First Sentier Asian Quality Bond Fund
Monthly review and outlook

Monthly Review and Outlook | March 2021

Market review

The drivers of Asian credit markets were little changed in March. Credit spreads have been compressed by encouraging developments on the vaccine front – China's efforts to contain the virus appear to have been effective and authorities have pledged to supply half a billion doses of the Chinese vaccine to more than 45 countries. In the US, all adults are expected to have been vaccinated by July. The outlook for company profitability in Asia and elsewhere has improved markedly as a result.

At the same time, anticipation of a pickup in economic activity levels and inflationary pressures saw Treasury yields increase further. The majority of voting officials at the Federal Reserve expect official borrowing costs to remain unchanged until the end of 2023 at the earliest, but this has not prevented investors from speculating that policy settings could be tightened if inflation increases meaningfully.

Rising Treasury yields acted as a drag on overall returns from Asian credit. The JACI Investment Grade Index declined in value by 0.46% over the month, and by 1.67% in the March quarter.

President Biden announced plans to spend more than US$2 trillion on infrastructure projects in the US over the next eight years. This may help support economic activity and company profitability over time, but was not greeted particularly warmly by credit investors given concerns about the possibility of higher Treasury yields impeding total returns from corporate bonds.

On the issuance front, PTT Global Chemical entered the offshore bond market with a dual-tranche senior note offering. This was the first deal from a Thai company this year, and raised US$1.25 billion. The 10-year and 30-year bonds were priced with spreads of 160 bps and 210 bps, respectively. Final order books were more than five times oversubscribed, continuing the strong demand theme we have seen in recent months. Moreover, both new securities performed well in secondary markets after the issuance process was complete.

Performance review

The First Sentier Asian Quality Bond Fund returned -0.47% for the month of March on a net-of-fees basis.

Similar to February, the return was negative largely due to a continued rise in US Treasury yield despite credit spread grinding tighter.

On a relative basis, the fund outperformed the index modestly in March as our short US duration positioning protected the portfolio from rising yields just as it did in the past few months. Our local currency exposure however detracted value as the rise in US Treasury also led to dollar strength as investors unwound their short USD positions.

- 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.

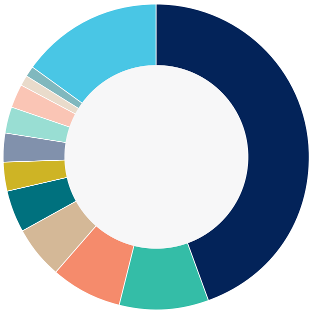
Cumulative performance in USD (%)[1]

	3 mths	YTD	1 yr	3 yrs	5 yrs	Since inception
Class I (USD - Acc)	-1.1	-1.1	7.1	16.1	21.4	89.9
Benchmark*	-1.7	-1.7	6.0	18.3	24.0	144.3

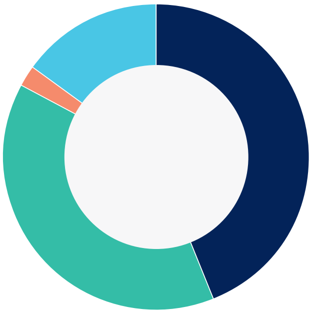
Calendar year performance in USD (%)[1]

	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

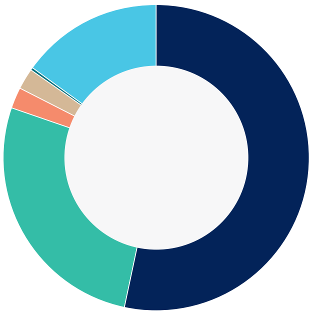
Asset allocation (%)[1]



Country
- China 44.6
- Singapore 9.4
- Indonesia 7.4
- Hong Kong 5.7
- Thailand 4.3
- India 3.1
- South Korea 3.0
- Malaysia 3.0
- Australia 2.3
- USA 1.2
- Other 1.2
- Liquidity 14.8



Sector
- Corporates 43.9
- Govt Related 39.0
- Treasury 2.3
- Liquidity 14.8



Credit rating
- BBB 53.4
- A 27.1
- AAA 2.2
- AA 2.2
- BB 0.3
- Liquidity 14.8

Top 10 holdings (%)[1]

Stock Name	%
People's Republic of China (Government)	5.0
Pertamina Persero PT	4.1
China National Offshore Oil Corp	3.2
China National Chemical Corp Ltd	3.0
Country Garden Holdings Co Ltd	2.8
China Huarong	2.4
DBS Group Holdings Ltd	2.2
China Overseas Land & Investment Ltd	2.1
Temasek Holdings (private) Ltd	2.1
Bank of Communications Co Ltd	1.9

Fund positioning

While we remain cautious on credits, exposure to high quality issuers including Capital Mall Trust and Alibaba was increased through new purchases. The Fund also participated in a dual tranche issuance of sub debt by Commonwealth Bank of Australia, a deal that was well received by global investors.

In Indonesia, the scale of the Fund's positions in Pertamina Persero was increased – we see better value in these quasi-government securities than in the country's sovereign bonds.

Elsewhere in the portfolio, performance was assisted again by the short duration position in the US Treasury market. This strategy continues to be held in anticipation of rates continuing to edge higher. US 10-year Treasury yields have risen more than 80 bps since the beginning of 2021 and while some further upside in yields is expected, the pace of increases seems likely to moderate in the months ahead.

On the currency front, exposures to the Chinese yuan and Singapore dollar detracted from performance. Both lost ground against the US dollar on the back of higher US Treasury yields. Nevertheless, we believe both countries are better placed than most others to contain the spread of Covid-19, which should help limit the extent of further downside.

Q2 2021 investment outlook

The optimism around global economic recovery we witnessed at the start of the year looks set to continue, with the rollout of Covid vaccines gathering pace. Progress varies between countries, but encouraging progress has been made overall. By the end of March, nearly 100 million adults in the US had received at least one shot, and more than 53 million – or more than 20% of the adult population – had been fully vaccinated. At this rate, all adults in the US could be vaccinated by July. China also appears to have done an effective job in containing the virus, and have also pledged to supply half a billion doses of Chinese vaccine to more than 45 countries. Progress in Europe has been slower, owing to issues with production and distribution in the region. Overall, we expect investors to continue to focus on the pace of vaccine rollouts worldwide, given the correlation between economic activity levels and corporate profitability.

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 J.P. Morgan JACI Investment Grade Index.
1 Source: Lipper & First Sentier Investors, Nav-Nav (USD total return) as at 31 March 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.

Despite signs of success in the containment of the virus and good progress with the vaccine rollout, President Biden recommitted to supporting the US economy through massive fiscal stimulus. To put some numbers into perspective, the US$1.9 trillion package Biden has approved equates to almost 9% of GDP. The package includes US$400 billion of direct payments to households, suggesting there could be an immediate impact on discretionary spending and, in turn, inflation. The additional US$2+ trillion infrastructure spending plan could result in additional inflationary pressure over time. Risk assets have understandably cheered these moves, and while these stimulus packages are likely to be positive for the US economy, there are some potential implications for markets that investors need to be mindful of.

The massive stimulus announced – and the probability of even more to come – suggests US Treasury supply could continue to rise sharply in the months ahead, in turn exerting further upward pressure on yields. Moreover, the unprecedented size of the fiscal stimulus, along with highly accommodative monetary policy, means there is a genuine risk of inflation surprising on the upside in the months ahead. This is despite Federal Reserve officials assuring investors that higher inflation is likely to be transient, and that official interest rates will not be raised until 2024 at the earliest. The Federal Reserve's central scenario seems plausible, but we believe there is a genuine risk that inflation surprises on the upside – perhaps increasing to its highest level since the Global Financial Crisis – and stays elevated for a longer period. We are also mindful that investors may have become too complacent regarding inflationary risks, with CPI being so low over the past decade. If higher inflation does materialize and remains persistent, we might therefore see bouts of volatility in financial markets, similar to those seen during the 'taper tantrum' period in 2013, when investors became jittery about the Federal Reserve reducing the scale of its quantitative easing program.

Approximately half of Asian corporates have reported earnings for the 2020 year, and the trend is clear. Firms have seen significantly lower revenues and earnings, and worsening debt and leverage ratios. The deterioration in credit fundamentals is not too unsettling at this stage, certainly among the investment grade universe. The decline in earnings so far has been most pronounced in Chinese high yield property names, such as Yuzhou, which reported losses of RMB166 million towards the end of March following two consecutive profit warnings. The good news is that may have seen the trough in earnings in this part of the market. That said, some caution is warranted, particularly with spreads on Asian investment grade issuers around 180 bps, below the 5 year average, and with 'all in' yields still on the low side.

Demand and supply dynamics in the Asian credit market remain supportive – new issues have generally seen strong demand among income-seeking investors. This helps explain why periodic sell-offs in recent years have tended to be quite shallow, and short lived. Indeed, any meaningful increase in spreads would present us with an opportunity to add some more risk into the portfolio, particularly if the spread widening coincided with a stabilization in US Treasury yields. We continue to monitor the new issuance calendar for new investment opportunities that are reasonably priced. Our dedicated credit analysts scrutinize the pricing and structure of new deals, looking for issues that can further diversify the portfolio.

With the likely increase in US Treasury supply in the years ahead to fund the additional fiscal stimulus, we see very little reason to change our structurally negative view on prospects for the US dollar. Nevertheless, should US Treasury yields continue to edge higher, and if the market starts pricing in an official interest rate hike earlier than 2024, we could see the US dollar strengthen in the next few months as investors further unwind the very crowded short dollar trade from last year. Consequently, we remain cautious around the duration risk associated with local currency bonds, especially higher beta issues like Indonesian and Indian bonds. On the other hand, any sell-offs could present interesting opportunities for us to initiate exposures in these securities given our concerns about the resilience of the US dollar over the longer term.

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