First State Investments
首域投資

First State Asian Quality Bond Fund

Monthly Review and Outlook

March 2019

- The Fund invests primarily in debt securities of governments and corporate issuers organised, headquartered or having their primary business operations in Asia.
- The Fund's investments may be concentrated in a single, small number of countries or specific region which may have higher volatility or greater loss of capital than more diversified portfolios.
- The Fund invests in emerging markets which may have increased risks than developed markets including liquidity risk, currency risk/control, political and economic uncertainties, high degree of volatility, settlement risk and custody risk.
- The Fund invests in sovereign debt securities which are exposed to political, social and economic risks.
- The Fund invests in debts or fixed income securities which may be subject to credit, interest rate, currency and credit rating reliability risks which would negatively affect its value. Investment grade securities may be subject to risk of being downgraded and the value of the Fund may be adversely affected. The Fund may invest in below investment grade, unrated debt securities which exposes to greater volatility risk, default risk and price changes due to change in the issuer's creditworthiness.
- The Fund may use FDIs for hedging and efficient portfolio management purposes, which may subject the Fund to additional liquidity, valuation, counterparty and over the counter transaction risks.
- For certain share classes, the Fund may at its discretion pay dividend out of capital or pay fees and expenses out of capital to increase distributable income and effectively a distribution out of capital. This amounts to a return or withdrawal of your original investment or from any capital gains attributable to that, and may result in an immediate decrease of NAV per share.
- It is possible that a part or entire value of your investment could be lost. You should not base your investment decision solely on this document. Please read the offering document including risk factors for details.

Market Review

March brought about yet another month of spectacular performance in the Asian credit markets largely driven by dovish rhetoric from the ECB as well as the Fed which seem to suggest that their tightening stance will no longer be appropriate amid the fast weakening economic data. Sentiments were further boosted by expectation of a positive outcome from the trade discussion between the US and China. As a result, JACI delivered a positive 2% return bringing year to date return to an impressive 4.89%. JACI spreads continued to tighten ending the month 7bps lower at 258bps while US treasury staged a massive rally with the 10 year yield lower by almost 30bps to 2.4%. Investment grade lagged high yield even though both returned positively at 1.80% and 2.73% respectively. By country, spread returns were all positive with the exception of Vietnam.

Early March, ECB left policy rates unchanged but lowered their growth (from 1.7% to 1.1%) and inflation (from 1.6% to 1.2%) forecasts significantly. ECB said it would introduce a new round of targeted longer-term refinancing operations, known as TLTRO-III with incentives to encourage bank lending, starting in September 2019 and ending in March 2021. With such pessimistic growth outlook, ECB all but ruled out any rate hike for the year. Later in the month, the US Federal Reserve brought even more cheer to the market by not just keeping policy rate on hold but announcing a conclusion to balance sheet normalisation in September 2019. The updated dot plot also suggested that the majority of FOMC participants (11 of 17) expected there would be no more rate hikes in 2019. This move by the Fed led to a massive rally in both rates and credit market with the Asian corporate perpetual bonds the clear outperformers.

China lowered its GDP growth target for 2019 to between 6.0% and 6.5%. The lower end of the range would represent the slowest rate of growth in nearly 30 years. Policymakers also announced tax cuts worth around USD 300 billion for the year in an effort to stabilise the slowing economy. Chinese exports declined by -16.6% year-on-year in February, reflecting the influence that US import tariffs are having on activity levels. Meanwhile the UK remained mired in Brexit-related uncertainty. For now, Britain remains in the European Union as politicians were unable to agree on details of the exit deal prior to the proposed 29 March 2019 exit date. UK Prime Minister May's repeated calls for unity and approval of her proposed withdrawal agreement fell on deaf ears within the Parliament, forcing the European Union to agree to an extension of the original deadline.

Asian credit supply remained strong amid robust investors' demand even though many new issues were priced with very little premium for investors. There were a total of USD 22.8b worth of new issues bringing year to date issuance to USD 71.7b, a 12% increase from the same period last year. Chinese high yield property issuance picked up sharply accounting for a third of the month's supply. The most notable deal has to be the USD 700m from China Orient Asset Management (International) Holding which was priced across the 5 and 10 year tenor drawing massive books that were 22 times and 31.7 times covered.

Performance Review

The First State Asian Quality Bond Fund returned 1.97% for the month of March on a net of fees basis. The positive return was largely attributed to the continuation of the rally in credit amid positive development on the trade discussion between China and the spectacular rally US treasuries with the Fed all but signaling an end to the rate hike cycle.

On a relative basis, the fund has outperformed the index as our overweight in credit along with security selection both added value since the start of the year. Our overweight in US interest rate duration expressed largely at the front end also contributed positively to our excess return.

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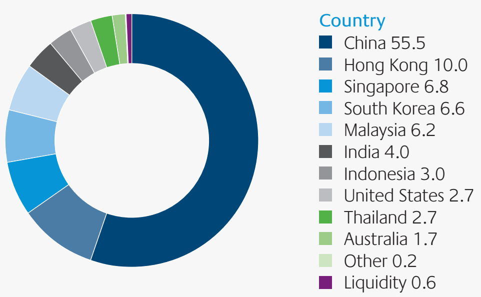
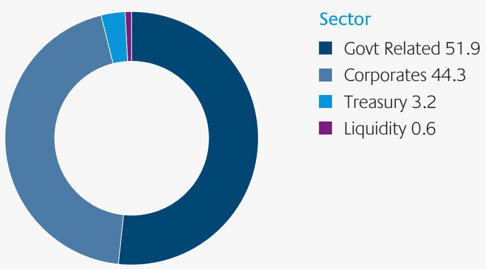
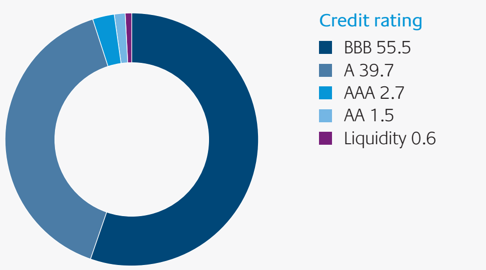
	Cumulative Performance in USD (%) [1]					
	3 mths	YTD	1yr	3yrs	5yrs	Since inception
Class I (USD - Acc)	4.7	4.7	4.6	9.4	18.8	71.1
Benchmark*	4.1	4.1	5.6	10.7	24.0	118.1

	Calendar Year Performance in USD (%) [1]				
	2018	2017	2016	2015	2014
Class I (USD - Acc)	-1.3	5.6	3.4	0.9	6.8
Benchmark*	0.0	5.5	4.5	2.2	9.0

Asset Allocation (%) [1]







Top 10 Issuers (%) [1]

Issuer Name	%
China Huarong	5.5
Bank of Communications Co Ltd	4.4
United Overseas Bank Ltd	4.2
Hyundai Motor Co	4.0
Nan Fung International Holdings Ltd	3.8
China Overseas Land & Investment Ltd	3.2
Sinochem Hong Kong (Group) Co Ltd	3.0
Pertamina Persero PT	3.0
Ping An Insurance Group Co of China Ltd	2.9
United States Treasury	2.7

Portfolio Positioning

In terms of strategy, we maintained our overweight positioning in investment grade bonds. We further increased our long position in US interest rate duration as we believe we have seen the end of the rate hike cycle in the US. Valuation is also very attractive as other developed market rates are now trading well below Treasury yields. Following months of strong rally in Asian credits, we took profits on some overweight positions including Vanke real estate and ChemChina. We have turned more defensive and would look for opportunities to further increase our exposure in high quality Singapore and Hong Kong corporates next. We remained underweight in Philippines sovereign on tight valuations. We do not like India banks and corporates as valuation does not reflect the fast weakening fundamentals. We are also underweight in Indonesia as we believe all the good news have been priced in and believe the upcoming election in April may bring about bouts of volatility, providing better entry points for investors. Within China, we are overweight Investment grade property, Banks' leasing companies and Asset Management companies while underweighting core SOEs, banks and LGFVs (Local government financing vehicles).

Investment Outlook

While growth concerns especially in the developed markets are likely to persist, the technical backdrop for risky assets including Asian credit has improved significantly in the near term following dovish rhetoric from both the Fed and the ECB. The Fed has all but ended their rate hike cycle, while the sharp downward revision by the ECB on both the growth and inflation outlook means that rate hike now looks like a distant possibility. What this means is the chase for yield is likely to continue though we would exercise caution given how sharply the market has rallied. We would also question the effectiveness of developed markets' ultra- easy monetary policies following a decade long of reckless money printing and what else could these central bankers do should we get another severe crisis.

Much focus by the market recently has been on the inverted yield curve in the US and the possibility of a recession. Recession or not, what is clear to us is that growth in the US has peaked around Q3 2018. In the absence of new fiscal stimulus; which will be especially hard to get approved just one year prior to the next election, it will be difficult for the US growth to surprise on the upside in the year ahead. While economic data could see

[1] Source: Lipper & First State Investments, Nav-Nav (USD total return) as at 31 March 2019. Allocation percentage is rounded to the nearest one decimal place and the total allocation percentage may not add up to 100%. Fund inception date: 14 July 2003. Performance is based on First State Asian Quality Bond Fund Class I (USD - Acc) is the non-dividend distributing class of the Fund. *The benchmark displayed is the JP Morgan Asia Credit Investment Grade Index.

a rebound following the end of the US government shutdown coupled with the possibility of a positive development around trade discussion between China and the US, effects from the previous rate hikes and monetary tightening cannot be discounted as that has been a drag on growth. Voicing concerns around the growth outlook, the Fed has effectively ended the hiking cycle and put an explicit end date to quantitative tapering. While market cheered this move and is likely to welcome another round of quantitative easing by the Fed, we are skeptical on the effectiveness of these measures ten years on. We are also of the view that the Fed took too long to start normalising interest rates and that balance sheet has also grown too large to the point that they now have limited ammunition in their war chest should we get another crisis. Against this backdrop of no more rate hike, slowing growth and a potential flight to quality should the next crisis hit, we turned more bullish on US treasuries. We maintain that the treasury curve will fully flatten to an even lower level of around 2.25-2.5%.

The situation in Europe is even more dismal. The above trend growth for a large part of 2018 proved to be short-lived with the ECB now slashing both growth and inflation for this year aggressively to around 1%. At the same time, rate hikes is now pushed back to beyond 2019 even though we were skeptical right from the start whether they can even deliver any hike at all. The toolkit that the ECB has to tackle the next crisis now look even lighter than that of the Fed. Four key leadership jobs including the President of the European Parliament, European Council, European Commission and ECB are set to change hands in 2019. These could hopefully bring about some positive changes but at this juncture we are not holding our breath.

Despite being at the receiving end of Donald Trump's provocation, China's nimbleness in diversifying its export markets away from the US has allowed them to cope better than the US in this trade war. More importantly, commitment from the government to maintain stability is strong ahead of the 70th anniversary of the founding of the People's Republic of China on the 1 October, which means we are likely to hear more positive development coming out of China in the near term. This has been evident so far this year as the government aggressively cut tax while the People's bank of China launched a bill swap program to help improve liquidity of perpetual bonds issued by banks. As a result, confidence has improved and credit growth has picked up.

The slowdown we were anticipating for the rest of Asia since the start of the year did materialised. The region's exports tumbled amid a maturing global trade cycle, ongoing trade war between US and China and lower commodity prices. While exports could stabilise should we get a positive outcome around the discussion between the US and China, we need to see a meaningful turnaround in semiconductor sales before we can declare a bottom in the current export downturn. The tightening cycle amongst Asian central banks is now officially behind us as data continues to disappoint in the past few months. In fact market is now expecting rate cuts in countries including India, Indonesia and Malaysia. Inflation is almost non-existent in Asia thereby providing central banks the ability to cut rates aggressively if they need to. While India, Indonesia and Philippines are still running current account deficits, the levels look manageable and are far from those crisis levels during the 2013 taper tantrums. Upcoming election in Indonesia and India may bring about some volatility should we get an upset, though our base case remains that they will be non-event and post-election, we could see some fiscal measures being roll out should the weak growth persists. Thus while challenges remain, Asia looks to be in a relatively good shape to deal with further slowdown especially when compared to the developed nations.

Asian credit has rebounded strongly during the 1st quarter with JACI IG spreads rallying almost 30bps from the peak of the sell-off. Coupled with the even stronger move in US treasury yields the Asian credit as an asset class has delivered exceptional returns for investors. Valuation is now looking less attractive with JACI IG spreads at around 190bps. However, technical backdrop still look very strong and with spreads at 40bps off recent tights, we would not rule out further tightening should credit fundamentals remain stable. The next round of earnings in the coming months should provide further clues as to whether that trend will continue. Our bullish outlook on US treasuries means they should further enhance returns for investors or at least provide a buffer for spread widening should the market retrace. In this quarter, our key focus would be to continue to explore opportunities via the new issue market and further increasing portfolio diversification through high quality names in Hong Kong and Singapore and South Korea. Credit selection and relative value analysis will likely continue be key drivers of excess returns.