First State Investments 首域投資

First State Asian Quality Bond Fund

Monthly Review and Outlook

November 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

Risky assets including Asian credits have a positive month amid rising optimism that the US and China are edging closer to a phase 1 trade deal. Economic data around the world are showing some signs of stabilizing, further boosting sentiments. All these factors led to a rise in US treasuries yield which saw the 10 year yield rising 9 bps to 1.78% while JACI spreads tightened by 4bps to 264 bps. Total return for the JACI came in at 0.28% as spread tightening and coupon income more than offset the rise in treasury yields. Year-to-date return for the JACI now stands at 10.97%. By country, spread returns were mostly positive with Sri Lanka being the only outlier with a negative return on news that the new government led by President Gotabaya will seek to undo USD 1.1b deal to lease port to China.

Economic data around the world turned more encouraging in November. In the US, the second estimate of GDP growth for the third quarter was revised higher from 1.9% to 2.1%. Durable goods orders were also above expectations in the US while unemployment remained at historical low. Conditions appeared to stabilize in Asia too with manufacturing PMI in China, India and Vietnam all showing improvement.

While the global macro backdrop has improved, concerns remain in certain countries and sectors. Moody's Investors Service ("Moody's") has changed the outlook on the Government of India's ratings to negative from stable and affirmed the Baa2 foreign currency and local currency long-term issuer ratings. Moody's decision to change the outlook to negative reflects increasing risks that economic growth will remain materially lower than in the past, partly reflecting lower government and policy effectiveness at addressing long-standing economic and institutional weaknesses than Moody's had previously estimated, leading to a gradual rise in the debt burden from already high levels. Tsinghua Unigroup and Peking University Founder Group bonds continued to be under pressure throughout the month as investors raised concerns over their enormous debt pile and uncertainty over the strength of government support. The 2023 maturity bond for Tsinghua now trade at a yield of 10.8% while that for Peking Founders trade at above 22% yield.

Supply remained robust during the month of November with total of USD 29.5b issued, bringing year-to-date issuance to USD 271.5b. With still another month to go before the year ends, 2019 issuance has already topped the record reached in 2017. Also interesting to note, year to date Asia HY corporate issuance topped USD 100b for the first time in a calendar year.

Performance Review

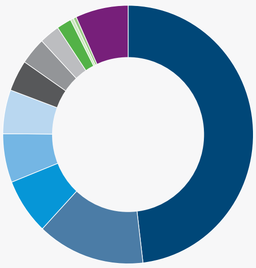
The First State Asian Quality Bond Fund returned 0.06% for the month of November on a net of fees basis.

The return was largely attributed to the tightening in credit spreads and coupons received which more than offset the rise in US treasury yields.

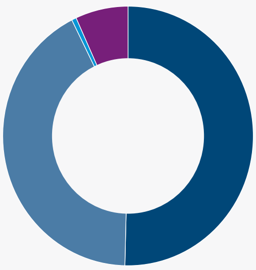
	Cumulative Performance in USD (%) [1]					
	3 mths	YTD	1yr	3yrs	5yrs	Since inception
Class I (USD - Acc)	-0.3	10.5	11.9	14.8	19.8	80.6
Benchmark*	0.2	10.7	12.2	16.4	24.6	132.0

	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

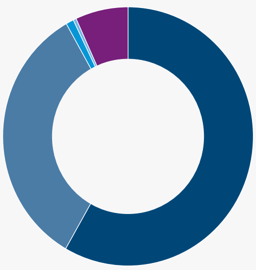
Asset Allocation (%) [1]



Country
- China 48.6
- Hong Kong 13.9
- Malaysia 7.0
- South Korea 6.1
- Singapore 5.5
- Indonesia 3.9
- India 3.4
- Thailand 2.6
- Australia 1.9
- USA 0.2
- Other 0.2
- Liquidity 6.8



Sector
- Corporates 50.5
- Govt Related 42.2
- Treasury 0.6
- Liquidity 6.8



Credit rating
- BBB 58.8
- A 33.5
- AA 0.8
- AAA 0.2
- Liquidity 6.8

Top 10 Issuers (%) [1]

Issuer Name	%
China Huarong	4.4
Genting Berhad	3.8
Bank of Communications Co Ltd	3.7
Sinochem Hong Kong (Group) Co Ltd	3.5
Hyundai Motor Co	3.4
United Overseas Bank Ltd	3.3
Industrial and Commercial Bank of China Ltd	3.3
Nan Fung International Holdings Ltd	3.2
China National Offshore Oil Corp	2.9
China Overseas Land & Investment Ltd	2.7

On a relative basis, the fund slightly underperformed the index due to our short in Indonesia and securities selection.

On a year-to-date basis, our overweight in credit along with security selection both added value during the January to April period. Our overweight in US interest rate duration which we held since the start of the year also contributed positively to our excess return. This outperformance was especially significant in the May to August period during which 10-year US treasury yield rallied by around 100bps. Our underweight in both Indonesia and Philippines spread duration detracted value for a big part of the year. Since September, we have gone neutral on US duration as we believe rates are likely to consolidate in a narrow range. We moved to short duration in November as we believe a trade war resolution between the US and China could exert upwards pressure on yields amid thinning year end liquidity. In credit, we remained cautious while selectively participating in new issues. These positioning resulted in our funds performing largely in line with index over the past few months.

Portfolio Positioning

We remained cautious in our credit positioning during the month as we look to protect the strong gains for the year. We have gone short duration on US interest rates as a trade resolution and talks of fiscal stimulus could potentially drive yields higher amid the thinning year end liquidity conditions in the market. Our country positioning remained unchanged. We are overweight in China and Hong Kong. Within China, we are overweight Investment grade property, big four banks' leasing companies and asset Management companies while underweighting core SOEs, banks and LGFVs (local government financing vehicles). With the stressed situation in TsingHua and Peking Founders, we expect more credit differentiation in the LGFV sector. We remained underweight in Philippines and Indonesia on tight valuations. We do not like India banks and corporates as valuation does not reflect the fundamentals, which have continued to weaken in recent months.

Q4 Investment Outlook

As we moved into the last quarter of the year, there are clearer signs that the world is and will continue to be struggling for growth. The Fed has since cut policy rate twice, which now look more reactive rather than preemptive as Chairman Powell had suggested. The ECB has rolled out a fresh round of quantitative easing though we remain skeptical on the impact it has on the real economy after a decade of overdose. The inverted yield curve in the US and signs of stress in the US repo markets further add to the complexity of the tasks on hand for the Fed and these occurrences are not to be taken lightly especially the repo market situation which looks set to emerge again. While many may say “this time it is different” due to the central banks omnipresence, such signs of stress are usually precursors for a crisis. Amid the gloom and doom, there could be some positive surprises for the financial markets in the coming quarter should we get some positive development out of the trade discussion between the US and China. Markets could also cheer any form of fiscal stimulus by the major economies as this now looks imminent should growth continues to weaken despite rate cuts and quantitative easing.

[1] Source: Lipper & First State Investments, Nav-Nav (USD total return) as at 30 November 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.

While the US Fed and many Asian central banks still has room to cut policy rates, we would question its effectiveness because the normalization process in the past few years did not bring interest rates back to pre-global financial crisis levels. It has become more consensual of late that in order to avert a sharp slowdown as we head into 2020, fiscal stimulus is likely to be the more effective policy tool from here. Let's analyze the fiscal situation across major economies.

Donald Trump's aggressive fiscal stimulus brought US budget deficit to around 4.6% of GDP from the previous years' slightly above 3% level. While aggressive stimulus is not likely to be approved ahead of the election in 2020, current budget deficit level is still a long way off from the 8% level hit during the post crisis period of 2010-2011. Meanwhile Eurozone's budget deficit at 1% level also looks benign and China's deficit is still below 3% despite the targeted stimulus rolled out in the past two years. What this means is while we do not expect fiscal stimulus to be of the same magnitude as 2008-2009, there is ample room for most government to roll out such measures especially when inflation across the globe remain benign or even non-existent. India has recently announced aggressive tax cuts and that is likely a precursor of more to come from other Asian economies. Fiscal stimulus however, is unlikely to be the panacea. Approval process takes time and even upon implementation there could be a delayed impact on the real economy. The uncertainty around the trade war makes it more difficult to determine which sector needs stimulus and as a result, most government are likely to take a more reactive approach thereby risking doing too little too late. Fiscal stimulus may also be less effective in some Asian economies where corruption is rife.

Looking at the performance across major asset classes, it is clear that the US and Europe rates markets have been spot on in identifying the slowing global growth trend as evidenced by the sharp rally in rates over the past year. One can also argue that some segments in the high yield space have started reflecting a weakening economy and rising default rates. Investment grade spreads have remained relatively stable, suggesting its more defensive profile in a downturn. One worrying sign that emerged of late is that the usually resilient US equity market is now showing some concerns about global economic outlook or at least is no longer reacting positively to Fed rate cuts. Should this trend of risky assets continuing to reprice to reflect the deteriorating outlook, a heightened bout of volatility will be imminent especially if growth starts to plunge regardless of what central banks do. Specific to Asian credits, notwithstanding the spectacular rally this year, both IG and HY have underperformed those in the US. Asian investment grade bonds are now trading at around a spread premium of around 30bps above that of the US, which is modestly above that of the five year average suggesting they do offer some value on a relative basis. While we have been and will continue to advocate caution and go for quality, we do see some value emerging in certain segments which include Hong Kong corporates such as New World Development and Hysan following the sell-off amid the protest in Hong Kong. We remain bullish on US interest rates as we believe the Fed will continue to cut policy rates amid slowing growth, which means it should support total return for Asian USD credits. Nevertheless, we do not think it will be a one-way street as there could be short term spikes in yields should we get any positive development around the trade discussion, any surprise stimulus roll out by Trump or a disruption in oil supply.