First Sentier Asian Quality Bond Fund
Monthly review and outlook

Monthly Review and Outlook | September 2021

Market review

Asian credit markets continued to struggle in September, due to rising US Treasury yields and ongoing concerns over the creditworthiness of large Chinese property developer Evergrande Group. The sell-off in Evergrande debt spilled over into other areas of the market, as some investors suggested the issue could present broader systemic risks to the Chinese financial system. The JACI Investment Grade Index closed the month 0.93% lower, which dragged returns back into negative territory in the 2021 calendar year-to-date.

Most of the new supply came in the middle of the month, before the Evergrande news really started to dominate attention and sentiment. Indonesia raised US$1.25 billion, issuing new 10- and 40-year sovereign bonds. The order book for the longer-dated securities was more than five times over-subscribed, but the bonds underperformed in the secondary market once the issuance process had been completed.

Sinochem – a Chinese state-owned entity that operates in the energy and chemicals industries – issued US$1.5 billion across three tranches. Again, demand for the new bonds was quite firm, with more than US$8 billion of orders. South Korean issuers were also quite active; Korea Electric Power, NH Investment and Securities, Industrial Bank of Korea, and Hyundai Motor all completed new issues during the month.

Elsewhere, casino operator Sands China raised nearly US$2 billion across three tranches. After the issuance process was complete, the Macau Government published a consultation paper for concession renewals, which resulted in a sizeable sell-off in gaming names. Wynn Macau was among the worst affected issuers, but Sands China performed poorly too – by month end, spreads on the new securities had widened from the issue price.

Performance review

The First Sentier Asian Quality Bond Fund returned -0.91% for the month of September on a net-of-fees basis.

The negative return was largely due to rising US Treasury yields as market started pricing in rate hikes by the US Fed. The modest tightening of Asian investment grade spread was not enough to offset this move.

On a relative basis, the fund outperformed the index largely due to our short US duration positioning.

- 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.

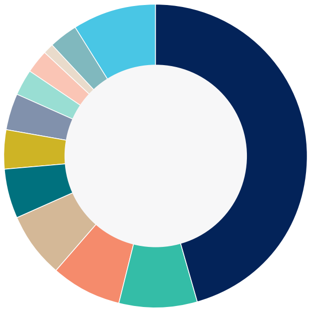
Cumulative performance in USD (%)[1]

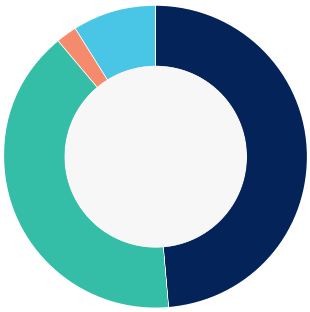
	3 mths	YTD	1 yr	3 yrs	5 yrs	Since inception
Class I (USD - Acc)	0.6	-0.4	1.1	17.8	16.8	91.2
Benchmark*	0.4	-0.1	1.1	19.8	20.2	148.1

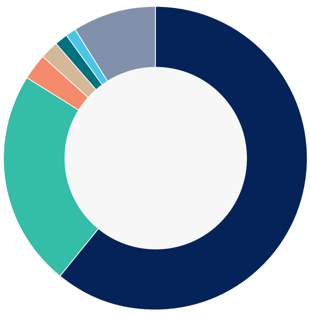
Calendar year performance in USD (%)[1]

	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]







Top 10 holdings (%)[1]

Stock Name	%
People's Republic of China (Government)	4.6
Shimao Group Holdings Limited	4.2
Indonesia (Republic of)	3.8
China National Offshore Oil Corp	2.9
China Huarong	2.7
China National Chemical Corp Ltd	2.6
Country Garden Holdings Co Ltd	2.4
Korea Investment Holdings Co., Ltd.	2.3
Pertamina Persero PT	2.0
China Mengniu Dairy Company Limited	2.0

Fund positioning

The Fund held an active short duration position in the US rates market, which added value as Treasury yields rose sharply. We used this move as an opportunity to reduce the scale of the position, locking in profits. Otherwise most of the existing credit exposures in the portfolio were unchanged over the month, although we did bank profits on longer-dated Haohua bonds, which have performed well recently.

On the new issue front, cash holdings were invested in shorter-dated bonds issued by companies that are relatively stable, in our view. The Fund participated in offerings by Shimao (China), Chiba Bank (Japan), and NH Investment and Securities (South Korea), for example.

Q4 2021 investment outlook

As we navigate into the last quarter of a tumultuous year there are some signs of optimism emerging, despite a backdrop that remains highly uncertain. Countries that have been suffering intensely from Covid-19 have seen daily cases decline sharply as community immunity has increased. Vaccination rates around the world have also risen significantly and we now expect more countries to achieve the critical 75% vaccination rate as early as the first half of 2022.

Economically, recent data releases in the US and China indicate that global growth momentum has slowed as the Covid Delta variant has spread. Nevertheless, after close to two years mired in a Covid world, there has been increasing commitment from many countries around the world to continue re-opening their economies. Progress with vaccinations in Asia has been particularly encouraging and many countries in the region are expected to achieve the all-important 75% vaccination rate by the end of this year. Even the worst hit countries, including India and Indonesia, are on track to reach the 75% threshold by the end of March 2022, which is much earlier than earlier projections. Moreover, while the Delta variant is more contagious than earlier forms of Covid-19, the symptoms are typically milder as the virus has mutated. Higher vaccination rates, a build-up of natural immunity in the community and the mutation of the virus into weaker forms suggests we could move from a pandemic towards an endemic phase in the next six to nine months.

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 30 September 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.

As the trajectory of the Covid situation continues to point towards an improvement, major central banks led by the US Federal Reserve and the Bank of England seem likely to start withdrawing their highly accommodative monetary policies. The Federal Reserve all but confirmed it will start tapering its bond purchase program in November, and will likely hike policy rates in 2022 if economic growth and labor markets continue to improve. Nonetheless, monetary conditions are expected to remain largely accommodative barring a sharp rise in longer-term inflation expectations. That would challenge the Federal Reserve's definition of 'transitory' inflation. How long can US policymakers allow inflation to stay at current elevated levels? Supply chain disruptions aside, could structural changes to business' cost base lead to a more sustained level of higher inflation? Will pent-up demand from consumers further propel prices higher? As the world has not experienced any meaningful inflation since after the Global Financial Crisis in 2009, the market may have underestimated the effect of a prolonged period of heightened inflation.

The Bank of England has taken things a step further, suggesting that interest rates could be raised before the UK's bond purchase program is complete. We see these kinds of moves as necessary; ultimately, keeping policy rates at very low levels while continuing with aggressive quantitative easing will affect central banks' ability to respond to future crises. We have always questioned the effectiveness of monetary policy to tackle problems caused by a virus. We also believe several years of money printing has sowed the seeds for a bigger problem we will have to deal with in the future; the magnitude of this future predicament could dwarf the effects of the Covid pandemic.

We were reassured by developments with China Huarong Asset Management during the September quarter, but the same kind of government support does not seem to be forthcoming for Evergrande Group. Consequently we are concerned about the potential contagion effect on other property developers and their ability to raise funds, particularly in offshore markets. This is being reflected in valuations – bonds issued by many B-rated developers are now trading on high double-digit yields. Some investment grade Chinese property names including Shimao and Cogard could come under pressure if the Evergrande situation deteriorates, although we remain comfortable at this stage with the credit profile of these two issuers. With the property sector accounting for at least 20% of China's GDP growth, we do not think Beijing can afford to let this sector sink deeper into a liquidity crunch and risk a run on property developers. Accordingly we expect to see some targeted easing of credit access, allowing developers to refinance upcoming debt maturity such that the construction process can continue. On a more positive note, the '3 Red Lines' policy that was put in place by the Chinese government in 2020 has already helped to improve the debt profile of the property sector, which augurs well for longer-term stability. While deleveraging looks set to continue, the government still has flexibility to fine-tune policies if other developers show signs of financial duress.

Following lackluster returns in the September quarter, Asian credit markets are still showing negative total returns in the calendar year to date. Investment grade issuers have outperformed their higher yielding peers this year due to their more resilient and stable credit profile. With the Huarong issue seemingly resolved, we believe investment grade spreads will remain fairly well supported. The key risk is that the US Federal Reserve increases borrowing costs more quickly and/or more significantly than the market expects. In that case, sentiment towards investment grade credit could be adversely impacted given all-in yields remain close to historical lows.

Finally, against the backdrop of likely tapering of bond purchases by the US Federal Reserve and the potential for interest rate hikes in 2022, the US dollar is expected to trade strongly against Asian currencies. Should expectations of monetary policy tightening in the US be pared back, however, or if Asian central banks embark on a monetary policy tightening path, the outlook for Asian currencies would be much brighter. How quickly Asian economies get the Covid pandemic under control will also likely have a meaningful influence on currencies' performance in the months ahead.

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