First Sentier
Asian Quality Bond Fund
Monthly review and outlook

Monthly Review and Outlook | November 2022

Market review

In a favorable turn in what has almost been a one-way down market for the year, the Asian credit market rebounded by 5.47% in November, as spreads tightened aggressively and US Treasury (USTs) rallied. The October Consumer Price Index (CPI) surprised on the downside and markets interpreted Powell's latest remarks in a dovish light indicating a slower pace of rate hikes, although a higher terminal rate is still in sight. Relaxation of zero-Covid policies in China also helped Asian credit markets rally; Asian Investment Grade (IG) spreads tightened by 37 basis points (bps) to 201bps. Despite the upbeat tone for the month of November, we still maintain a defensive stance in managing credit exposure across portfolio as recession risk lingers in the horizon.

In the Asian Investment Grade space, despite onshore macro data (exports numbers, credit growth, services Purchasing Managers' Index (PMI) and inflation) still showing weak prints, sentiments rebounded as the Chinese government announced broad-based relaxations of its zero-Covid policy. Prices of Chinese property bonds rallied by 10-30pts as mobility restrictions and lockdown curbs were gradually eased. We view that the default risk for higher-grade issuers such as Vanke and Longfor have substantially reduced. In other Asian news, the absence of any single political bloc commanding a majority in Malaysia's general election saw the formation of its first unity government comprising key members of various coalitions. Malaysian Government Bonds traded firm, and the Malaysian ringgit rallied on hopes of political stability and more effective policy delivery as long-time opposition leader Anwar Ibrahim was sworn in as prime minister after a three decade wait.

Sovereign bonds spreads made a huge turnaround. Although broad Emerging Market (EM) bonds still posted outflows, hard currency bonds started to see a turn of tide with inflows returning. Indonesian, Philippines, and Malaysian sovereign bonds rallied along with its quasi-sovereign counterparts such as Pertamina, Perusahaan Listrik Negara (PLN), and Petronas. Frontier market bonds, in particular Mongolia, enjoyed positive sentiment spillover from China's zero-Covid relaxations, with its benchmark 10-year bond rising by 10bps in November. Meanwhile, Sri Lankan and Pakistan bonds also rose with broader market optimism though the prices of these sovereign bonds remained languishing at depressed levels, weighed down by weak economic fundamentals and bloated refinancing needs. Valuations for IG sovereign bonds are looking increasingly expensive, although we continue to see decent spreads in Indonesia quasi-sovereign bonds such as Perusahaan Listrik Negara and Indonesia Asahan Aluminum. We maintain a cautious stance on frontier economies at this stage.

Overall issuance volume in the Asia's primary market remained subdued despite the strong rally in Treasury and credit spreads.

Fund positioning

As the market rallied, the portfolio added credit duration and purchased issuers that were still attractively priced. The fund added Indofood, PLN, and Huarong. The fund also took some profit on Tencent.

Performance review

On a net-of-fees basis, the First Sentier Asian Quality Bond Fund returned 4.99% in November, outperforming its benchmark by 1.13%.

The positive returns was largely due to the tightening of credit spreads, with exposure to Chinese property names being the main contributor to returns.

- The Fund invests primarily in debt securities of governments or quasi-government organization in Asia and/or 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 may also expose to RMB currency and conversion risk.
- 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.

	We thought that...	Therefore, we...	And the results...
US rates	The Federal Reserve would aggressively hikes rates even at the cost of economic growth and US rates had room for further rise.	Closed an underweight duration position versus the benchmark and maintain a neutral stance for US rates in the portfolio.	Tactical positioning, mostly in the neutral range versus the benchmark had a marginally positive impact on portfolio performance.
Asian IG	Fundamentals remain sound in Asian Investment Grade corporates but volatility in credit markets may remain elevated for a sustained period.	While still cautious on credit, the steep turnaround of the credit market led us to increase our credit duration in select names that we believed still offer value.	The fund's exposure to Chinese property names was additive to performance, but this was partially offset by the underweight versus the benchmark in sovereign names in Indonesia and the Philippines.

Q1 2023 investment outlook

The three key themes driving the Asian credit market's performance this year have been the US Federal Reserve's tightening monetary conditions amid record high inflation, negative sentiments towards China especially its zero-Covid policies and global recession concerns. While we expect these factors to continue driving market sentiment as we move into 2023, their impact on market's performance is likely to be more subdued. The Asian credit market is set to record its first double-digit loss since the Global Financial Crisis. Nevertheless, at a low double-digit negative return, it compares favorably to the high-teens loss in global bonds, as well as the 20% loss seen in emerging market debt. At an all in yield of close to 6% as compared to a historical average of 4%, Asian Investment Grade bonds are looking very attractive especially for long-term investors. While credit spreads may still widen should we get a deep global recession, the high US Treasury yields by historical standards do provide sufficient buffer against the risk of widening credit spreads. With stable debt ratios and still healthy cash balances, we believe that the solid fundamentals in Asian Investment Grade corporates will help the asset class remain resilient through a downturn.

In the near term, we expect the US Fed to continue hiking policy rate towards the 5.00-5.25% range as long as unemployment stays low. While prices can still be rising, the rate of increase is likely to slow given the high base effect. We are of the opinion that we may have seen the peak in inflation and thus market's expectation of the terminal fed fund rate should not move higher from here. There have been signs of a slowdown in economic growth in the US as evidenced in the housing market, lay-offs in the technology sector and a sluggish semi-conductor industry. This could possibly explain why the US yield curve has inverted quite sharply of late, as long-term rates are pricing in heightened uncertainty. However, we deem any talks of rate cuts to be premature at this juncture.

Post President Xi's consolidation of power at the 20th National Congress of the Chinese Communist Party (CCP), we have observed positive policy developments in China which suggest that the nation could move more swiftly to address its weak economic growth with a focus on infrastructure spending. Policy measures to help the ailing Chinese property sector have been trickling in since the early part of the year but saw a meaningful pickup in November 2022, both in terms of policy line-up and financial firepower. We are hopeful that the China's relaxation of its zero-Covid policy will be steady and incremental. Downside risk remains with weak primary sales in the property sector. For a sector that has been undergoing such a prolonged policy induced liquidity crisis, primary market sales recovery remains crucial for the longer-term survival of some private developers before we can assume the worst is over for the Chinese property sector. Until we see strong evidence of primary market sales recovery, property bonds will likely remain volatile, with price swings vacillating between policy optimism and fragile fundamentals.

We expect the Bank of Japan (BOJ) to maintain the Yield Curve Control (YCC) program at least until the end of Kuroda's term in April 2023. Japan's recent border reopening may spur a short-lived bounce in growth data. However, poor wage growth and weak consumption remains deeply entrenched challenges in an economy that is now feeling the effects of cost-push inflation. We do not rule out the possibilities of adjustments to the current YCC program, though with ample reserves at hand, the BOJ is likely to intervene in the foreign exchange (FX) market should we get another bout of yen weakness instead. In other words, the BOJ could still seek to keep Japanese Government Bond (JGB) yields stable for the medium term.

The strength of the greenback witnessed in 2022 is starting to show signs of waning. We see higher certainty of the Euro and other Asian currencies appreciating against the US dollar, as the European Central Bank is further behind in completing its policy tightening measures. Select Asian currencies with relatively benign inflation and lower interest rates as compared to developed markets, could see further upside from China's reopening measures as economic activity picks-up in the region.

Investors remain worried of the prospects of an economic recession. Food and energy supply chains disruptions could further deepen in certain economies in Europe and the UK, particularly against a backdrop where real disposable incomes have been falling for the most part of 2022. Geopolitical concerns – the protracted Russia-Ukraine war and simmering US-China trade tensions, remain threats that could thrust the world into a deep recession and sustain the dollar's strength, and these concerns could feature more strongly in 2023.

Source : Company data, First Sentier Investors, as of end of November 2022