First State Investments
首域投資

First State Asian Quality Bond Fund

Monthly Review and Outlook

February 2020

- The Fund invests primarily in debt securities of governments and corporate 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 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.

Market Review

Sentiment towards financial markets remained dominated by news and developments associated with coronavirus. Towards month end, it had become apparent that disruptions and delays associated with the disease will have a much more detrimental impact on economic growth than many people had first thought – both within Asia and globally. News reports confirmed the virus was spreading rapidly, initially through Asian countries and later into Europe, Africa and North America.

In turn, investors looked to reduce their exposure to risk assets in the final few days of the month. This resulted in sharp sell-offs in equity and credit markets. Lower activity levels are almost certain to weigh on global growth rates and corporate profitability in the March quarter, and possibly for quite some time thereafter.

While credit spreads widened, a sharp downward move in Treasuries provided a strong tailwind and enabled Asian credit to register a positive return in February. JACI added 1.01% over the month. Government bond yields fell worldwide as 'safe haven' assets were favoured.

Interest rates were lowered in Thailand and the Philippines during February as economic indicators worsened. Policy settings were subsequently eased elsewhere, in a globally coordinated move by major central banks. Borrowing costs in the US and Australia were cut by 50 bps and 25 bps, respectively, in early March. Elsewhere, the Bank of Japan foreshadowed more quantitative easing and officials at the European Central Bank suggested they are ready to take "appropriate and targeted measures" to respond to the mounting crisis. It is likely that central banks around the world are also pressuring governments to pursue more aggressive fiscal stimulus measures (e.g. tax cuts, expanded government spending, loans to struggling business sectors, etc.). As interest rates move closer to zero in key regions the task of smoothing out the economic cycle is increasingly falling on governments, which may or may not have the capacity to step up.

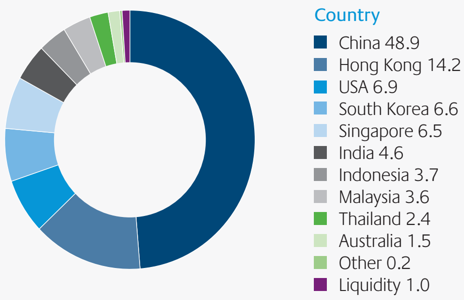
We are beginning to see data on how the slowdown is affecting activity levels in 2020. China reported the worst Purchasing Managers' Index statistics on record for January, for example, which will likely be a concern for policymakers across the Asia Pacific region. In many cases, factories were shut in China as workers were quarantined and as government imposed travel bans. Some factories have since recommenced production, but this appears to be happening unevenly and with reduced capacity. This makes the prospect of a 'V' shaped recovery – one where a sharp slowdown is followed by an equally sharp recovery – increasingly unlikely.

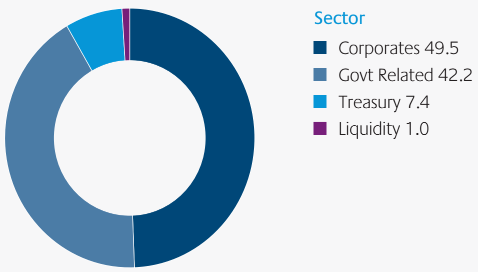
New issuance remained reasonably strong in Asia, as companies appeared willing to look through the current choppy market conditions. A combination of record low Treasury yields and tight credit spreads mean borrowing costs for Asian firms have rarely been lower. The high level of new issuance in the calendar year-to-date reflects companies' desire to capitalize on these

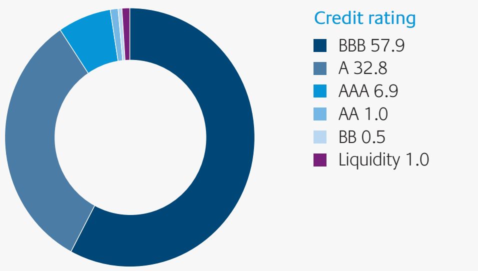
Cumulative Performance in USD (%) [1]	3 mths	YTD	1yr	3yrs	5yrs	Since inception
Class I (USD - Acc)	3.2	2.9	11.1	16.4	22.4	86.4
Benchmark*	3.1	2.9	11.6	17.9	26.4	139.2

Calendar Year Performance in USD (%) [1]	2019	2018	2017	2016	2015
Class I (USD - Acc)	10.9	-1.3	5.6	3.4	0.9
Benchmark*	11.0	0.0	5.5	4.5	2.2

Asset Allocation (%) [1]







Top 10 Issuers (%) [1]

Issuer Name	%
United States Treasury	6.9
China Overseas Land & Investment Ltd	4.3
China Huarong	4.1
Bank of Communications Co Ltd	3.4
Sinochem Hong Kong (Group) Co Ltd	3.2
Hyundai Motor Co	3.1
Nan Fung International Holdings Ltd	3.0
ICBC Financial Leasing Co Ltd	3.0
United Overseas Bank Ltd	3.0
China National Offshore Oil Corp	2.8

historically low financing costs. More than US$26 billion of USD fixed supply was priced in February. Whilst below January's run rate, this was 13% above levels from February 2019. Chinese firms were particularly active, accounting for around two thirds of the total issuance volume.

Performance Review

The First State Asian Quality Bond Fund returned 1.45% for the month of February on a net-of-fees basis.

The strong positive return was largely attributed to the strong rally in US treasury, which more than offset the widening in credit spreads. US 10-year Treasury yield was 36bps lower for the month as market priced in significant downside to economic growth following the outbreak of the coronavirus to regions outside China. JACI IG spreads widened by 14bps to 200bps as market went into a risk-off mode in the second half of the month.

On a relative basis, the fund outperformed the index due to our long US interest rate duration and short Indonesia positioning.

Portfolio Positioning

Our funds remained cautiously positioned in credit spreads though we selectively participated in the high quality issuance including DBS AT1 and CHIOLI for the Asian Quality Bond fund. We also added some SGD currency exposure as we deemed the currency was oversold amid the panic of the Coronavirus outbreak. We maintained our long position in US rates at the front end as we believe there is plenty of room for it to fall should the US Fed cut policy rate.

Q1 2020 Investment Outlook

Writing an outlook for 2020 is turning out to be a lot easier when compared to the same time a year ago, as many of the factors and uncertainties that hampered market sentiments for a big part of 2019 have either changed course or dissipated. A year ago bond investors were in angst as we were still in the midst of a Fed rate hike cycle. The Fed has since cut policy rate three times which felt inconceivable to many even as recent as the middle of last year. The US-China trade war which showed no signs of ending may finally start to ease, as the two economic powers look set to sign on a phase one deal with a potential for a phase two coming around the middle of the New Year. Even the United Kingdom looks likely to now make a breakthrough on Brexit after years of postponement and negotiations, potentially leaving the European Union in an orderly manner on 31 January 2020.# The optimism arising from these recent development on a macro level looks set to continue as we start the New Year, further boosted by recent global economic data which point to some stabilisation in growth.

Growth has slowed in the US throughout 2019 but they were not as bad as what market had feared. The slowdown was largely due to weaker fixed investments and exports, even though consumption has held up reasonably well. What is encouraging

[1] Source: Lipper & First State Investments, Nav-Nav (USD total return) as at 29 February 2020. Allocation percentage is rounded to the nearest one decimal place and the total allocation percentage may not add up to 100%. Fund inception date: 14 July 2003. Performance is based on First State Asian Quality Bond Fund Class I (USD - Acc) is the non-dividend distributing class of the Fund. * The benchmark displayed is the JP Morgan Asia Credit Investment Grade Index. # Please note that the UK has left the European Union on 31 January 2020.

is the revision of 3rd quarter GDP growth estimate from 1.9% to 2.1% suggesting signs of improvement of late. Durable goods orders were also above expectations in the US while unemployment remained at historical low. Unemployment is now the lowest in 50 years though quality of jobs has been poor, which partly explains why there has been a lack of inflation. This set of decent economic numbers should allow Trump to tick many of the boxes on his list of deliverables as he heads into election in 2020. We will now likely to hear more of his rhetoric around his wish for a weaker dollar and lower rates in the months ahead. Development around the US election will be one of the key drivers of the market in the months ahead.

In our previous outlook, we questioned the effectiveness of monetary policies in the developed economies and advocated that fiscal stimulus is likely to be the more effective policy tool as we start the new decade. Since then, Japan announced a massive USD 162.5b fiscal stimulus which aim to support economic growth beyond the upcoming Olympics. Indonesia is also likely to boost infrastructure spending in Jokowi's second term in charge. Jokowi has already announced a plan to move the nation's capital from Jakarta to East Kalimantan. While Asian central banks still have room to cut interest rates to support growth, we expect to see more fiscal stimulus albeit in a moderate and targeted manner.

Asian credits' fundamentals have been broadly stable in recent years as many corporates have been deleveraging and improving their balance sheets. While there has been areas of distress mainly in the Chinese Industrial and Indonesia high yield space, they tend to be more idiosyncratic in nature. Hence default rate in Asia will likely remain benign in the 2-2.5% range for 2020. Rising defaults in China has been well documented in the past two years. While defaults in China will remain elevated as we move into the New Year, we do get some comfort that Chinese defaults both onshore and offshore in 2019 did not increase materially from 2018. One key point bond investors should take note of is that with the defaults, there will more credit differentiation amongst Chinese issuers including those issued by State Owned Enterprises (SOEs) and Local Government Financing Vehicles (LGFVs). The recent default by the Tewoo Group and the turmoil around the Peking University Founder Group are timely reminders to investors that credit risks amongst State Owned Enterprise in China is rising with reduced implicit support from the government and that trend is likely to continue.

One of the key reasons behind the strong performance in 2019 was the return of the onshore Chinese investors after being largely absent the year before. Their continued participation will be a great boost for market's technical. On top of that, gross supply for 2020 is expected to moderate following a record year of issuance, providing further support to market prices. The significant increase in new issue allocation to Asian investors is also a positive trend for our credit market.

Following massive spreads tightening last year, which saw JACI IG spreads tighter by 40bps and high yield spreads tightening by 100bps, valuations are now hovering around the 5-year average. We believe JACI IG spreads of around 180bps at the point of writing has more or less reflected its stronger fundamentals and resilient nature as an asset class. The 100bps rally in US treasury also made all in yield less compelling for investors. Hence we would stay advocate staying defensive and await a pullback before increasing our risk exposure.

In summary, macro backdrop has turned more stable for now which bodes well for risky assets including credits. Fundamentals in Asian credit remain sound while demand and supply technical backdrop is highly supportive. Nevertheless, following such stellar performance last year during which we recorded double digit gains in both investment grade and high yield it pays to be more cautious and focus on avoiding potholes. It is also worth noting that in 2019, the spectacular returns in both equity and bond markets were delivered despite a bleak macro outlook. Will 2020 turn out to be a mirror image of the year before? At this stage we would not bet against it.