First Sentier Asian Quality Bond Fund
Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | April 2023

Market review

The Asian credit market returned +0.89% in April, driven by tighter Investment Grade Credit spreads and declining US Treasury yields (USTs). Credit spreads tightened marginally in Asian Investment Grade (IG) credits as market volatility subsided since the banking crisis. Asian High Yield (HY) bonds, however, continued to weaken after the volatility incited by Sino-Ocean's coupon deferral (SINOCE) in March. Over the course of the month, Asian IG spreads tightened 9bps to 186bps, and Asian HY spreads widened by 43bps to 913bps. US Treasury (UST) 10-year yields declined by 5bps, ending the month at 3.43%.

Investment Grade Asian credit had a relatively quiet April as the month saw regional mid-week holidays. Overall sentiment was less bearish than the first quarter, albeit the cautious undertones of a looming recession in the later part of the year. China IG technology names saw spreads widened in benchmark names such as Alibaba and Tencent as news broke on a potential executive order that would negatively impact the Chinese technology sector. The gaming sector looked upbeat as MGM China released strong quarterly results for Q1 2023, suggesting that visitation numbers is on an uptrend following China's reopening.

Continued news of downgrades and potential defaults starkly reminded investors that even with aggressive policy support measures, the liquidity crisis in China property names continues to brew. Despite delivering on its coupon payment of its perpetual bonds in March, Sino-Ocean (SINOCE) received qualified opinion from auditors for its financial year 2022 financial reports and did not repay its syndicated loan amortization due in March. The company remains in discussion to extend c.CNY4bn worth of syndicated loans that will come due in June. Moody's downgraded SINOCE to B3 with its rating under further review. Meanwhile, Dalian Wanda's (DALWAN) efforts to achieve listing status for its commercial property arm (Zhuhai Wanda) encountered difficulties in getting CSRC approval, sparking concerns that approximately CNY40bn repayment to pre-IPO investors could come due should the entity fail to achieve public listing status by the end of 2023. At the end of the month, KWG missed payments on CNY 212mn offshore debt, likely triggering CNY31.2bn in cross defaults, including offshore bonds. KWG's close rivals – Agile, Powerlong, and China SCE felt selling pressures on concerns that the delay in contracted sales recovery could further test their shaky liquidity situation. In the absence of more supportive communication from China's latest political bureau meeting, we believe that contracted sales recovery and prudent management from Chinese property developers will be key elements to watch for the rest of the year.

Spreads of Asian investment grade sovereign and quasi-sovereign bonds tightened over the month. Coupled with the downshift in USTs, the Fund's overweight in names such as Indofood, Pertamina, and Indonesia Asahan Aluminum benefitted from the price appreciations.

Issuance was slow at the start of the month but eventually picked up as the month progressed. Investors saw high quality names such as Kookmin Bank, CK Hutchinson and Korea Ocean coming to the market with USD issuances.

- 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.

Fund positioning

The Fund reduced exposures to CNH bonds on a bearish view on China's rates by paring down exposures in its big four Chinese banks. In the secondary market, the Fund purchased a fixed rate perpetual bond with medium term expectations that the bond will eventually be called.

In the primary market, the Fund participated in Rural Electrification Corporation (REC) Limited, an Indian utility firm, as well as PT Pertamina Geothermal, a 5-year green bond that was part of Indonesia's strategic push to promote renewable energy.

Performance review

On a net-of-fees basis, the First Sentier Asian Quality Bond Fund returned 0.91% in April, underperforming its benchmark by -0.28%.

On a relative basis, the Fund underperformed its benchmark as overweights in Chinese property detracted from performance. This was offset by the Fund's exposure in Indonesian quasi-sovereigns where spreads tightened over the month. In local currency bonds, the Fund's holding in Malaysia Government Bonds contributed to performance as sovereign spreads tightened.

	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 contributed to positive returns as US rates moved marginally lower during the month.
Asian IG	Fundamentals remain sound in Asian Investment Grade (IG) corporates but a cautious stance remains warranted should spread leak wider.	Remained focused on high quality names that are deemed more resilient through risk-off market conditions.	The Fund's exposure to Chinese property names detracted from performance as spreads widened. This is offset by an overweight in Indonesian-quasi sovereigns.

Q2 2023 investment outlook

Risky assets started the year in euphoria as a moderation in US inflation led the US Fed to switch to a more gradual path of rate hikes. A complete relaxation in China's zero-Covid policy further boosted market's sentiment up to a point valuations in credit markets is no longer pricing in any risk of a global recession. While uncertainty around global growth remains, the high all in yield for Asian Credit is an attractive proposition for us to stay constructive in this asset class.

US economy appears resilient of late and labor market remains tight as jobs creation surprised on the upside. Corporate earnings remain decent though outlook is looking increasingly cautious. We are of the view that the stronger than expected headline figures, especially that of the labor market is likely to have veiled the underlying weakness in the US economy. This weakness may have already started during Q4 2022, during which major US technology firms started laying off workers, a clear indication the outlook is not looking too rosy. US imports have also slowed down significantly in recent months, a trend that is highly evident as we simultaneously witnessed sharp decline in Asian exports. With interest rate now at elevated levels, we are starting to see stress in the housing market as many Americans struggle with the high mortgage rate. With consumer prices moving significantly higher, real disposable income has inevitably declined and this will significantly impact consumption going forward even if inflation is to moderate. We believe the US Fed will continue hiking policy rate at 25bps per meeting so long as unemployment rate stays low and economy continues to expand. We also believe it is inconceivable for the Fed to continue tightening without bringing about a recession. In other words, we believe a recession is imminent. The only question is when it will happen and how deep it gets.

Similar to the US, Eurozone economy held up well despite the numerous challenges it faces which include the Russian-Ukraine war. Inflation though remains a serious problem and looks to be much worse than that in the US at this juncture. This means the ECB will likely remain hawkish and play catch-up on policy tightening with the US Fed. Nevertheless, we do take some comfort that the region is now better prepared for further energy shocks as inventory level is high as the region adjusts to a prolonged Russian-Ukraine war. This should help alleviate concerns around a further spike in inflation figures should the war take a turn for the worse.

Meanwhile in Japan, border re-opening since last October didn't quite help bring about a strong recovery in economic activities. In fact growth momentum is showing signs of slowing as exports declined amid weakening global demand especially those from US and Europe. We are skeptical that China re-opening could give Japan a much needed lift. Despite being stuck in a deflationary spiral over the past three decades, Japan did not welcome the current strong inflationary environment as it is costs led rather than demand driven. The weakening yen has further exacerbated the problem to the point it is affecting consumption. While BOJ recently maintained that they will not tweak monetary policy due to supply side issues, we do think a further widening of the yield curve control could not be totally ruled out. We believe BOJ will continue to curb excessive weakness in the Yen while adopting a gradual change to monetary policy if needed.

Asian credit market continued its strong rally towards the end of 2022 on the back an expectation of a more gradual rate hike by the US Fed coupled with positive sentiment around China's re-opening. Valuation for investment grade bonds are now tighter than historical average. Nevertheless, we remain positive on the credit fundamentals of Asian IG and we expect little credit rating changes from here. Supply is also likely to remain soft and hence supportive for bond's demand and supply technical. Should the Fed continue to bring terminal rate higher, the high all in yield of close to 6% would make Asian Investment Grade bonds too attractive to ignore. In other words despite of a cautious global economic outlook, we remain constructive on Asian IG. Asian High Yield led by Chinese properties bonds have done very well of late and is likely to take a pause. We do believe the worse could be over for this sector though we do need to see pre-sales figures improving significantly before bond prices can move higher from here. Following a strong run in the past few months, Asian currencies retraced some of its gain as the dollar regained some ground as market started pricing in a higher terminal Fed fund rate. We do believe this trend may continue a little longer though any further weakness could provide investors a more attractive entry point into Asian currencies. We also expect most Asian central banks to be on hold as inflation figures look relatively benign when compared to developed market peers.

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