First State Investments
首域投資

First State Asian Quality Bond Fund

Monthly Review and Outlook

December 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

Demand for Asian credit remained strong throughout the month as the breakthrough in the trade negotiation between the US and China supported sentiment towards risk assets. This enabled spreads to narrow, in line with global peers. The move in spreads offset an increase in US Treasury yields, which acted as a headwind to performance. The JACI Index returned 0.34% over the month, extending gains to more than 11% in the 2019 year. Investors' appetite was skewed towards high yield as the spread differential relative to investment grade remains attractive. In terms of total return for the year, high yield outperformed investment grade with returns of 12.76% and 10.98% respectively.

Like in other major fixed income markets around the world, investor attention was focused on trade dialogue between US and Chinese officials. Following months of hostilities, a compromise was apparently reached during December. The escalating conflict during 2019 had a seriously detrimental impact on industrial production in China and elsewhere in Asia as export demand dissipated. Hence this deal provided market with a much needed reprieve as investors can now hope for a rebound in Chinese exports which will in turn benefit other export oriented countries in this region.

During the month, there was a bond exchange and tender offers by the Tewoo Group, the first time a Chinese state owned enterprise (SOE) defaulted on its USD bonds in twenty years. There was also a missed coupon payment by the Peking University Founder Group though bondholders have agreed on a payment extension. While default in both onshore and offshore Chinese debt has remained stable when compared to 2018, these recent episodes highlights rising credit risks amongst SOE in China with reduced implicit support from the government.

We have a record year of issuance with a total of USD 279b fixed rate issues, representing a 45% year-over-year increase. By sector, Investment Grade corporates was up 56% while High Yield saw an increase of 45%. Sovereign issuance was unchanged from the previous year.

Performance Review

The First State Asian Quality Bond Fund returned 0.33% for the month of December 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.

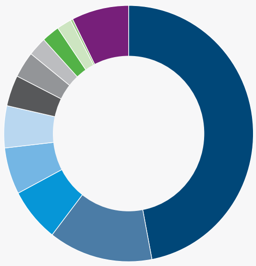
On a relative basis, the fund slightly outperformed the index due to our short interest rate duration positioning and securities selection.

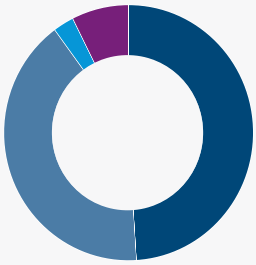
On a year-to-date basis, our overweight in credit along with security selection both added value during the January to April period. Our overweight in US interest rate duration which we held since the start of the year also contributed positively to our

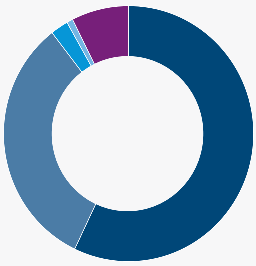
	Cumulative Performance in USD (%) [1]					
	3 mths	YTD	1yr	3yrs	5yrs	Since inception
Class I (USD - Acc)	0.6	10.9	10.9	15.6	20.6	81.2
Benchmark*	0.8	11.0	11.0	17.0	24.9	132.5

	Calendar Year Performance in USD (%) [1]				
	2019	2018	2017	2016	2015
Class I (USD - Acc)	10.9	-1.3	5.6	3.4	0.9
Benchmark*	11.0	0.0	5.5	4.5	2.2

Asset Allocation (%) [1]







Top 10 Issuers (%) [1]

Issuer Name	%
China Huarong	4.3
Genting Berhad	3.7
Bank of Communications Co Ltd	3.6
Sinochem Hong Kong (Group) Co Ltd	3.4
Hyundai Motor Co	3.3
United Overseas Bank Ltd	3.2
Industrial and Commercial Bank of China Ltd	3.2
Nan Fung International Holdings Ltd	3.1
China National Offshore Oil Corp	2.8
Pertamina Persero PT	2.6

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.

Portfolio Positioning

We remained cautious in our credit positioning as we approach the end of the year as we look to protect the strong gains for the year. We maintained our short duration in US interest rates that was initiated in November as we believe a trade resolution between US and China could potentially drive yields higher and the move could be exacerbated by a thin 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.

Q1 2020 Investment Outlook

Writing an outlook for 2020 is turning out to be a lot easier when compared to the same time a year ago, as many of the factors and uncertainties that hampered market sentiments for a big part of 2019 have either changed course or dissipated. A year ago bond investors were in angst as we were still in the midst of a Fed rate hike cycle. The Fed has since cut policy rate three times which felt inconceivable to many even as recent as the middle of last year. The US-China trade war which showed no signs of ending may finally start to ease, as the two economic powers look set to sign on a phase one deal with a potential for a phase two coming around the middle of the New Year. Even the United Kingdom looks likely to now make a breakthrough on Brexit after years of postponement and negotiations, potentially leaving the European Union in an orderly manner on 31 January 2020. The optimism arising from these recent developments on a macro level looks set to continue as we start the new year, further boosted by recent global economic data which point to some stabilization in growth.

Growth has slowed in the US throughout 2019 but they were not as bad as what market had feared. The slowdown was largely due to weaker fixed investments and exports, even though consumption has held up reasonably well. What is encouraging is the revision of 3rd quarter GDP growth estimate from 1.9% to 2.1% suggesting signs of improvement of late. Durable

[1] Source: Lipper & First State Investments, Nav-Nav (USD total return) as at 31 December 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.

goods orders were also above expectations in the US while unemployment remained at historical low. Unemployment is now the lowest in 50 years though quality of jobs has been poor, which partly explains why there has been a lack of inflation. This set of decent economic numbers should allow Trump to tick many of the boxes on his list of deliverables as he heads into election in 2020. We will now likely hear more of his rhetoric around his wish for a weaker dollar and lower rates in the months ahead. Development around the US election will be one of the key drivers of the market in the months ahead.

In our previous outlook, we questioned the effectiveness of monetary policies in the developed economies and advocated that fiscal stimulus is likely to be the more effective policy tool as we start the new decade. Since then, Japan announced a massive USD 162.5b fiscal stimulus which aim to support economic growth beyond the upcoming Olympics. Indonesia is also likely to boost infrastructure spending in Jokowi's second term in charge. Jokowi has already announced a plan to move the nation's capital from Jakarta to East Kalimantan. While Asian central banks still have room to cut interest rates to support growth, we expect to see more fiscal stimulus albeit in a moderate and targeted manner.

Asian credits' fundamentals have been broadly stable in recent years as many corporates have been deleveraging and improving their balance sheets. While there has been areas of distress mainly in the Chinese Industrial and Indonesia high yield space, they tend to be more idiosyncratic in nature. Hence, default rate in Asia will likely remain benign in the 2 - 2.5% range for 2020. Rising defaults in China has been well documented in the past two years. While defaults in China will remain elevated as we move into the new year, we do get some comfort that Chinese defaults both onshore and offshore in 2019, did not increase materially from 2018. One key point bond investors should take note of is that with the defaults, there will more credit differentiation amongst Chinese issuers including those issued by SOEs and LGFVs. The recent default by the Tewoo Group and the turmoil around the Peking University Founder Group are timely reminders to investors that credit risks amongst SOE in China is rising with reduced implicit support from the government and that trend is likely to continue.

One of the key reasons behind the strong performance in 2019 was the return of the onshore Chinese investors after being largely absent the year before. Their continued participation will be a great boost for market's technical. On top of that, gross supply for 2020 is expected to moderate following a record year of issuance, providing further support to market prices. The significant increase in new issue allocation to Asian investors is also a positive trend for our credit market.

Following massive spreads tightening last year, which saw JACI IG spreads tighter by 40bps and high yield spreads tightening by 100bps, valuations are now hovering around the 5-year average. We believe JACI IG spreads of around 180bps at the point of writing has more or less reflected its stronger fundamentals and resilient nature as an asset class. The 100bps rally in US treasury also made all in yield less compelling for investors. Hence we would advocate staying defensive and await a pullback before increasing our risk exposure.

In summary, macro backdrop has turned more stable for now which bodes well for risky assets including credits. Fundamentals in Asian credit remain sound while demand and supply technical backdrop is highly supportive. Nevertheless, following such stellar performance last year during which we recorded double digit gains in both IG and HY, it pays to be more cautious and focus on avoiding potholes. It is also worth noting that in 2019, the spectacular returns in both equity and bond markets were delivered despite a bleak macro outlook. Will 2020 turn out to be a mirror image of the year before? At this stage we would not bet against it.