# Asian investment grade corporate bonds: A complement to global credit

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We are an advocate that an allocation to Asian investment grade corporate bonds should be a strategic allocation for investors. When we compare across multiple asset classes, the risk-adjusted returns for Asian corporate bonds over the last five years compares well. Recently we analysed across key markets the risk-adjusted returns comparing against Asian investment grade corporate bonds. As the analysis shows the risk-adjusted returns (via a sharpe ratio comparison) for Asian investment grade corporate bonds stands out against the asset classes (we find) are in focus for Asian-based investors.

| | 5-year US Treasury | US IG | US HY | Asian USD IG | Global Equities | US Equities | EM Equities | Asia Ex-Japan Equities |
|---|---|---|---|---|---|---|---|---|
| Annualised return | 1.8% | 3.1% | 8.3% | 6.1% | 11.2% | 16.4% | 3.4% | 7.2% |
| Annualised volatility | 2.5% | 2.7% | 6.2% | 3.8% | 12.3% | 11.1% | 17.3% | 16.1% |
| | | | | | | | | |
| Sharpe ratio | 0.7 | 1.1 | 1.3 | 1.6 | 0.9 | 1.5 | 0.2 | 0.4 |

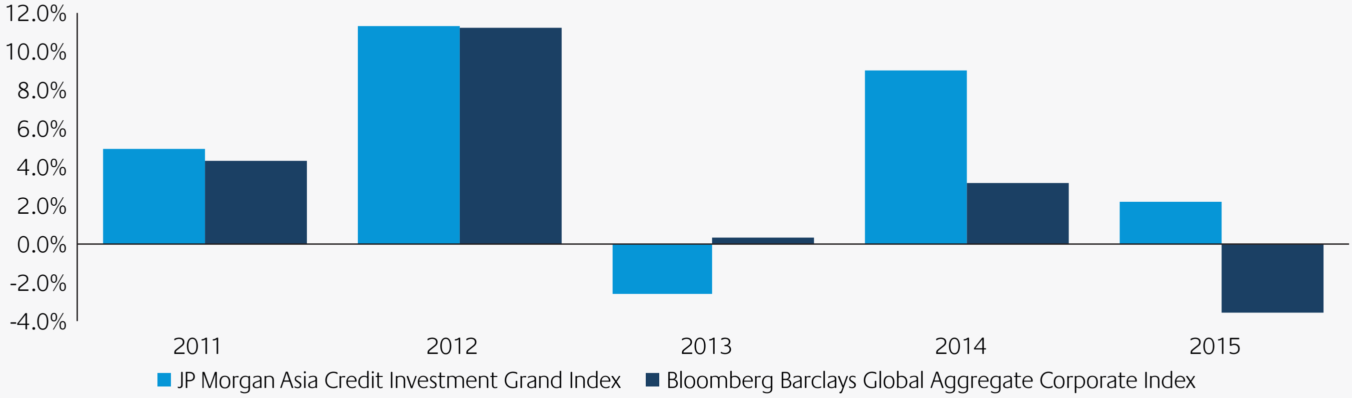
Source: Bloomberg, First State Investments, Markit, JP Morgan, Barclays, MSCI, S&P as at 30 September 2016.

In this article we seek to be more fixed income specific and compare Asian investment grade corporate bonds returns (via the JP Morgan Asia Credit Index ) to global credit returns (via the Bloomberg Barclays Global Aggregate Corporate Index). An interesting conversation with a potential client recently revolved around this comparison. The view expressed was that the client was getting their 'Asian exposure' via their global credit allocation, and that the return profile for Asian investment grade corporate bonds was not compelling by comparison. Following on from this we undertook analysis to compare Asian investment grade corporate bonds to global credit with some interesting results.

## Returns

When comparing the returns of the JP Morgan Asian Credit Investment Grade Index to the Bloomberg Barclays Global Aggregate Corporate Index, for some the results may be surprising. Asian investment grade corporate bonds outperformed global credit four out of the five years under review. The period in which Asian investment grade corporate bonds underperformed was 2013 when the Chairman of the Federal Reserves, Ben Bernanke, surprised the market with a hint of tapering. Cumulative returns over the same five-year period have outpaced global credit as well.

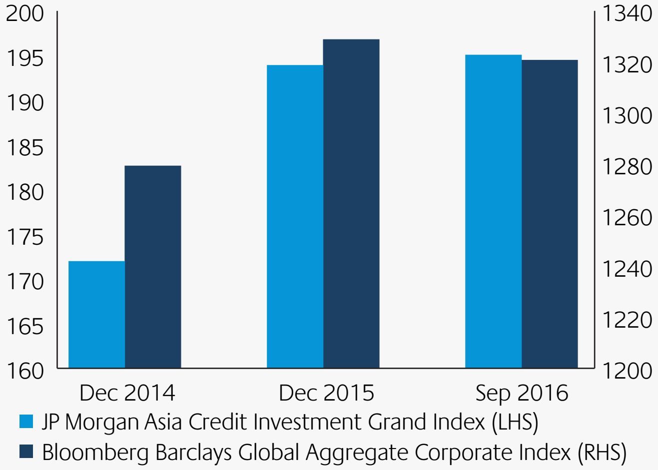
### Index annual returns




Source: Bloomberg, JP Morgan, Barclays as at 31 December 2015.

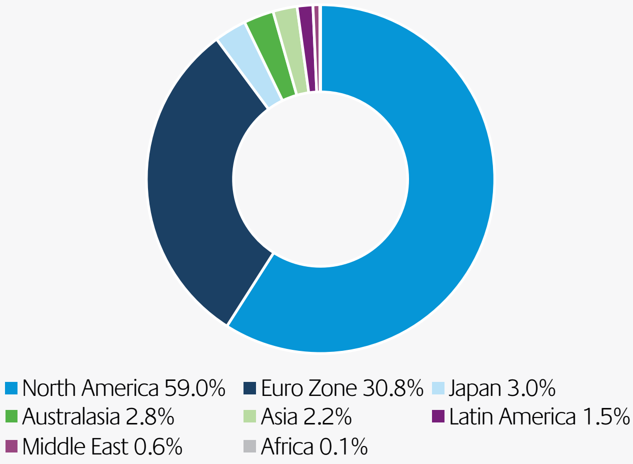
One of the advantages of investing in a global credit fund is that of diversification. Clearly investing directly in Asian investment grade corporate bonds offers less. This is an obvious assessment given the nature of the index with approximately six times more issuers than in the Bloomberg Index. However the view that an investor is accessing their 'Asian exposure' via global credit could be misplaced. Assessing the regional allocation in the Bloomberg Barclays Global Aggregate Corporate Index shows that Asia represents only 2.24%. The allocation is dominated by issuers from the US, with European issuers second. We believe that given Asia remains the region with the best prospect for growth, a more meaningful allocation into Asian investment grade corporate bonds could complement an investor's allocation to global credit.

## Number of issuers




Source: Bloomberg, JP Morgan, Barclays as at 30 September 2016.

## Bloomberg Barclays Global Aggregate Corporate Index




Source: Bloomberg, Barclays as at 30 September 2016.

## Risk profile

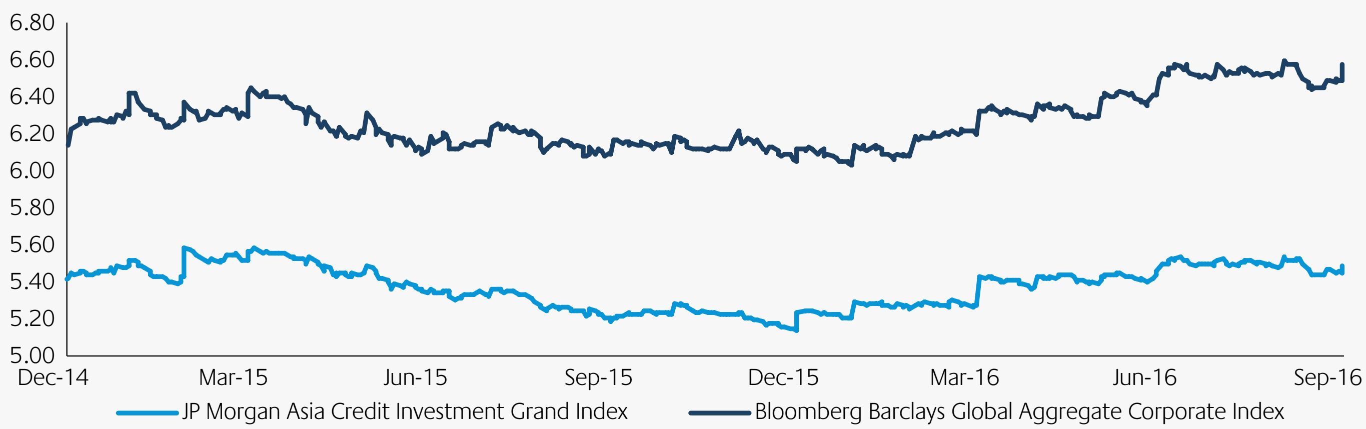
The key risk statistic (to our mind) that our analysis has uncovered is that of credit risk. Whilst (as mentioned previously) there is significantly less issues in the JP Morgan Asia Credit Index, the average effective rating for both benchmarks is identical.

| Index | Effective ratings |
|---|---|
| JP Morgan Asia Credit Investment Grade Index | A- |
| Bloomberg Barclays Global Aggregate Corporate Index | A- |

Source: Bloomberg, JP Morgan, Barclays as at 30 September 2016.

Lastly, when assessing the historical duration between the two, the JP Morgan Asia Credit Index is significantly lower. It is widely expected that from 2017 onwards, the Federal Reserve will embark on a rate rising cycle. Whilst it is anticipated to be a slow process over a long period, a rate hiking cycle should result (in time in higher yields). This is a positive for Asian investment grade corporate bonds given the lower duration of the index and hence less sensitivity to higher yields should the rate rising cycle come to fruition.

## Historical duration




Source: Bloomberg, JP Morgan, Barclays as at 30 September 2016.

## The outlook of Asian investment grade corporate bonds in 2017

If you had suggested at the beginning of 2016 that we would have enjoyed the total return year-to-date in investment grade credit, you may have been laughed at. Yet again Asian investment grade corporate bonds have delivered strong positive returns yet the question is what 2017 looks like. The drivers of returns this year has been the demand dynamic and within that two strong forces at work namely Central Bank activities and Chinese banks and we believe that this theme will continue into 2017. Three major Central Banks (Bank of Japan, European Central Bank and Bank of England) are buying fixed income securities within their market as part of their quantitative easing programs. This buying crowds out other investors, causing them to look elsewhere for yield. These programs have also resulted in approximately US$13 trillion of fixed income securities that have a negative yield. Asian investment grade corporate bonds continue to be a source of yield and pay a premium relative to US Investment Grade and we have seen evidence of flows away from those negative yielding markets into Asia. The second dynamic has been the demand from Chinese banks. Chinese banks deposits in USD cash has grown rapidly as domestic savers convert their RMB to USD on concerns of a depreciating currency. We see evidence of strong demand from onshore Chinese banks because of this and see no reason (whilst it is anticipated that the RMB will continue to depreciate) why this won't continue. Therefore we expect that 2017 can deliver consistent returns given these drivers albeit at a slower pace relative to 2016.

## The outlook for Asian corporates in 2017

There is no doubt that when assessing where we are in the credit cycle, that we are heading into a period of deterioration. Leverage is increasing and balance sheets deteriorating yet this does not mean the asset class is to be avoided, rather we are entering into a period where the quality of your credit research will dictate your success. That said, Asian corporates benefit from a much better growth outlook (compared to other regions) and for that reason we remain confident that Asian investment grade corporate bonds will continue to show resilience in 2017.

## A complement to global credit

The Asian investment grade corporate bonds market is under allocated to despite the consistent returns it delivers year-on-year, in a risk efficient manner. Yet where do we see it sitting from an asset allocation perspective? An allocation to Global Credit delivers the diversification and beta it is designed to provide; yet has limited allocation to the one region with yield, and a better growth outlook. We believe that an allocation to Asian investment grade can act as a complement to global credit as the percentage of Asia in the index remains very small.