First Sentier Asian Quality Bond Fund
Monthly review and outlook

First Sentier Investors

Monthly review and outlook | January 2021

Market review

Returns from investment grade corporate bonds in Asia were almost flat in January. The JACI Investment Grade Index returned -0.04% over the month. Credit spreads continued to grind tighter, but this beneficial impact was offset by an upward move in US Treasury yields.

There was an unprecedented level of new supply, presenting investors with new investment opportunities. More than US$50 billion of new bonds were priced. This set a new monthly record, and was more than 40% above the level from January 2020. The performance of these new issues was positive on the whole, but there was some dispersion as different areas of the market are not necessarily performing uniformly. This may continue to be the case, with some issuers faring better than others as virus-related restrictions are lifted in Asia and elsewhere.

Bonds issued by Chinese companies on the US sanctions list – CNOOC and Haohua, for example – remained particularly closely scrutinised. Again, this is likely to remain the case for the foreseeable future. Sentiment in the near term will also be affected by the tone of listed companies' quarterly earnings releases, as well as accompanying outlook statements.

Performance review

The First Sentier Asian Quality Bond Fund returned 0.07% for the month of January on a net-of-fees basis.

The return was only a slight positive as spread tightening was almost all offset by higher US Treasury yields as US President Joe Biden vowed to roll out aggressive fiscal stimulus, which inevitably means higher US Treasury issuance.

On a relative basis, the fund outperformed the index in January as our short US duration positioning protected the portfolio from rising yields.

- 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.

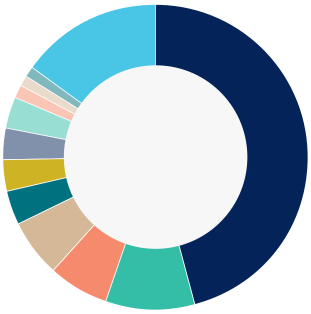
Cumulative performance in USD (%)[1]

	3 mths	YTD	1 yr	3 yrs	5 yrs	Since inception
Class I (USD - Acc)	1.5	0.1	4.5	16.5	25.7	92.0
Benchmark*	1.2	0.0	5.2	19.4	28.8	148.3

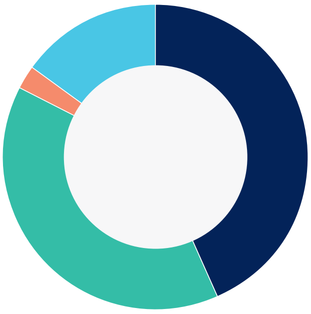
Calendar year performance in USD (%)[1]

	2020	2019	2018	2017	2016
Class I (USD - Acc)	5.9	10.9	-1.3	5.6	3.4
Benchmark*	6.9	11.0	0.0	5.5	4.5

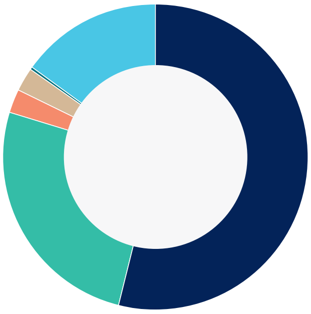
Asset allocation (%)[1]



Country
- China 45.9
- Singapore 9.5
- Indonesia 6.5
- Hong Kong 6.0
- Thailand 3.7
- India 3.3
- South Korea 3.3
- Malaysia 3.3
- USA 1.3
- Taiwan 1.2
- Other 1.1
- Liquidity 14.9



Sector
- Corporates 43.5
- Govt Related 39.0
- Treasury 2.5
- Liquidity 14.9



Credit rating
- BBB 54.1
- A 25.7
- AA 2.5
- AAA 2.4
- BB 0.3
- Liquidity 14.9

Top 10 holdings (%)[1]

Stock Name	%
People's Republic of China (Government)	5.4
China National Chemical Corp Ltd	3.3
Country Garden Holdings Co Ltd	3.1
China Huarong	2.7
Pertamina Persero PT	2.5
DBS Group Holdings Ltd	2.4
China Overseas Land & Investment Ltd	2.4
Indonesia (Republic of)	2.3
Temasek Holdings (private) Ltd	2.3
PTT PCL	2.2

Fund positioning

The Fund was quite active in the new issue market, participating in a number of new deals. Indonesian sovereign bonds were added to the portfolio, for example, and capital was deployed in corporate names including Haidilao, Shimao and Cogard.

The Fund also invested in a new, US$500 million bond issued by Singapore Airlines. This was the company's inaugural USD-denominated issue and offered investors an attractive yield. Maturing in 2026, the bond was priced 260 bps above comparable US Treasuries and will complement other income-generating investments in the portfolio over the next five years. Other investors were also attracted by the offer – the deal attracted strong levels of interest and the final order book was nearly six times oversubscribed. This enabled Singapore Airlines to tighten the valuation from initial guidance. Proceeds from the bond sale will be used for aircraft purchases and aircraft-related payments, ready for an anticipated boom in overseas travel once border restrictions are lifted. These bonds supported performance in the Asian Quality Bond Fund during the month, trading extremely well in the secondary market after the issuance process was complete.

Q1 2021 investment outlook

As we move into 2021, the economic outlook seems a lot brighter than it was just three months ago. Vaccines against the Covid-19 virus are now being rolled out; more than four million doses have been administered, across nine countries. There will undoubtedly be distribution and logistical challenges in developing regions, but we are reassured by the pace at which the vaccine is being rolled out in countries including the US and Singapore. Hopefully these nations can provide support for others, for collective benefit. We are also encouraged by the high efficacy rate of the approved vaccines and the potential implications for economic activity levels. China, the first country to be hit by Covid-19 – and also the first to have it under control, even before the vaccines – has seen a strong recovery in consumer spending and retail activities. This positive trend may emerge elsewhere if the virus is contained. Many consumers are showing signs of lockdown and work-from-home fatigue, suggesting spending could pick up quite strongly as restrictions are eased.

Performance is based on First Sentier Asian Quality Bond Fund Class I (USD - Acc) is the non-dividend distributing class of the Fund, the performance quoted are based on USD total return (non-dividend distribution).
This Fund is a sub fund of Ireland domiciled First Sentier Investors Global Umbrella Fund Plc.
* The benchmark displayed is the JP Morgan Asia Credit Investment Grade Index.
1 Source: Lipper & First Sentier Investors, Nav-Nav (USD total return) as at 31 January 2021. 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.

On the political front, the new Biden administration in the US is expected to be more collaborative with major global trading partners. Some of the inward-looking policies introduced by President Trump might even be unwound during 2021, perhaps helping to rebuild damaged relations with China. A much reduced focus on Trump's social media activity should be a further welcome development, as his random outbursts over the past four years have often spooked investors and resulted in an uptick in market volatility. In Europe, the UK has now left the European Union, following more than four years of negotiation that has dominated policymakers' agenda. December's trade agreement appears to have greatly reduced uncertainty in the region, which has weighed on sentiment since 2016.

While geopolitical uncertainty appears to be easing, we will continue to closely monitor US sanctions against companies on the list of alleged military-backed entities. The list includes several high profile State Owned Enterprises in China – Three Gorges, SinoChem, China National Chemical Corporation and China General Nuclear Power Group, for example – which are frequent issuers of US$-denominated bonds. The inability to sell bonds to US investors will inevitably affect the liquidity of these securities. We would also be concerned if US banks were prohibited from trading in these names, as such a move would further affect liquidity. The aforementioned names are among the highest quality credits in the Asian universe and any negative developments relating to these issuers could therefore limit spread tightening in the broader market.

Major central banks appear likely to keep monetary policies accommodative to help economies rebound from the Covid shock. We have questioned the effectiveness of monetary policies in dealing with what is a health crisis rather than a cyclical economic slowdown, and are relieved that US officials are starting to voice concerns about the unintended consequences of quantitative easing measures. There remains scope for financial instability worldwide if large-scale asset purchase programs are kept in place for too long. That said, we are not expecting tighter monetary conditions any time soon; it will take time for the current ultra-easy monetary policy settings to be reversed. Policymakers have indicated that policy settings will remain accommodative until there is "significant progress in economy recovery".

At some stage in 2021, we expect Federal Reserve officials to provide clearer forward guidance on the interest rate front. For now, the risk with maintaining such vague guidance is that longer-dated US government bonds could sell off sharply if economic growth and unemployment rebound strongly, particularly if inflation in the US breaches the Federal Reserve's 2% target. Such a move would affect risk assets worldwide, including corporate credit.

The Federal Reserve will likely tolerate a gradual rise in Treasury yields, in our view, particularly as 10-year yields of around 0.9% remain well below the previous low of around 1.4% in 2016. US policymakers' commitment to keep interest rates close to zero until the end of 2023 should support the 'search for yield' theme in global markets. At the same, spreads for both investment grade and high yield credit in Asia remain well above the tights seen in 2017-18, and remain attractive compared to US peers. Fundamentally, credit metrics should further improve as the availability of Covid vaccines boosts consumer and business confidence.

Persistent economic headwinds still suggest default rates in Asia will rise, but a default rate of between 3% and 4% now appears most likely; much lower than forecasts from a few months ago. Stress is most likely to be seen in idiosyncratic names, with minimal spill over anticipated in the broader market. Demand for Asian credit is therefore expected to hold up strongly and any sell-off in the market is likely to be shallow, unless confidence craters and liquidity freezes up as it did in March 2020. The sheer weight of money ready to be deployed into yielding investments is significant. The demand/supply dynamic should therefore remain a powerful technical factor driving spreads tighter in early 2021, and should be supportive of a continued rally in the Asian credit market.

While current spreads look attractive against this backdrop, the sharp drop in US Treasury yields in 2020 means the all-in yield of the JACI Investment Grade index is now close to historical lows. Indeed, we are mindful that returns could be adversely affected by a quicker-than-expected steepening in the Treasury curve. With that in mind, portfolio positioning remains cautious, with higher quality names continuing to be favoured. We will look to further diversify exposures as opportunities are identified in the new issuance market.

A further spike in Covid cases – including the spread of variants of the virus similar to what we have seen recently in the UK – remains the biggest risk to the overall encouraging outlook.

Source : Company data, First Sentier Investors, as of end of January 2021