First Sentier Asian Quality Bond Fund
Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | November 2023

Market review

The Asian credit market had one of its best months of the year. Market sentiment was generally upbeat with the constructive narrative coming from Biden-Xi's dialogue in the Asia-Pacific Economic Cooperation (APEC) meeting as well as US economic data suggesting that the resilient run the US economy has had thus far was finally showing signs of weakening. The Asian credit market returned 3.69% in November. Asian Investment Grade (IG) credit spreads tightened by 12 basis points (bps), leading to total monthly returns of 3.5% for the month. The rally in rates featured strongly in Asian Credit total returns as US 10-year treasuries yields fell by a respectable 60bps over the month.

In the asset management company (AMC) sector, Huarong's (HRINTH) recent bond purchases culminated in the announcement of its acquisition of a 5.01% stake in CITIC Ltd. Along with the purchase, Huarong will also adopt a name change to China CITIC Financial Asset Management Company. The market reacted positively and prices of HRINTH bonds increased 3-6pts on the news. The release of the latest list of global systemically important banks (G-SIBs) by the Financial Stability Board saw revisions made to capital surcharge requirements for some of China's Big Four banks. Notably, Bank of Communication (BOCOM) was also added to the G-SIB list for the first time, thus requiring BOCOM to also comply with more stringent capital requirements. We expect BOCOM to maintain a slower asset growth and pursue growth in lower risk weighted assets to reduce its capital adequacy gap.

In Asian IG, the technology, media, and telecom (TMT) sector saw some positive rating actions. Moody's revised Weibo's outlook to Stable from Negative and S&P upgraded Meituan to BBB from BBB-. In the asset management company (AMC) space, Huarong's (HRINTH) recent bond purchases culminated in the announcement of its acquisition of a 5.01% stake in CITIC Ltd. With the purchase, HRINTH would also rebrand itself as China CITIC Financial Asset Management Company. The market reacted positively and prices of HRINTH bonds increased 3-6pts on the news. The release of the latest list of global systemically important banks (G-SIBs) by the Financial Stability Board saw revisions made to capital surcharge requirements for some of China's big banks. Notably, Bank of Communication (BOCOM) was also added to the G-SIB list for the first time, thus requiring BOCOM to also comply with more stringent capital requirements. China Construction Bank (CCB) and Agricultural Bank of China (ABC) will both incur higher capital surcharges with their move up in the G-SIBs tier. We expect these large banks in China, especially BOCOM, to maintain slower asset growth and pursue growth in lower risk weighted assets to reduce their capital adequacy gaps.

Spreads in quasi-sovereign names in Indonesia remained steady while sovereign spreads continued to grind to historical tights on improving fundamentals. High yield sovereign bonds in Pakistan performed well as the nation's funding prospects improved on the back of its shrinking current-account deficit and supportive political headlines amid impending elections.

Month on month, primary issuance rose both in terms of total issuer volume as well as issuance size. Activity was dominated by financial names with China taking the lead. Indonesia and the Philippines also issued USD2bn and USD1bn respectively in sovereign bonds. By quantum, Green bonds comprised approximately a quarter of these new issuances.

Fund positioning

Riding on the encouraging rally in bond prices, the Fund added positions in high quality credits. Positions in China, Indonesia and Australia were increased relative to its benchmark.

Performance review

On a net-of-fees basis (SGD terms), the First Sentier Asian Quality Bond Fund returned 4.15% in November, outperforming its benchmark by 0.85%.

The Fund's overweight in duration was positive for performance as bonds rallied on the back of lower US Treasury yields. An underweight in sovereign bonds from Indonesia and the Philippines detracted from performance, but this was compensated by an overweight in Indonesian quasi-sovereigns. Exposure in Malaysian Government bonds and the Japanese yen added to performance as the US Dollar weakened.

	We thought that...	Therefore, we...	And the results...
US rates	The US economy would start showing signs of weakening and US rates would start to show signs of peaking. However, prices will remain high and the likelihood or rate cuts remains low	Maintained an overweight bias for US rates in the portfolio, with a tactical approach in light of the recent volatility in rates	The Fund's overweight in US rates versus the benchmark contributed to returns as US rates moved lower 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 continued to tighten, contributing to the Fund's overweight in credit. An underweight in sovereigns in Indonesia and the Philippines detracted from performance as spreads narrowed, though this was offset by the overweight in Indonesian quasi-sovereigns

Q1 2024 investment outlook

2023 has not been for the faint-hearted. The euphoric mood from China's post-Covid reopening that highlighted the start of 2023 revealed its alter ego as the year progressed with a slew of turbulent events, such as the regional banking crisis and Israel Hamas war. Adding to that, Asian Credit was dealt a challenging hand – the persistent increase in US rates, a struggling Chinese property sector as well as China's economic slowdown. Thankfully, the resilience of the Asian Credit market came through, with the index as a whole still chalking almost 5% in total returns year-to-date.

Entering 2024, we expect global growth, in aggregate, to be slower than in 2023. Our earlier views that US economic conditions were bleaker than hard data suggested was arguably early, but as Covid-era savings run dry, jobless claims rise and retail sales weaken, we are beginning to see the sobering reality of an economy under strain due to the prolonged high interest rate, high inflation environment. We now expect the Federal Reserve (Fed) to adopt a wait-and-see approach over the next few months before deciding on their next move. Barring a re-acceleration of inflation in 2024, we believe the Fed has reached the end of the current rate hike cycle.

In Europe, sustained high prices continue to depress economic growth. Even as headline inflation trends lower, stronger European countries such as Germany are grappling with faltering growth as manufacturing and services activity continue to contract. Unless inflation cools off significantly enough to meet the European Central Bank (ECB's) 2% target, we expect the ECB risks not cutting rates soon enough to cushion the effects of the slowdown in growth in the EU. We believe that growth in Europe in 2024 would be subdued, at best.

China's policies have been turning highly accommodative even though they stop short of a massive stimulus like the one in 2008-2009. By allowing budget deficit to widen to above 3%, it is a very strong indication of China's commitment to prop up growth. However, despite the political commitment to stabilise growth in China, the multilayered problems causing China's slowdown means that we don't expect a quick recovery. The property sector and weak consumer sentiment will remain weak links that need to be addressed. In other words, we still need actual gross domestic product (GDP) numbers and pre-sales in the property sector to pick up on a sustained basis before market confidence can be restored. Nevertheless, we are of the belief that the Chinese economy will emerge much stronger from this consolidation process and maintain a positive long-term outlook for the economy.

Asian economies have been resilient thus far, but effects from China's slowdown are not negligible. The growth outlook in Asia is showing signs of weakness especially for exports oriented countries including Singapore, South Korea and Taiwan, caused not only by China's slowdown, but also reflective of the lackluster demand from developed economies. We believe that this trend is likely to stay. Within the Asian region, countries with a stronger domestic story, such as India and Indonesia, are likely to fare better. Against this weakening external backdrop, most Asian central banks have paused rate hikes as inflation moderated and shifted attention to supporting growth. 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.

Thus far, the rising inflation in Japan has been insufficient to convince Japanese regulators to normalise monetary policy. However, the 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. We see higher certainty of the Euro and other Asian currencies continuing its appreciation against the US dollar, a trend that is largely driven by the Fed's move. Asian local currency bonds may perform well should the Fed cut interest rates in 2024, as this will likely lead to further dollar weakness versus Asian currencies, further boosting Asian local bond returns.

We remain constructive in Asian IG credit. Fundamentals are now mixed but technicals will likely remain a tailwind during the early part of 2024. Even as credit spreads are almost at post-GFC tights, high all-in yields well above 5% does makes this asset class attractive from an income carry perspective. Our bias is to focus on higher quality names that have the liquidity and resilience to withstand a hard global landing, should such a scenario emerge.

Source : Company data, First Sentier Investors, as of 30 November 2023