

Asian Fixed Income

“EM Light” for Global Investors

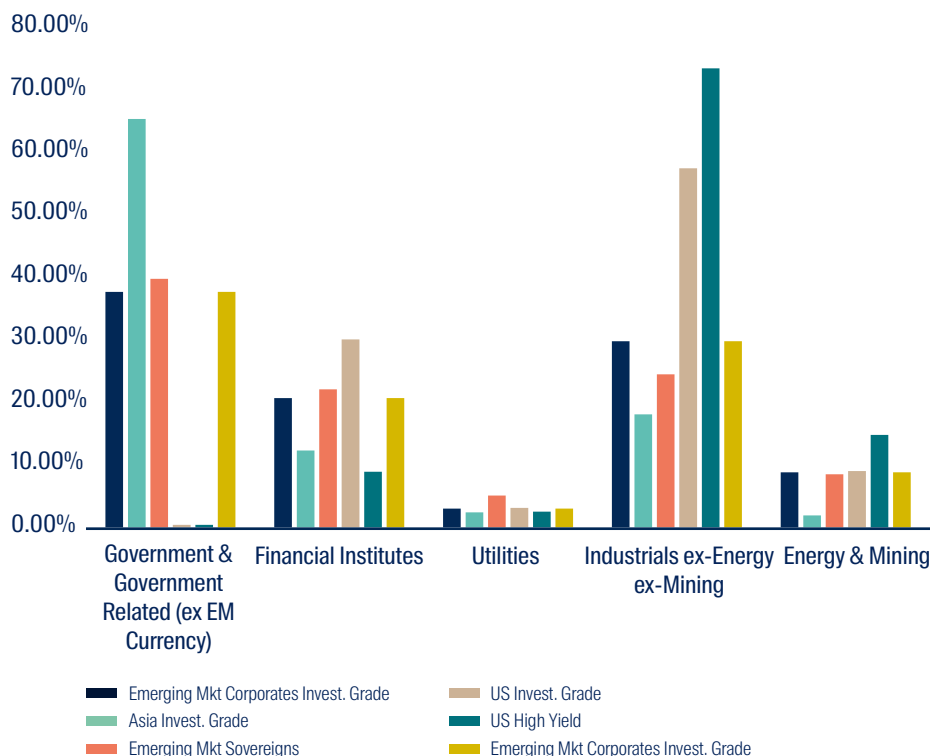
Introduction

In July 2017, we published the “Investment Case for Asian Fixed Income” ([click here](#)) where we presented our thoughts on why Asia represented an opportunity for fixed income investors. In the paper, we assessed (among other things) the growth outlook for Asia relative to other parts of the world, the outlook for Asian demographics, the diversification within the universe of issuers and also compared volatility and returns against other fixed income markets. The results were highly favourable to allocating to Asian fixed income but in a post COVID-19 world, what case can be made for Asia USD investment grade credit?

Stability

In 2017, we assessed the volatility of returns for Asian fixed income, comparing to US investment grade. The research showed that as the market has continued to mature, the volatility profile continues to mirror that of the US investment grade credit. Stepping into 2020, this relationship is set to continue and in our assessment, it is driven by several key factors. Firstly, the type of issuers that dominate, and hence make the largest part of benchmarks, are government related / state-owned enterprises. Chart 1 shows that for Asia USD investment grade credit, it has the highest market value. Given the government ownership, these companies are inherently less risky than general corporates.

Chart 1. Market value (%) by industry



Source: Bloomberg, JPMorgan, FSI as at 31 Aug 2020

RISK FACTORS

This is a financial promotion for The First Sentier Asian Fixed Income Strategy. This information is for professional clients only in the UK and EEA and elsewhere where lawful. Investing involves certain risks including:

- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- **Credit risk:** The issuers of bonds or similar investments may not pay income or repay capital when due.
- **Charges to capital risk:** The fees and expenses may be charged against the capital property. Deducting expenses from capital reduces the potential for capital growth.
- **Single country / specific region risk:** investing in a single country or specific region may be riskier than investing in a number of different countries or regions. Investing in a larger number of countries or regions helps spread risk.
- **Below investment grade risk:** Below investment grade debt securities are speculative and involve a greater risk of default and price changes than investment grade debt securities due to changes in the issuer's creditworthiness. In periods of general economic difficulty, the market prices may fluctuate and decline significantly.
- **Interest rate risk:** bond prices have an inverse relationship with interest rates such that when interest rates rise, bonds may fall in value. Rising interest rates may cause the value of your investment to fall.
- **Emerging market risk:** Emerging markets tend to be more sensitive to economic and political conditions than developed markets. Other factors include greater liquidity risk, restrictions on investment or transfer of assets, failed/delayed settlement and difficulties valuing securities.

For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document for each Fund.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

We do not believe in treating them all the same or placing all of our trust in the ownership structure. Each issuer has the same level of scrutiny as any corporate and we seek to invest in those state-owned enterprises we feel are the best in this sector. Equally important to note are two additional trends. Firstly, developed market investment grade benchmarks are typically dominated by financial institutions, due to their needs for capital. Asia has less financials in the benchmark relative to peers such as US investment grade. The dominant issuers within this sector in Asia are the high quality financial institutions from Singapore, China and Hong Kong. The second trend that was noted in our 2017 research was that Asian investors were buying Asia. This trend continues with approximately 75% of new issues being invested in by Asia based investors. Finally when we look at the dominant issuers for the industrials we see high profile, well capitalised, profitable global names that represent diversity and exposure to the growth story of Asia.

Returns

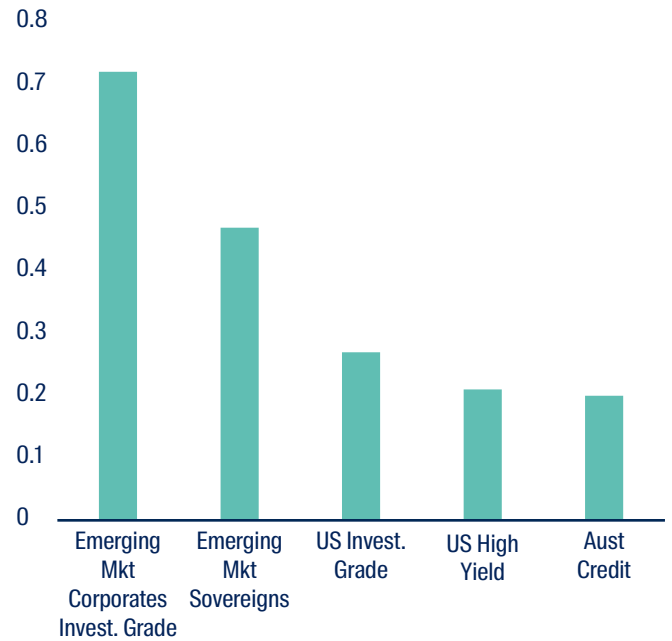
The return profile of Asian investment grade when compared to other fixed income markets remains robust and more importantly offers yield. In today’s COVID-19 heavily impacted world where Central Banks in developed markets have slashed interest rates to zero or near zero, Asia is still able to offer yield. Given the stability mentioned earlier, we believe this translates to an acceptable risk/ return profile for investors as shown per Chart 2.

Index Name	5 Year (p.a) Return	Average Coupon
Asia IG Credit	5.52%	3.85
US IG Corporate	5.95%	3.80
Australia IG	5.19%	3.56
European IG Corporates	3.75%	1.59
EM Sovereigns	6.15%	5.18
EM IG Corporates	5.71%	4.18

Source: Bloomberg, FSI as of 30 Sep 2020

Additionally, we considered how Asia USD investment grade credit could fit within portfolios for global investors, considering return correlations to other fixed income markets. Unsurprisingly Asia USD investment grade credit has a high correlation to Emerging Markets corporates, yet not as high as we instinctively thought. Against global credit constituents, namely US Investment Grade, Emerging Markets Sovereigns, High Yield and Australian Credit, the correlation of returns for these fixed income markets are very low due to the constituents of the benchmark. We attribute this to the dominance of state-owned enterprises, lower allocation to financial, limited energy and mining exposure (a sector that has been volatile in 2020 due to global growth and oil price uncertainty).

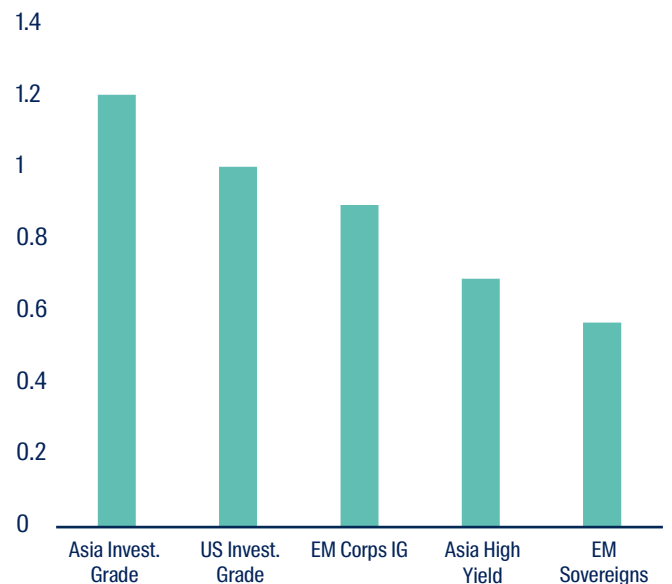
Chart 2. Return correlation with Asia investment grade



Source: Bloomberg, FSI as at 31 August 2020

When we consider the reasons for stability in the context of the return profile, it is not surprising to us that on a risk adjusted return basis (Sharpe ratio) Asia investment grade is a standout. We have presented this as part of our case for Asia USD investment grade credit for many years. Not only does Asia compare favourably against other fixed income markets, but compares favourably across other asset classes as well.

Chart 3. Sharpe ratio



Source: Bloomberg, FSI as at 31 August 2020

Outlook

Global growth is suffering from the COVID-19 pandemic as economies have experienced lockdown and reopened at different times. These interrupt activities and challenge supply chains. The economic data shows that contraction is occurring across virtually all economies and is negatively impacting the outlook for global growth. Asia is not insulated from this with some countries impacted worse than others from the pandemic. Forecasts show that whilst growth is slowing in Asia, it remains the highest growth region in the global economy. Additionally, Asia's share of global GDP has been rising over the last decade and that is expected to continue. This is supportive for Asian corporate health in general. Asian corporates were in good health prior to the pandemic and are likely to be the corporates best placed to survive the challenges for 2020 and beyond.

For further institutional enquiries contact institutionalenquiries@firstsentier.com
For wholesale enquiries contact enquiries@firstsentier.com

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