First State Investments
首域投資

First State Asian Quality Bond Fund

Monthly Review and Outlook
March 2020

- 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

There were extraordinary developments in bond markets in March as investors tried to quantify the economic impact of coronavirus and related disruptions in Asia and elsewhere. In many cases, non-essential services have been shut down, which will unfortunately have a meaningful impact on corporate profitability globally.

Governments appear determined to minimize the impact of the slowdown and are trying to ensure economies bounce back hard after an inevitable slump. With this goal in mind, US officials unveiled a US$2.2 trillion fiscal support package during the month; the largest in history. Singapore announced two separate fiscal stimulus programs and similar moves are anticipated elsewhere in Asia in the weeks and months ahead. Interest rates were also slashed in most regions, which should also prove beneficial over time.

Separately, central banks were forced to intervene in financial markets to provide much-needed liquidity. Some local bond funds experienced sizeable redemptions as investors de-risked portfolios, which exerted downward pressure on valuations in the thinly-traded market. The US Federal Reserve recommenced a quantitative easing program that is 'unlimited' in size and the European Central Bank increased the size of its existing asset purchase program. These announcements helped provide some stability in global credit markets towards month end. In the month as a whole, however, there were substantial selling pressure across Asian credit markets and, in some cases, no bidders. At times, the only firm bids in the market were on bonds issued by Chinese state-owned enterprises.

Despite the various support mechanisms, Asian credit spreads widened to their highest levels since the Global Financial Crisis more than a decade ago. Fortunately, a further move lower in US Treasury yields helped offset the spread widening and reduced the extent of the negative move in valuations. The JACI Index nonetheless closed the month -5.83% lower.

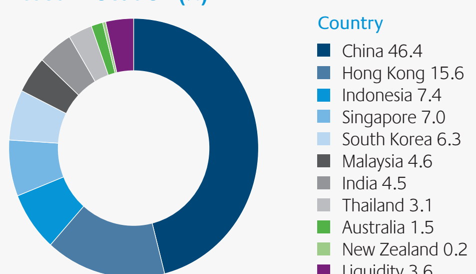
Economic data releases were completely overwhelmed by the latest virus-related statistics and announcements. It will be a few more weeks before we see the effects of the disruptions in economic statistics across the region. The indicators are dire – Chinese manufacturing surveys, for example, nosedived in February reflecting earlier shutdowns in that country. Investors can expect to see similarly subdued readings in other Asian countries and globally as manufacturing and services surveys and GDP growth data filter through during April and May.

The new issuance market in Asia was effectively closed in March. No new issues came to market at all, reflecting investors' lack of appetite for credit. Issuers that had indicated an intention to issue during the month were forced to delay deals. Those with bonds maturing in the next few months will have to consider accessing credit lines with banks if the new issuance market does not recover.

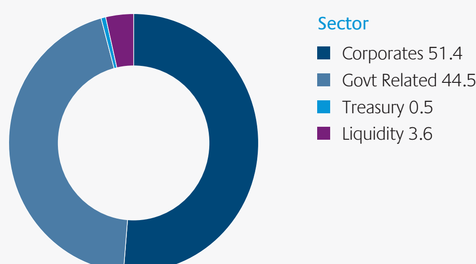
	Cumulative Performance in USD (%) [1]					
	3 mths	YTD	1yr	3yrs	5yrs	Since inception
Class I (USD - Acc)	-2.2	-2.2	3.6	10.4	15.8	77.3
Benchmark*	-0.9	-0.9	5.6	13.3	20.9	130.5

	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

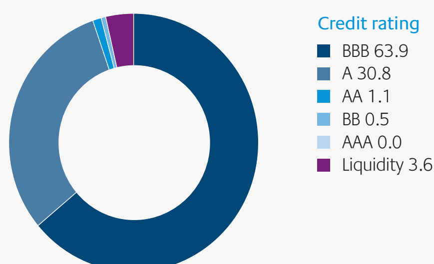
Asset Allocation (%) [1]



Country
- China 46.4
- Hong Kong 15.6
- Indonesia 7.4
- Singapore 7.0
- South Korea 6.3
- Malaysia 4.6
- India 4.5
- Thailand 3.1
- Australia 1.5
- New Zealand 0.2
- Liquidity 3.6



Sector
- Corporates 51.4
- Govt Related 44.5
- Treasury 0.5
- Liquidity 3.6



Credit rating
- BBB 63.9
- A 30.8
- AA 1.1
- BB 0.5
- AAA 0.0
- Liquidity 3.6

Top 10 Issuers (%) [1]

Issuer Name	%
Pertamina Persero PT	5.6
China Overseas Land & Investment Ltd	4.8
China Huarong	4.3
Bank of Communications Co Ltd	4.0
Sinochem Hong Kong (Group) Co Ltd	3.7
Nan Fung International Holdings Ltd	3.4
United Overseas Bank Ltd	3.3
China National Offshore Oil Corp	3.1
Ping An Insurance Group Co of China Ltd	2.6
Malaysia (Government)	2.5

Performance Review

The First State Asian Quality Bond Fund returned -4.91% for the month of March on a net of fees basis.

The negative return was the result of a massive spread widening which we saw the JACI IG spread widened by 100 bps to 300bps despite the strong rally in US treasuries.

On a relative basis, the fund underperformed the index largely due to securities selection. This includes our overweight in Singapore and Thailand banks, along with Chinese asset management companies, which underperformed the broader investment grade market during the month. Our overweight in Indonesian quasi versus the sovereign also detracted value. Our countries positioning of short Indonesia and Philippines did well, though the magnitude of outperformance was not enough to offset the losses.

Portfolio Positioning

Despite the reduced liquidity in markets, we were able to make some changes. The scale of the short position in Indonesia was reduced, for example, by buying some long-dated Pertamina bonds at an attractive valuation as spreads widened. We also profited from volatility in US Treasury yields, implementing a tactical short duration position as US rates briefly trended higher. This strategy was established when the US 10-year Treasury yields were trading around 0.75% and was neutralized when they reached 1.00%. The move proved well timed, as the US 10-year Treasury yields had slumped to 0.67% by month end. We also took advantage of pockets of liquidity in the market to reduce exposure to some short-dated, high quality bonds. These sales helped increase the cash holding and improved the fund's liquidity position in case of any short-term increase in redemption requests. At the end of March, the Asian Quality Bond Fund had a long credit spread duration position and neutral interest rate duration.

Q2 2020 Investment Outlook

We started the year with a fairly sanguine outlook and sentiment, but this did not last for long as the widespread coronavirus outbreak caused havoc in economies and financial markets. Initially the disease was expected to be contained within China, but it has evolved into a global pandemic. Despite the inevitable economic downturn due to closures and disruptions, the coordinated response by central banks and governments around the world is encouraging. Travel restrictions and shutdowns implemented worldwide are providing some comfort that governments are aware of the severity of the pandemic and the scale of the task they have in controlling it.

Investors have effectively written off any chance of meaningful economic growth in the 2nd quarter of this year and conditions could remain subdued in the 3rd quarter. Singapore's GDP contracted at an annual pace of -2.2% in Q1, prompting the government to revise down its full year forecast to between

[1] Source: Lipper & First State Investments, Nav-Nav (USD total return) as at 31 March 2020. 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. # Please note that the UK has left the European Union on 31 January 2020.

-1% and -4%, from the previous -0.5% to 1.5% range. This contraction is likely to be typical among other economies in the coming months. The US Federal Reserve has acted swiftly and aggressively to cut policy rates to close to zero, although this move is only likely to boost confidence rather than improve conditions in the real economy. We expect more interest rate cuts and quantitative easing from central banks around the world in the months ahead.

In terms of the global credit market, for a couple of years now we have been concerned about limited liquidity in secondary trading. Conditions worsened during March, when the credit market was effectively frozen as it was during the 2008-9 Global Financial Crisis. This was partly due to intense regulations on banks' ability to take on risk post the Global Financial Crisis, which has led to poor secondary market liquidity. Banks no longer have the balance sheet capacity to take on risk. Consequently when investors look to sell bonds as they did in March, pricing becomes perilous as there are no bids from banks.

The Federal Reserve is unlikely to concede that it may have contributed to the latest sell-off by over regulating banks, but it was quick to announce primary and secondary market facilities in March. This allows them to buy up to US$200 billion of shorter-dated investment grade corporate bonds, providing some much-needed support to the global credit market. The scope may seem small relative to the US$8 trillion market capitalization of the US investment grade credit market, but the program could nonetheless pave the way for larger-scale purchases in future. We see this as an important development in helping to support credit markets, particularly given the prospect of widespread downgrades to credit ratings. In some cases, these downgrades are likely to result in more forced selling among 'fallen angels' from the investment grade universe.

Governments around the world have started rolling out fiscal stimulus packages, which we believe will be more effective than monetary policy in propping up economies and supporting sectors in distress. The US$2.2 trillion fiscal stimulus package in the US dwarfs the US$800 billion package that was rolled out during the Global Financial Crisis. Following news that the June 2020 Olympic Games will be postponed until next year, Japan has also vowed to roll out massive stimulus. Other Asian central banks are pursuing similar policies – the two stimulus packages recently announced in Singapore, for example, amount to a combined 11% of GDP and Malaysia has announced a MYR250 billion (US$57 billion) package. The big question is whether these unprecedented stimuli will be sufficient to offset the coming downturn, particularly if the pandemic persists for longer than anticipated. We remain particularly concerned about developing economies with large populations and rudimentary medical facilities. As well as the potential human cost, the prospect of a prolonged growth slowdown could also worsen poverty issues in these countries.

It will be interesting to see how credit markets react with central banks slashing policy rates towards zero and governments rolling out aggressive stimulus packages. Markets rebounded quite sharply following the Global Financial Crisis following coordinated central bank and government actions that helped restore confidence and trust in the financial system. This may not necessarily be the case this time around, particularly as it remains unclear how long it will take to bring the spread of coronavirus under control. For markets to stabilize, we will likely need to see a slowdown in the rate of new reported cases and a full containment of the virus globally for markets to fully turn the corner. During 2003, China, Hong Kong and Singapore were affected by SARS for around five months. In comparison with coronavirus, SARS spread more slowly but had a higher mortality rate. Adding another three months to the coronavirus pandemic for its possible containment would bring us to the end of October, assuming a March start date when the virus spread globally. Against this background, it is plausible that markets could gyrate primarily based on sentiment rather than fundamentals for the next few months. More positively, we could see a strong 'V-shaped' recovery in both markets and economies if the virus is contained more quickly.

In our previous outlook three months ago, we advocated waiting for a pullback in credit spreads before adding risk. JACI Investment Grade spreads have since widened by more than 100 bps, with many A-rated names trading at more than double their 5-year average spread. While the call proved prescient, there was a feeling of "be careful what you wish for" during March's market dislocation. Nevertheless, our investment philosophy and process are expected to add value over the full credit cycle. Holding names with strong credit fundamentals should help us ride out this period of volatility and generate favorable performance when the coronavirus pandemic is defeated and as markets eventually recover.

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