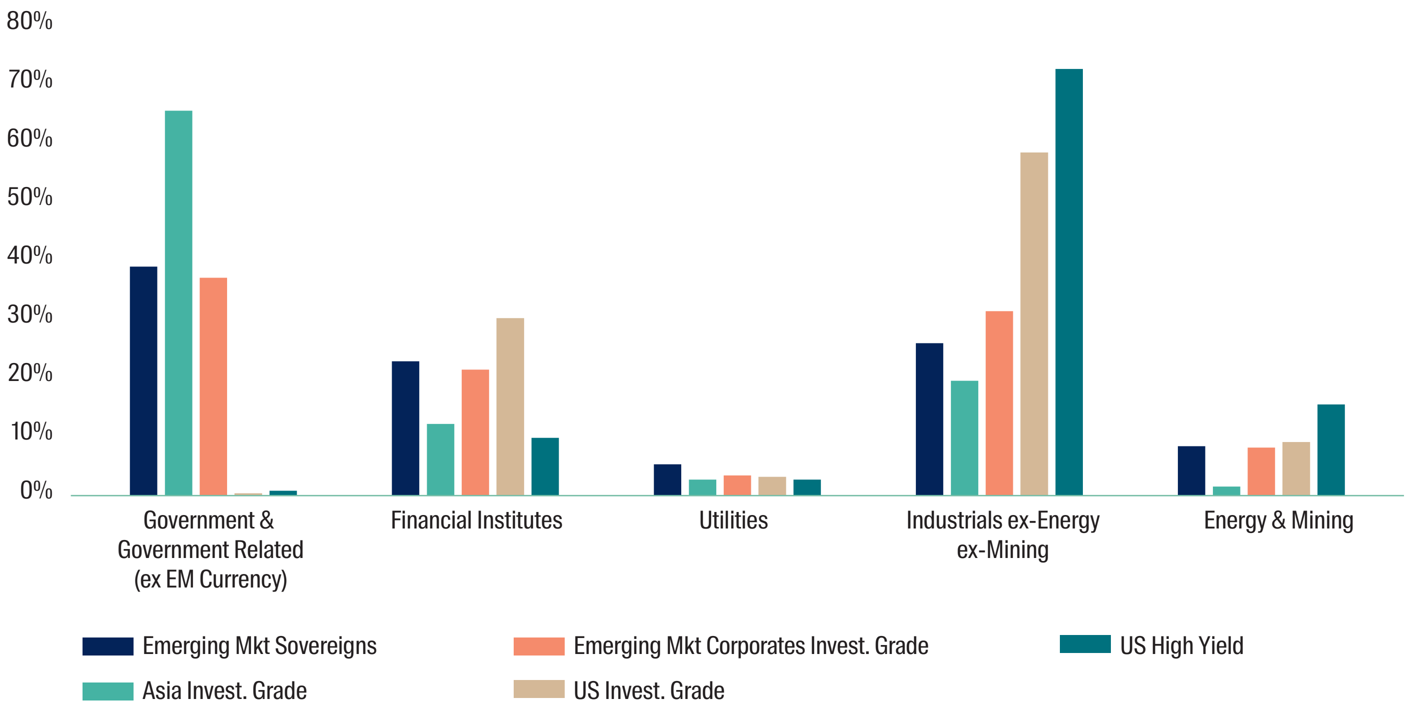
Introduction

We believe bond market demand in Asia represents an opportunity for fixed income investors. There are many factors driving this positivity; Asia's strong growth outlook relative to other parts of the world, its demographics, the diversification within the universe of issuers and compared volatility and returns with other fixed income markets. As we look towards a post-Covid world, what case can be made for investing in Asia USD Investment Grade Credit?

Stability

In 2017 we assessed the volatility of returns for Asia Fixed Income, comparing to US investment grade. The research showed that as the market has continued to mature, the volatility profile continues to mirror that of US Investment Grade Credit. Step forward to today and this relationship is set to continue and in our assessment is driven by several key factors. Firstly the type of issuers that dominate, and hence make the largest part of benchmarks, are Government Related / State Owned Enterprises. Chart 1 shows that for Asia USD Investment Grade Credit this industry/sector has the highest market value. Given the government ownership, these companies are inherently less risky than general corporates. We do not believe in treating them all the same or placing all of our trust in the ownership structure. Each issuer has the same level of scrutiny as any corporate and we seek to invest in those State owned Enterprises we feel are the best in this sector. Equally important to note are two additional trends. Firstly developed market investment grade benchmarks are typically dominated by financial institutions, due to their need for capital. Asia has less financials in the benchmark relative to peers such as US Investment Grade. The dominant issuers within this sector in Asia are the high quality financial institutions from Singapore, China and Hong Kong. The second trend that was noted in our 2017 research was that Asian Investors were buying Asia. This trend continues with approximately 75% of new issues being invested in by Asian based investors. Finally when we look at the dominant issuers for the industrials we see high profile, well capitalized, profitable global names that represent diversity and exposure to the growth story of Asia.

Chart 1: Market value (%) by industry



Source: Bloomberg, JPMorgan, FSI as at 31 March 2021

Returns

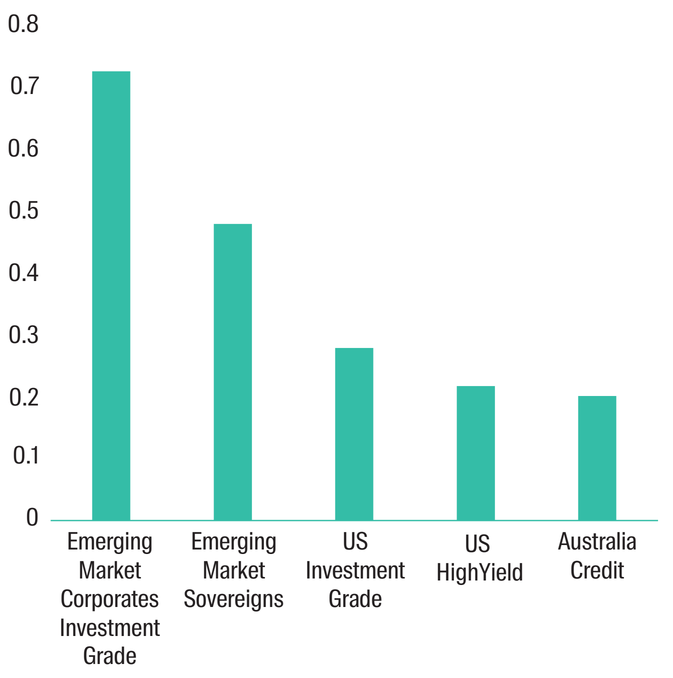
The return profile when compared to other fixed income markets remains robust and importantly has yield. In a COVID world where Central Banks in developed markets have slashed interest rates to zero or near zero, Asia has yield. Given the stability mentioned prior, we believe this translates to an acceptable risk/return profile for investors as per Chart 2.

Index Name	5 Year (p.a.) Return	Average Coupon
Asia IG Credit	4.4%	3.50
US IG Corporate	4.9%	3.69
Australia IG	4.8%	3.26
European Corporate IG	2.3%	1.52

Source: Bloomberg as at 31 March 2021. Returns and coupons are in the each index’s respective local currencies.

Additionally, we considered how Asia USD Investment Grade Credit could fit within portfolios for global investors, considering return correlations to other fixed income markets. Unsurprisingly Asia USD Investment Grade Credit has a high correlation to Emerging Markets Corporates, yet not as high as we instinctively thought. Against global credit constituents namely US Investment Grade, Emerging Markets Sovereigns, High Yield and Australian Credit the correlation of returns for these fixed income markets are very low due. We attribute this to the dominance of State owned Enterprises, lower allocation to financials and limited energy and mining exposure (a sector that has been volatile during the COVID period due to global growth and oil price uncertainty).

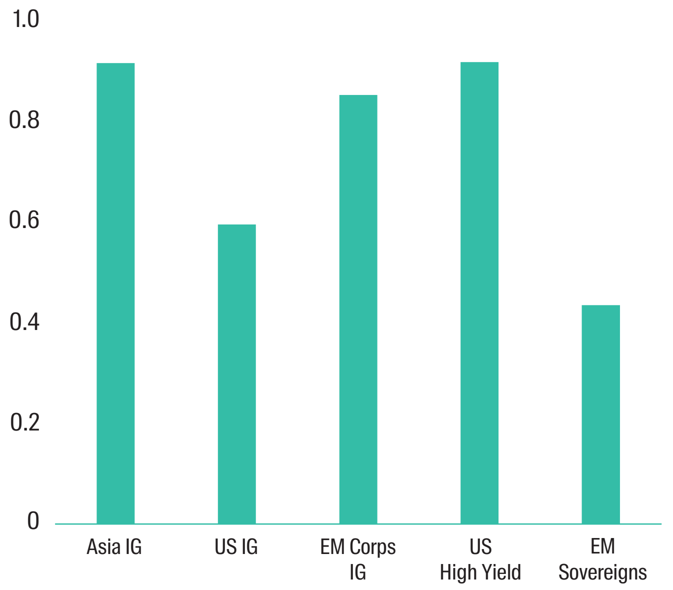
Chart 2: Return correlation with Asia investment grade



Source: Bloomberg, FSI as at 31 March 2021

When we consider the reasons for stability in the context of the return profile, it is not surprising to us that on a risk adjusted return basis (Sharpe Ratio) Asia Investment Grade is a standout. We have presented this as part of our case for Asia USD Investment Grade Credit for many years. Not only does Asia compare favorably against other fixed income markets, but compares favorably across other asset classes also.

Chart 3: Sharpe ratio



Source: Bloomberg, FSI as at 31 March 2021

Outlook

Global growth is suffering in a COVID world as economies have experienced lock down and reopened at different times. This interrupts activity and challenges supply chains and the economic data shows that contraction is occurring across virtually all economies and is negatively impacting the outlook for global growth. Asia is not insulated from this with some countries impacted worse than others from the pandemic. Forecasts show that whilst growth is slowing in Asia, it remains the highest growth region in the global economy. Additionally, Asia’s share of global GDP has been rising over the last decade and that is forecast to continue. This is supportive for Asian corporate health in general. Asian corporates were in good health prior to COVID and are likely to be the corporates best placed to survive the challenges going forward as growth returns.