First Sentier Asian Quality Bond Fund
Monthly review and outlook

Monthly Review and Outlook | January 2023

Market review

The Asian credit market returned +2.98% in January. The strong performance was largely due to the strong rally in US treasuries as market started pricing in a slower rate hike trajectory by the US Fed. The positive sentiments in Asian credit market was further boosted by China's relaxation to their zero-Covid policy along with continued policy support to the beleaguered property sector. Unsurprisingly, we witnessed very strong rally in both investment grade and high yield Chinese property bonds during the month. Emerging market sovereign spreads, namely Indonesia and Philippines were also boosted by the positive sentiments.

Despite the positivity, Asian Investment Grade spread widened modestly by 4bps to 183bp, a slight retracement following the strong rally during the last two months in 2022. The broader emerging market enjoyed strong inflows as we kick started the year, a sharp contrast to the relentless outflows in 2022. This led to Asian sovereign spreads now looking rich in terms of valuations. Indonesia quasi sovereign spreads do however still provide a decent pickup over the sovereign bonds.

Primary market issuance had an active start to 2023. In the sovereign space, Indonesia and the Philippines issued multi-tranche deals both of which were well received. In the corporate space, SK Hynix, HK Government, HK Airport Authority, Exim Bank Korea and Posco also came to the market with new issues taking full advantage of the pent up demand for papers following a barren 2022.

Fund positioning

It was an active month in terms of portfolio activities as the Fund participated in several new issues, including Hong Kong Government International bonds, Hong Kong Airport Authority, Exim Bank Korea, Posco Co Ltd, Woori Bank, and SK Hynix. The Fund also added China Overseas Land on the back of improved sentiments within the Chinese property sector. Credit exposure in Lenovo was reduced as valuation started to look stretched. The fund pared down on some of its currency exposures that were accumulated in Q4 2022 following strong rally in currencies. We ended the month largely neutral on duration.

Performance review

On a net-of-fees basis, the First Sentier Asian Quality Bond Fund returned 3.40% in January, outperforming its benchmark by 1.18%.

The positive return was largely due to the rally in US treasuries, while the sharp tightening of credit spreads from Chinese property names contributed strongly to the outperformance relative to the benchmark.

- 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 be less aggressive in hiking rates, however rate cuts is premature with high prices remains.	Maintained a tactical/neutral stance for US rates in the portfolio.	The Fund's neutral stance in US rates versus the benchmark had a negligible impact on portfolio performance.
Asian IG	Fundamentals remain sound in Asian Investment Grade (IG) corporates but a cautious stance remains warranted following the sharp rally in the past few months.	Tactically traded high quality names in the primary and secondary markets in names that offered attractive issuance premium and still offered value.	The Fund's exposure to Chinese property names was additive to performance, but this was partially offset by the underweight versus the benchmark amongst sovereign names in Indonesia and the Philippines. Exposure in Malaysian Government bonds was positive for performance.

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 January 2023