First State Investments
首域投資

First State Asian Quality Bond Fund

Monthly Review and Outlook

May 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

Sentiment towards Asian credit continued to improve in May, supported by news that most major economies are starting to reopen after coronavirus-related shutdowns. This news was well received by credit investors, as it suggested company profitability could start to improve. At the same time, there was further optimism around the development of a vaccine for COVID-19, which also supported risk appetite.

The JACI returned 2.07% over the month, benefiting from a narrowing in credit spreads across Asia. Pleasingly, gains in May mean returns from the JACI have returned to positive territory in the calendar year-to-date – a reasonable outcome given the extent of the sell-off earlier in the year.

Treasury yields hardly moved at all during May and did not therefore influence performance one way or the other. The Fund's short duration position in the US Treasury market was maintained. Again, this strategy did not affect performance in May, but remains in place in anticipation of slightly higher Treasury yields in the months ahead.

China's plan to impose new national security laws in Hong Kong was among the most significant news in Asia over the month. Some commentators suggested this was a further indication that China is seeking to increase its control over Hong Kong, which was supposed to maintain autonomy from Chinese rule until 2047 at the earliest. This development threatened to reignite tensions between the US and China, only a few months after the two superpowers agreed a truce on their trade dispute. Indeed, US officials suggested trade agreements with Hong Kong could be reviewed following the news. Concern around this issue dampened sentiment in the final few days of what was otherwise a strong month for Asian credits.

Companies took advantage of strong demand by issuing large quantities of new bonds. Several high profile issues came to the market, including a jumbo multi-tranche deal from Chinese conglomerate Tencent. On the whole, these new tenders were well supported by investors. This underlined the appetite for yielding investments against a background of very low government bond yields and cash rates. That said, activity in the secondary market remained slightly lower than before the COVID-19 crisis. Bids from market dealers remained sporadic in some names, underlining the importance of careful issuer selection and ongoing monitoring of portfolio holdings.

Performance Review

The First State Asian Quality Bond Fund returned 2.13% for the month of May on a net of fees basis.

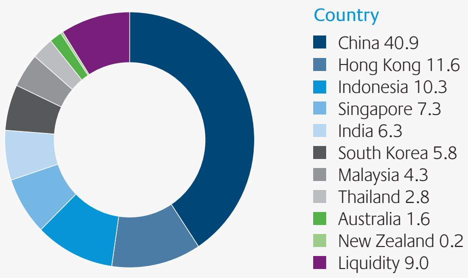
The positive return was largely attributed to the rally in credit which saw the JACI IG spread narrowed by 24bps for the month.

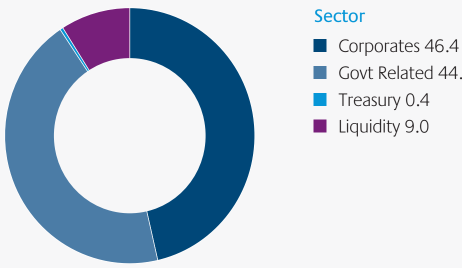
On a relative basis, the fund outperformed the JACI IG. Our overweight in Indonesia quasi and banks' sub debt contributed positively to excess return as these names recovered strongly in May.

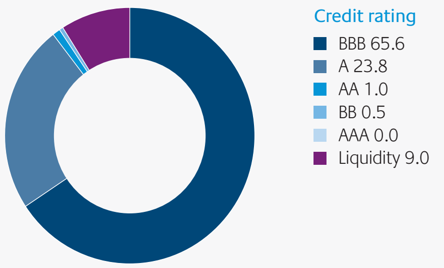
Cumulative Performance in USD (%) [1]						
	3 mths	YTD	1yr	3yrs	5yrs	Since inception
Class I (USD - Acc)	-1.9	0.9	5.1	12.4	19.7	82.8
Benchmark*	-0.9	2.0	6.9	15.2	24.4	137.0

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	%
Pertamina Persero PT	6.2
China Overseas Land & Investment Ltd	4.5
China Huarong	4.2
Bank of Communications Co Ltd	3.6
Sinochem Hong Kong (Group) Co Ltd	3.4
United Overseas Bank Ltd	3.2
Nan Fung International Holdings Ltd	3.1
DBS Group Holdings Ltd	2.7
India (Republic of)	2.6
Ping An Insurance Group Co of China Ltd	2.4

On a year-to-date basis, return for the fund has turned positive following the strong performance in May. On a relative basis though, the fund continues to lag the index even though the gap has now narrowed. We believe a continuation of credit spreads tightening amid an improvement in sentiments will allow us to make up more lost ground in the coming weeks. Our tactical trades in US duration has also added value throughout this year.

Portfolio Positioning

During the month of May, we added exposure in Indonesian quasi namely PT Pertamina and PT Perusahaan Listrik Negara. We also bought Power Finance as we believe valuation looks attractive despite downgrade concerns. We participated in the Tencent new issue which was met with strong demand from investors and subsequently performed very well. We maintained our short duration position in US treasury as we believe yields could head higher as we move closer to an eventual containment of the COVID-19 which also means further re-opening of the economy. The increase in treasury bonds supply could further 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 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

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

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.