First Sentier Asian Quality Bond Fund
Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | November 2021

Market review

The lower move in US Treasury yields more than offset the widening in credit spreads. As a result, the JACI Investment Grade Index returned 0.51% in November month.

The spreads of Asian credit was volatile, reflecting continued concern over Chinese high yield property sector. Whilst not affecting investment grade issuers directly, news headlines affected sentiments and created volatility. Earlier in the month, the spreads initially widened sharply, then it reversed and went to the tightest level since 2019. Toward the end of the month, concerns over the new omicron Covid-19 strain changed the sentiments to risk-off mode once again. Asia Investment Grade credit spreads ultimately closed the month 8bps wider to 181bps level.

Encouragingly, embattled Chinese state-owned asset manager Huarong International received approval from the China Banking and Regulatory Insurance Commission to issue bonds in the domestic market. The company also signed agreements to raise RMB42 billion (around US$7 billion) of fresh equity capital. This news supported Huarong bonds and financial names more broadly.

Various other developments prevented the market from making further progress. Most importantly, news that a new variant of Covid-19 had been discovered saw investors rein in their risk appetite. Little is known about the Omicron strain as yet, but some investors suggested it could result in further travel restrictions and perhaps more localized social distancing rules being implemented. Various countries have tried to limit transmission of the variant by ceasing flights from Southern Africa, where it was first detected. Doubts on the efficacy of current vaccines, coupled with uncertainties surrounding the transmissibility and virulence of Omicron, caused panic among investors towards month end.

At the company level, some lackluster financial results were announced from large firms like Tencent Holdings and Alibaba Group. At the same time, the Chinese government continued to meddle in the telecoms, media and technology sectors. Regulators ordered Tencent to halt the rollout of new apps, for example, and requested that ride-share app operator Didi delist from US exchanges.

A reasonable amount of new supply came to the market, although the pace of issuance is expected to slow through December and into early 2022 owing to Christmas and then the Chinese New Year holidays. Notable deals completed included a US$1.2 billion raising from Chinese delivery services and logistics company SF Holding and a multi-tranche, dual-currency offer from Sinochem. The Chinese state-owned conglomerate issued 3-year and 5-year bonds in USD and EUR, raising US$800 million and 500 million euros.

Outside of China, Singaporean financial giant DBS Group raised US$1 billion and Renesas, a Japanese semiconductor manufacturer, came to market with 3-year and 5-year notes worth a combined US$1.35 billion.

Performance review

The First Sentier Asian Quality Bond Fund returned -1.00% for the month of November on a net of fees basis.

The negative return was largely due to the widening of credit spreads during the month and as we have an underweight strategy on interest rate duration, the returns from treasury did not offset the negative returns from spreads movement.

- 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 may also expose to RMB currency and conversion risk.
- 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.

On a relative basis, the fund underperformed the index largely due to our overweight in two Chinese property developers SHIMAO and COGARD which witnessed some spread widening amid the sharp sell-off in the high yield space. Meanwhile, outperformance of HRINTH help to offset some of the underperformance.

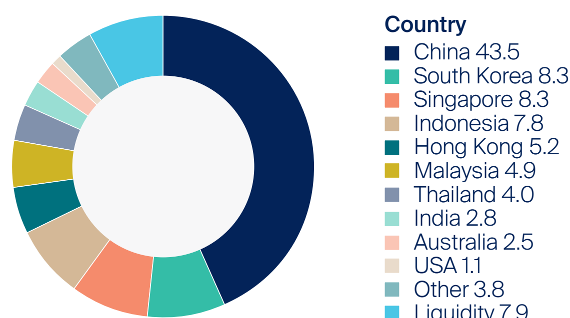
Cumulative performance in USD (%)[1]

	3 mths	YTD	1 yr	3 yrs	5 yrs	Since inception
Class I (USD - Acc)	-2.0	-1.4	-1.0	17.2	20.3	89.2
Benchmark*	-0.7	0.1	0.3	20.2	24.7	148.6

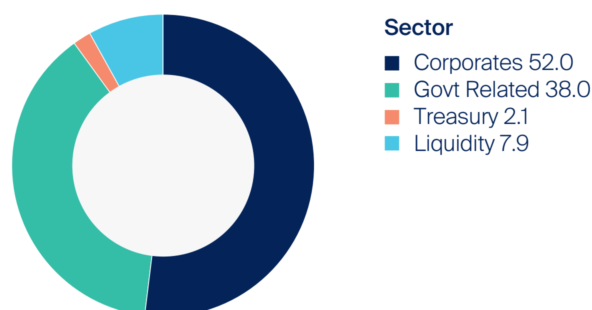
Calendar year performance in USD (%)[1]

	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

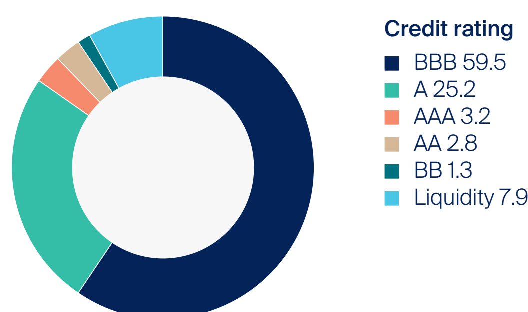
Asset allocation (%)[1]



Country
- China 43.5
- South Korea 8.3
- Singapore 8.3
- Indonesia 7.8
- Hong Kong 5.2
- Malaysia 4.9
- Thailand 4.0
- India 2.8
- Australia 2.5
- USA 1.1
- Other 3.8
- Liquidity 7.9



Sector
- Corporates 52.0
- Govt Related 38.0
- Treasury 2.1
- Liquidity 7.9



Credit rating
- BBB 59.5
- A 25.2
- AAA 3.2
- AA 2.8
- BB 1.3
- Liquidity 7.9

Top 10 holdings (%)[1]

Stock Name	%
People's Republic of China (Government)	4.8
China National Offshore Oil Corp	3.0
Indonesia (Republic of)	2.8
Shimao Group Holdings Limited	2.6
China National Chemical Corp Ltd	2.4
China Huarong	2.3
Korea Investment Holdings Co., Ltd.	2.3
China Mengniu Dairy Company Limited	2.0
China Overseas Land & Investment Ltd	2.0
Temasek Holdings (private) Ltd	2.0

Fund positioning

The evolving risk/reward trade-off in the market following the Omicron news prompted us to reduce overall credit risk in the portfolio. Spread duration in China was lowered and investment was directed towards higher quality names in the property sector. Exposure to cross-rated issuers like Shimao and Cogard was reduced, with the proceeds of the sales being reinvested in higher quality peers including Vanke and Longfor.

Elsewhere we used the rally in Huarong to lighten exposure to the name, although an overweight position was maintained. We also sold ENN Energy, locking in profits from a position that was established in 2020. We remain comfortable with the company's credit fundamentals, but a proposed change to the shareholding structure presented some unexpected uncertainty. Some of the cash from these sales was used to participate in new issues from Sinochem and Renesas.

Finally, a short duration was maintained in the US Treasury market. Yields moved slightly lower during November, but we expect them to rise as investors refocus on the likelihood of interest rate increases in the first half of 2022 as officials try and dampen rampant inflation. Towards the end of November, the Chair of the Federal Reserve conceded that inflation in the US was likely to be more persistent than previously forecast.

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

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 November 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.

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.

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 November 2021

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