First State Investments
首域投資

First State Asian Quality Bond Fund

Monthly Review and Outlook
April 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

The scale of support packages rolled out by governments and central banks worldwide helped risk assets rebound sharply from March's lows. Equities and credit both enjoyed a month of much more favorable returns. That said, sentiment remained fragile – while some investors seemed comfortable looking through the inevitable period of economic weakness and lower corporate profitability, lockdowns remain in place in most key regions. This continues to cloud the outlook for economic growth and corporate earnings.

As well as narrowing spreads, which provided a strong tailwind, Asian credit valuations were supported by a further downward move in US Treasury yields. The JACI Index returned 1.81% in April. Credit markets have not yet fully recovered from March's sell-off, but it was encouraging that the market was able to claw back some of its earlier lost ground.

During the month, Bank Indonesia started buying Indonesian government bonds as part of a 'quantitative easing' (QE) program. This unconventional policy involves central banks buying large quantities of bonds on the open market. This provides additional liquidity and supports the normal functioning of fixed income markets. QE programs have been used in Japan over the past decade or so, but have not previously been deemed necessary elsewhere in Asia. Bank Indonesia's move was therefore an interesting one.

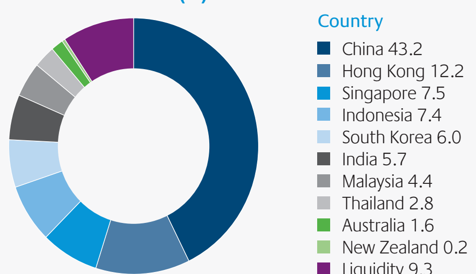
On the economic front, investors focused on the latest GDP data in China. The economy shrank at an annual rate of -6.8% in the March quarter; a sharp slowdown from the 6.0% year-on-year growth seen in the December quarter of 2019. In fact, this was the first contraction seen in the Chinese economy since records began in 1992. Even as activity levels in the Chinese economy ramp up, conditions could remain subdued for the foreseeable future. Export demand will be dampened by negative growth rates in other countries and domestic demand may not be able to fully compensate. As a result, substantial stimulus programs are anticipated in the months ahead as authorities try to get the world's second largest economy back on track. Data released in other countries in the weeks and months ahead will be closely scrutinized, especially statistics and indicators for the month of April and beyond, when most economies were in some form of shutdown. In many cases, closures and mobility restrictions were not implemented until late March, so data covering that month (and the March quarter) is not particularly informative.

Encouragingly, new issuance picked up after grinding to a halt during March. Companies looked to take advantage of improving risk appetite and inflows into credit markets by offering a substantial amount of new bonds. In some cases, this was to bolster balance sheets to help cushion the impact of a more prolonged period of lower profitability. Malaysian energy giant Petronas completed the largest deal, issuing USD6 billion of new paper. The deal was more than six times over-subscribed and the bonds fared well in the secondary market after the deal was complete. The Philippine government also completed a new bond issue, affirming that investors were rediscovering their risk appetite.

	Cumulative Performance in USD (%) [1]					
	3 mths	YTD	1yr	3yrs	5yrs	Since inception
Class I (USD - Acc)	-2.6	-1.2	4.4	11.1	16.7	79.0
Benchmark*	-1.4	0.2	6.4	14.0	22.0	132.9

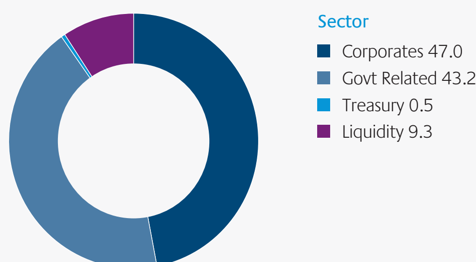
	Calendar Year Performance in USD (%) [1]				
	2019	2018	2017	2016	2015
Class I (USD - Acc)	10.9	-1.3	5.6	3.4	0.9
Benchmark*	11.0	0.0	5.5	4.5	2.2

Asset Allocation (%) [1]



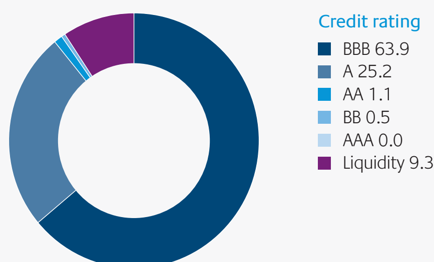
Country

- China 43.2
- Hong Kong 12.2
- Singapore 7.5
- Indonesia 7.4
- South Korea 6.0
- India 5.7
- Malaysia 4.4
- Thailand 2.8
- Australia 1.6
- New Zealand 0.2
- Liquidity 9.3



Sector

- Corporates 47.0
- Govt Related 43.2
- Treasury 0.5
- Liquidity 9.3



Credit rating

- BBB 63.9
- A 25.2
- AA 1.1
- BB 0.5
- AAA 0.0
- Liquidity 9.3

Top 10 Issuers (%) [1]

Issuer Name	%
Pertamina Persero PT	5.6
China Overseas Land & Investment Ltd	4.8
China Huarong	4.4
Bank of Communications Co Ltd	3.8
Sinochem Hong Kong (Group) Co Ltd	3.5
United Overseas Bank Ltd	3.2
Nan Fung International Holdings Ltd	3.2
DBS Group Holdings Ltd	2.8
Ping An Insurance Group Co of China Ltd	2.5
Malaysia (Government)	2.4

Performance Review

The First State Asian Quality Bond Fund returned 0.99% for the month of April on a net of fees basis.

The positive return was achieved amid a calmer market with spreads tightening modestly along with lower US Treasury yields.

On a relative basis, the fund performed largely in line with the index. Our overweight in certain credits benefitted as these names recovered modestly from the lows in March. The gain was however offset by our short in US duration as US rates continued to grind lower.

On a year-to-date basis, return for the fund is still negative as the massive widening in credit spreads in March more than offset the decline in US Treasury yields. On a relative basis, securities selection was the main detractor of performance. This include our overweight in Singapore and Thailand banks along with China Asset Management companies which underperformed the broader investment grade market significantly during the sell-off in March. Our overweight in Indonesian quasi versus the sovereign also detracted value. We have several strategies that has worked well even though the magnitude of outperformance was not enough to offset the YTD losses. This include our countries positioning of short Indonesia and Philippines. Our tactical trades in US duration has also added value.

Portfolio Positioning

Portfolio positioning remained conservative and a high level of diversification was maintained to help spread risk. A short duration position was also established in the Treasury market, designed to benefit from upward movements in US government bond yields. Interest rates are likely to remain at low levels for an extended period, but there will likely be some volatility in bond yields as investor confidence ebbs and flows. Active managers should therefore be presented with opportunities to implement tactical trades that may not be in place for long, but which could boost performance. Currently, we believe sentiment could be buoyed by anticipation of an eventual containment of the virus, in turn pushing sovereign bond yields higher, and prices lower. Technical factors are also unsupportive of sovereign bonds – ultimately, governments will have to meaningfully increase the supply of new bonds to help finance their spending plans; such a sharp increase in supply could exert upward pressure on yields and weigh on valuations.

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

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

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% 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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