First Sentier Asian Quality Bond Fund
Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | July 2023

Market review

Asian credit continued to perform with resilience, even as US Treasury yields moved 12 basis points (bps) higher and the Fed delivered on another 25bps in rate hike. The JACI Index returned +0.27% over the month of July, driven by the strong performance in Asian Investment Grade (IG) credit which saw spreads tighten by 8bps to 165bps over the month. On the other hand, Asian high yield credit was dragged down by Chinese High Yield (HY) property names which suffered further losses due to negative headlines that spooked investors.

Geopolitical tensions simmered beneath the seemingly calm surface of Asian Investment Grade Credits. In another episode of the intense tech race between China and the US, the Wall Street Journal reported of further possible tightening on tech access for Chinese companies by US policymakers. If implemented, the move could slow the advancement of artificial intelligence in China. Countering external headwinds, however, the regulatory tone towards Chinese technology firm grew more positive as Chinese Premier Li Qiang met senior executives from China's leading technology platform companies to convey the government support for further innovation. Coupled with a strong technical backdrop, spreads of Chinese technology bonds remained firm and valuations stayed in fair territory. In more positive news, Meituan's venture into the artificial intelligence space via the acquisition of Light Year Group was well received by investors who saw potential upside for Meituan's core retail business should the synergies materialize. Given how much Asian IG spreads have tightened over the year, we maintain a defensive position in the event of negative headlines that might trigger sector wide sell-offs.

Spreads in quasi-sovereign names in Indonesia held firm over the month as the country continues to benefit from improving economic fundamentals and strong technicals.

In primary markets for Asian Credit, South Korea remained the outlier in new bond supply, leading rankings in terms of issuance volumes and activity. The largest issuances were notably in green bonds from industry heavyweights, such as Korea Electric Power Generation, Shinhan Financial Group as well as Korea Hydro & Nuclear Power.

Fund positioning

The Fund maintained an active long duration stance while making switches in credits when presented with meaningful opportunities. Positions in more vulnerable names were reduced for allocations to more stable sectors. The Fund took profit in a Malaysian quasi-sovereign as spreads in investment grade credits tightened further.

Performance review

On a net-of-fees basis, the First Sentier Asian Quality Bond Fund returned 0.30% in July, underperforming its benchmark by -0.13%.

On a relative basis, the Fund underperformed its benchmark as overweights in Chinese property detracted from performance. This was partially offset by the Fund's exposure in high quality quasi-sovereigns and longer dated credits. Exposure in Malaysian Government bonds and the Japanese yen added to performance as Asian currencies recovered slightly over the month.

- 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.

Exposure in Malaysian Government bonds and the Japanese yen added to performance as Asian currencies recovered slightly over the month.

	We thought that...	Therefore, we...	And the results...
US rates	The Federal Reserve would be closer to the end of its rate hike cycle and be less aggressive in hiking rates. However, prices will remain high and the likelihood or rate cuts remains low	Maintained an overweight stance for US rates in the portfolio	The Fund's overweight in US rates versus the benchmark detracted from returns as US rates moved higher during the month
Asian IG	Amid rich valuations, fundamentals remain sound in Asian Investment Grade (IG) corporates	Remained focused on high quality names that are deemed more resilient should the market enter a risk-off mode	Overall investment grade spreads were largely stable. However, the Fund's exposure to Chinese property names detracted from performance as the sector suffered from negative headlines. This is offset by an overweight in Indonesian-quasi sovereigns

Q3 2023 investment outlook

2023 has thus far been a more upbeat year than 2022 for Asian Fixed Income, with positive returns year-to-date driven in part by the anticipated slowdown in the Federal Reserve's pace of rate hikes, as well as China's border re-opening. This performance looks even more commendable against the backdrop of market uncertainties brought on by the collapse of Silicon Valley Bank and Credit Suisse Bank. In supply technicals, the significant slowdown in primary market issuance for Asian Credit slowed additional price support for credits, as evidenced by the resilience in credit spreads during periods of market stress, such as the US regional banking crisis.

We expect the second half of the year to be constructive for Asian credit markets. It is difficult to fathom 10 consecutive rate hikes amounting to more than 500bps not having any effect on the economy. Despite headline growth data still coming in above expectations, particularly in terms of consumption data, we attribute a large part of this to a sharp increase in household debt in the form of credit card and home equity loans, rather than a robust job market and strong wage growth. In other words, we do not believe a debt-fueled economy is sustainable if interest rates stay elevated. While the US regional bank crisis appears to be contained for the time being, the root trigger of the crisis - risk-free T-bills still yielding higher than deposit rates – remains, leading many to ponder what else remains beneath the seeming calm. The more obvious path to us is that further tightening of credit conditions will restrict economic growth for the foreseeable future.

Debate abounds the US Federal Reserve's next move. We believe we are close to the end of the current rate hike cycle. With core inflation now below the Fed fund rate, it does give the Fed an opportunity to take a pause, assess the impact of the past year of rate hikes before deciding on their next step. With unemployment rate still near historical lows, we do not believe the Fed will be cutting policy rates this year. Barring a sharp deterioration in economic growth, the dollar may stay strong in the coming quarter as long as it maintains a favorable interest rate differential against the EUR and JPY. Bank of Japan's next move should be closely watched as any signs of change to their Yield Curve Control policy will have significant implications for the course the dollar's strength.

The euphoria following China's lifting of its zero-COVID policy has proven to be short-lived amid faltering economic momentum in recent weeks. Nevertheless, tailwinds from China's re-opening should continue to benefit the Asian region. The path to recovery will be a winding and bumpy, but coming off a low base, achieving the 5% growth rate for 2023 should be feasible. We believe the probability of large-scale stimulus to be low, but should China's growth falter, the central Chinese government could implement targeted policy measures to support the country's economy.

Inflation in Asia is relatively benign when compared to developed markets, giving Asian central banks more flexibility to cut rates to spur growth should the need arise. In fact, many Asian central banks have paused their rate hikes in recent weeks as inflation moderated further. We remain constructive on the region's longer-term growth prospects as Asian economies continue to move up the value chain in the global economy.

We remain constructive in Asian IG credit while staying selective in Asian High Yield. Despite signs of slowing earnings and weaker economic activity in the region, fundamentals of Asian Investment Grade (IG) corporates remain sound. Considering the mounting macro uncertainty, valuations are starting to look rich, despite modest weakening in Asian IG credit metrics within still solid territory. Nevertheless, high all-in yields well above 5% does makes this asset class attractive from an income carry perspective. Our bias is to look for idiosyncratic and relative value opportunities.

Source : Company data, First Sentier Investors, as of end of July 2023

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