First State Investments

First State Asian Quality Bond

Monthly Review and Outlook
September 2019

Market Review

Asian credit market sentiment was boosted at the start of the month when news emerged that the US and China have agreed to continue their trade discussion in October. This led to a bout of credit spreads tightening and higher US treasury yields as we saw unwinding of bearish positions that were put on in the previous months. As concerns around global growth outlook increases following the announcement of a new round of QE by the ECB and rate cut by the US Fed, credit spreads gave up some of the early month's gain while US treasury yields also retraced lower. Nevertheless, JACI spreads ended the month 5 bps lower while 10-year US treasury yield increased by 19bps to 1.69%, resulting in a negative 0.18% total return for the index. Despite the pullback, year-to-date gain for the JACI remains at a remarkable 10.08%. By country, spreads return were all positive led by Macau, Mongolia and Vietnam.

Besides the trade war, China was very much in the limelight throughout the month. The PBOC cut its reserve requirement ratio (RRR) by 50bps for all banks, with an additional 100bps for certain city commercial banks. This was followed shortly after by the scrapping of QFII and RQFII investment quotas for qualified investors. However, China was dealt with a setback towards the end of the month when FTSE Russell decided not to add China to the widely tracked World Government Bond Index (WGBI), citing scant trading activity, lack of flexibility in FX execution and too long a settlement cycle as the key reasons.

Central banks around the world continue to be in an easing mode with the Fed cutting policy rate by another 25bps while the ECB announced a new round of QE. Over in Asia, Bank Indonesia (BI) lowered its 7-day reverse repo rate by 25bps to 5.25%, marking its third straight month of rate cuts. India went a step further by announced aggressive corporate tax cuts, which could be a precursor of what is to come from other Asian economies should growth continues to stutter.

Supply rebounded strongly in September with a total issuance of USD 29.3b which was more than twice the amount in August. This brought year to date issuance to USD 222b, a 57% increase year-over-year. There were some notable non-China deals announced during the month and both were well received.

Bangkok Bank issued USD 1.2b of a 15NC10 Tier 2 bond, their first since the bullet 9.025% 29s issued 20 years ago. The bond received strong support due to its scarcity value and the deal was more than three times oversubscribed with interest coming from 190 accounts across various regions. They eventually priced the issue 30bps lower than the initial price guidance at T+190bps. South Korea's SK Hynix debuted with their first IG-rated dollar bond, a 5 year, USD500m issue that was seven times oversubscribed. Final pricing came in at T+162.5, which was 27.5bps tighter from initial price guidance.

Performance Review

The First State Asian Quality Bond returned -0.53% for the month of September on a net of fees SGD term.

The negative return was largely attributed to the sharp rise in US Treasury yields even though credit spreads were tighter.

On a relative basis, the fund under-performed the index in September largely due to our overweight in US duration and underweight in Indonesia and Philippines spread duration.

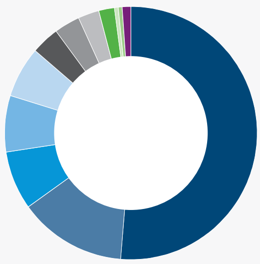
On a year to date basis, our overweight in credit along with security selection both added value during the January to April period. Our overweight in US interest rate duration which we held since the start of the year also contributed positively to our excess return. This outperformance was especially significant in the May to August period during which 10 year US treasury yield rallied by around 100bps. Our underweight in both Indonesia and Philippines spread duration detracted value.

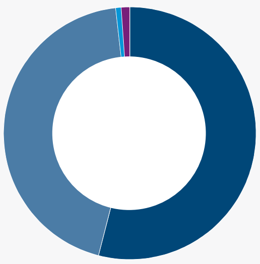
Annualised Performance in SGD (%) [1]	1 yr	3 yrs	5 yrs	Since inception
Class A (SGD - Q Dist) (Ex initial charges)	9.5	N/A	N/A	2.7
Class A (SGD - Q Dist) (Inc initial charges)	5.1	N/A	N/A	1.3
Benchmark*	10.7	N/A	N/A	3.8

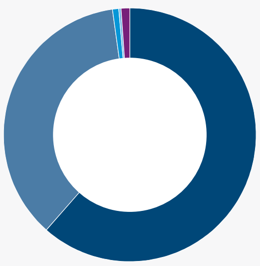
[1] Source: Lipper, First State Investments. Single pricing basis with net income reinvested. Data as at 30 September 2019. The First State Asian Quality Bond inception date: 1 November 2016. * The benchmark displayed is the JP Morgan Asia Credit Investment Grade Index (SGD Index) (Hedged to SGD).

	Cumulative Performance in SGD (%) [1]				
	3 mths	1 yr	3 yrs	5 yrs	Since inception
Class A (SGD - Q Dist) (Ex initial charges)	2.0	9.5	N/A	N/A	8.1
Class A (SGD - Q Dist) (Inc initial charges)	-2.1	5.1	N/A	N/A	3.7
Benchmark*	2.3	10.7	N/A	N/A	11.3

Asset Allocation (%) [1]







Top 10 Issuers (%) [1]

Issuer Name	%
China Huarong	4.7
Genting Berhad	4.1
Bank of Communications Co Ltd	3.9
Sinochem Hong Kong (Group) Co Ltd	3.7
Hyundai Motor Co	3.6
United Overseas Bank Ltd	3.5
Industrial and Commercial Bank of China Ltd	3.5
Nan Fung International Holdings Ltd	3.4
China National Offshore Oil Corp	3.2
China Overseas Land & Investment Ltd	2.9

Portfolio Positioning

While staying cautious in our credit positioning, we did selectively participate in issues including the Bangkok Bank deal while at the same time picking up oversold Hong Kong corporates such as New World Development. We reduced our duration in US rates at the long end to neutral as we believed a positive outcome in October around the trade discussion could push rates higher in the short term. We kept our long duration at the front end as we believe the US Fed will continue to cut rates as the US economy remains on a weakening trajectory. Our country positioning remained unchanged. We are overweight in China and Hong Kong. Within China, we are overweight investment grade property, big four banks' leasing companies and asset management companies while underweighting core SOEs, banks and LGFVs (local government financing vehicles). We remained underweight in Philippines and Indonesia on tight valuations. We do not like India banks and corporates as valuation does not reflect the fundamentals, which have continued to weaken in recent months.

Q4 Investment Outlook

As we moved into the last quarter of the year, there are clearer signs that the world is and will continue to be struggling for growth. The Fed has since cut policy rate twice, which now look more reactive rather than preemptive as Chairman Powell had suggested. The ECB has rolled out a fresh round of quantitative easing though we remain skeptical on the impact it has on the real economy after a decade of overdose. The inverted yield curve in the US and signs of stress in the US repo markets further add to the complexity of the tasks on hand for the Fed and these occurrences are not to be taken lightly especially the repo market situation which looks set to emerge again. While many may say “this time it is different” due to the central banks omnipresence, such signs of stress are usually precursors for a crisis. Amid the gloom and doom, there could be some positive surprises for the financial markets in the coming quarter should we get some positive development out of the trade discussion between the US and China. Markets could also cheer any form of fiscal stimulus by the major economies as this now looks imminent should growth continues to weaken despite rate cuts and quantitative easing.

While the US Fed and many Asian central banks still has room to cut policy rates, we would question its effectiveness because the normalisation process in the past few years did not bring interest rates back to pre-global financial crisis levels. It has become more consensual of late that in order to avert a sharp slowdown as we head into 2020, fiscal stimulus is likely to be the more effective policy tool from here. Let's analyse the fiscal situation across major economies.

Donald Trump's aggressive fiscal stimulus brought US budget deficit to around 4.6% of GDP from the previous years' slightly above 3% level. While aggressive stimulus is not likely to be approved ahead of the election in 2020, current budget deficit level is still a long way off from the 8% level hit during the post crisis period of 2010-2011. Meanwhile Eurozone's budget deficit at 1% level also looks benign and China's deficit is still below 3%

[1] Source: Lipper, First State Investments. Single pricing basis with net income reinvested. Data as at 30 September 2019. The First State Asian Quality Bond inception date: 1 November 2016. * The benchmark displayed is the JP Morgan Asia Credit Investment Grade Index (SGD Index) (Hedged to SGD).

despite the targeted stimulus rolled out in the past two years. What this means is while we do not expect fiscal stimulus to be of the same magnitude as 2008-2009, there is ample room for most government to roll out such measures especially when inflation across the globe remain benign or even non-existent. India has recently announced aggressive tax cuts and that is likely a precursor of more to come from other Asian economies. Fiscal stimulus however, is unlikely to be the panacea. Approval process takes time and even upon implementation there could be a delayed impact on the real economy. The uncertainty around the trade war makes it more difficult to determine which sector needs stimulus and as a result, most government are likely to take a more reactive approach thereby risking doing too little too late. Fiscal stimulus may also be less effective in some Asian economies where corruption is rife.

Looking at the performance across major asset classes, it is clear that the US and Europe rates markets have been spot on in identifying the slowing global growth trend as evidenced by the sharp rally in rates over the past year. One can also argue that some segments in the high yield space have started reflecting a weakening economy and rising default rates. Investment grade spreads have remained relatively stable, suggesting its more defensive profile in a downturn. One worrying sign that emerged of late is that the usually resilient US equity market is now showing some concerns about global economic outlook or at least is no longer reacting positively to Fed rate cuts. Should this trend of risky assets continuing to reprice to reflect the deteriorating outlook, a heightened bout of volatility will be imminent especially if growth starts to plunge regardless of what central banks do. Specific to Asian credits, notwithstanding the spectacular rally this year, both IG and HY have underperformed those in the US. Asian investment grade bonds are now trading at around a spread premium of around 30bps above that of the US, which is modestly above that of the five year average suggesting they do offer some value on a relative basis. While we have been and will continue to advocate caution and go for quality, we do see some value emerging in certain segments which include Hong Kong corporates such as New World Development and Hysan following the sell-off amid the protest in Hong Kong. We remain bullish on US interest rates as we believe the Fed will continue to cut policy rates amid slowing growth, which means it should support total return for Asian USD credits. Nevertheless, we do not think it will be a one-way street as there could be short term spikes in yields should we get any positive development around the trade discussion, any surprise stimulus roll out by Trump or a disruption in oil supply.