First Sentier Asian Quality Bond Fund
Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | March 2022

Market review

Asian credit continued to struggle in March, with returns down by a further -1.91%. This extended negative returns to -5.39% in the calendar year to date. The majority of the negative return in March came from higher US Treasury yields. Ten-year yields rose more than 50 bps over the month (and by 83 bps in the first quarter) to 2.34%. Concerns over rising inflation in the US are being exacerbated by higher oil prices caused by sanctions imposed on Russia, one of the world's largest oil producers. Moreover, after raising official cash rates by 0.25 percentage points in March, hawkish comments from Federal Reserve officials led to a further sell-off in US Treasuries. Meanwhile, credit spreads remained volatile with 'risk-off' sentiments dominating. We saw heavy selling in the first two weeks of the month, in particular. Sentiment improved markedly towards the end of March, which enabled spreads to tighten by 11 bps in the month as a whole.

In the investment grade space, spreads initially moved wider following 'risk-off' sentiment, but rebounded quickly and closed the month tighter. A few negative headlines in the Chinese investment grade space brought some weakness in certain issuers. Rising Covid-19 cases in China and the strict measures introduced as a result led to renewed growth concerns. The Haidilao bond price traded lower, driven by news of fresh lockdowns, for example, and the issuer was downgraded by Fitch to BBB-/stable outlook on the back of lower EBITDA expectations, short-term disruptions from Covid-19, and muted expectations for a meaningful recovery owing to weak demand.

In the Chinese technology sector, we continued to see delisting headlines that eroded sentiment towards the space. The US has included Baidu and its subsidiary to SEC lists for possible delisting. Meanwhile, Meituan, a possible 'fallen angel', posted stronger-than-expected quarterly earnings although some of its new initiatives remain loss making. The downgrade risk hinges on stemming losses in new initiatives, though S&P highlighted that downside risk is reduced due to topline growth, margin expansion and lower-than-expected losses.

We saw a negative performance in the sovereign investment-grade space, mostly due to movements in US Treasuries. Spreads corrected to wider levels following 'risk-off' sentiment in the broader Emerging Market credit space, before rallying and closing the month tighter. Hard currency EM bonds also experienced heavy outflows in March, while supply was muted due to ongoing volatility. Higher commodity and food prices pose inflation risk and may complicate monetary and fiscal consolidation policies in emerging economies. While inflation risk remains generally manageable in the Asia investment grade space, there are increasing concerns in India with headline inflation printing above the central bank's target. In Indonesia and Malaysia, the external position should be supportive as both countries are net exporters of commodities.

Performance review

The First Sentier Asian Quality Bond Fund returned -1.93% in March on a net-of-fees basis.

The negative return was largely due to weakness in US Treasury yield.

On a relative basis, the fund performed in line with the index. Some of our credit position detracted value like Country Garden however our defensive positioning in overall credit and underweight US rates helped to offset the underperformance.

- 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.

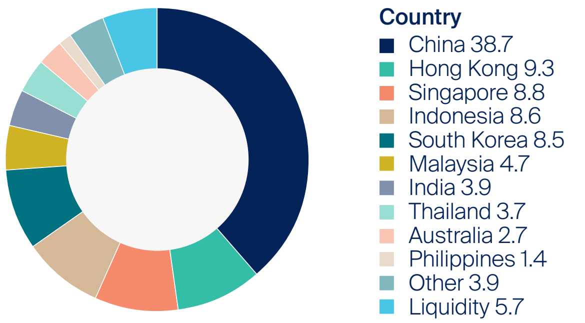
Cumulative performance in USD (%)[1]

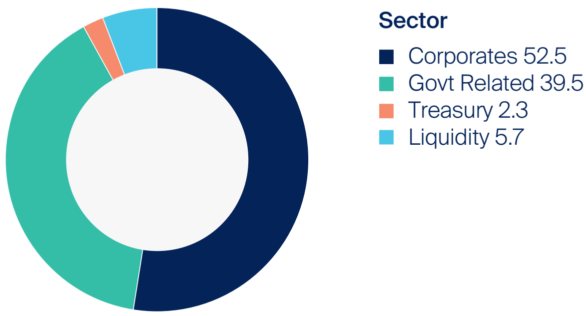
	3 mths	YTD	1 yr	3 yrs	5 yrs	Since inception
Class I (USD - Acc)	-6.2	-6.2	-6.9	3.4	10.1	76.9
Benchmark*	-5.4	-5.4	-3.8	7.7	15.6	135.0

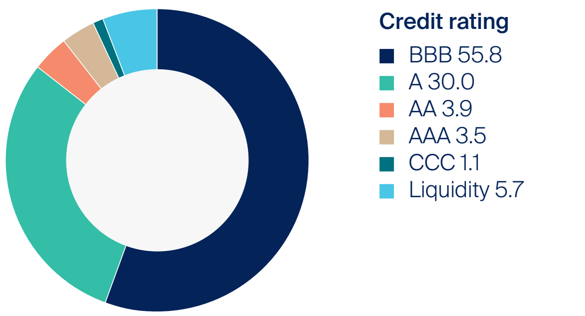
Calendar year performance in USD (%)[1]

	2021	2020	2019	2018	2017
Class I (USD - Acc)	-1.8	5.9	10.9	-1.3	5.6
Benchmark*	0.0	6.9	11.0	0.0	5.5

Asset allocation (%)[1]







Top 10 holdings (%)[1]

Stock Name	%
People's Republic of China (Government)	5.0
Indonesia (Republic of)	2.9
China National Offshore Oil Corp	2.9
PCCW LTD	2.6
China Overseas Land & Investment Ltd	2.5
Pertamina Persero PT	2.5
Korea Investment Holdings Co., Ltd.	2.4
China Mengniu Dairy Company Limited	2.1
Temasek Holdings (private) Ltd	2.0
United Overseas Bank Ltd	1.9

Fund positioning

We closed our underweight in US rates position to Neutral, as their yield has risen sharply pricing in rate hike by the Federal Reserve. We moved to overweight credit as we view the valuation on a yield basis were attractive as UST settles at a higher level and credit spreads widened. We added China technology names like Alibaba and Tencent, China state-owned names such as Cnooc and Sinopec, Indonesia and India space such as Pertamina and Exim Bank India. When the spreads rebounded towards the end of March, we de-risk further from weaker investment grade property names like Country Garden. We also reduced our exposure in Haidilao as rising Covid-19 cases and strict measure in China pose risk to the name.

Q2 2022 investment outlook

Such a meaningful repricing in the US Treasury market was unsurprising given the strength and persistence of inflation. Headline CPI in the US remained stubbornly high throughout the quarter, with escalating geopolitical tensions adding to already disrupted supply chains. Specifically, the Russia-Ukraine war pushed up oil, commodity and food prices and fed through to heightened inflationary expectations going forward.

Many market participants are likening the current interest rate outlook in the US to the rate hiking cycle in 1994. It is important to note, however, that inflation at that time was lower than it is now, and that the Federal Reserve was not as far behind the curve as it appears to be today. Moreover, we have not seen a stagflationary environment since the 1970s; few investors have experienced conditions like we are seeing now in their careers. The ongoing Covid situation and the Russia-Ukraine conflict are adding to the complexity in analysing and navigating markets.

The military conflict in Eastern Europe is now into its second month and could have meaningful implications for Asia if it persists. The war has already disrupted oil and commodity supplies, resulting in a sharp increase in prices. This will likely act as a pressure point for external balances; with the exception of Malaysia, most Asian economies are net commodity importers. India and Philippines appear most at risk. While Indonesia will end up having a higher energy import bill, this should be partially offset by its higher exports of other commodities including palm oil, coal and base metals. We have witnessed some weakening of the Indian rupee and Indonesian rupiah and the central banks might have to intervene with more aggressive rate hikes if the weakness persists. The more open economies in Asia – including South Korea, Singapore and Taiwan – all started their monetary policy normalisation path in Q3 last year and are set to continue. Indonesia and Malaysia are expected to raise rates in Q2, while the Philippines and Thailand will likely follow suit later in the year. All are expected to normalise policy settings gradually, but the probability of them having to move more quickly than expected has undoubtedly increased.

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 2022. 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.

In the US, the Biden administration seems determined to reduce the budget deficit, unwinding several years of excesses during the Trump Presidency. This means monetary and fiscal policies are both becoming more restrictive at a time when the world is grappling with the uncertainties of the Covid-19 pandemic and the Ukraine conflict. The likelihood of stagflation in the US has therefore increased, as suggested by the Treasury yield curve. The curve inverted briefly in March, with yields on 2-year notes rising above those on comparable 10-year securities. We are seeing similar inflationary pressure in Europe, suggesting the European Central Bank will have to bring forward its own rate hiking cycle. Elsewhere, while inflation in Japan remains below the central bank's 2% target, the recent rise in Japanese Government Bond yields could be a warning signal for financial markets that the Bank of Japan will also eventually act, following many years of ultra-easy monetary policy.

On a more positive note, the recently concluded China National People's Congress meeting confirmed a commitment by the Government to target GDP growth of 5.5%. This appears optimistic, in our view, given the ongoing contraction in the property sector, which is estimated to account for at least 20% of GDP. The high likelihood of further large-scale lockdowns owing to China's 'zero tolerance' approach to Covid-19 also suggests Government policy will be pro-growth in the months ahead. Support will likely come in the form of targeted fiscal stimulus, while monetary policy will likely remain accommodative. We are also comforted by an easing in policy stance, following months of downturn in the property sector. A relaxation in local policy settings seems likely and overall financing conditions for property firms should improve in the months ahead. Debt restructuring in Kaisa and Evergrande (expected in the second half of the year) could provide more clarity for the path ahead for other developers, thereby boosting sentiment towards the distressed sector.

Sentiment towards Chinese credits has been hampered by slowing GDP growth. We have also seen increased regulation across several sectors including property, education and technology. The possible delisting of Chinese technology stocks listed in the US and concerns around US sanctions should China invade Taiwan are also eroding investors' confidence. While many of these concerns are warranted, some of the associated spread widening appears to have been overdone. Accordingly, we are seeing some value emerging, especially in the technology space and in selected State Owned Enterprises.

Asian investment grade spreads closed the quarter at +192bps, close to the five-year average. Current valuations therefore seem fair given the prevailing uncertain environment globally. That said, following the recent increase in US Treasury yields, the 'all in' yield for Asian investment grade credit is above 4%. This presents an appealing potential return, particularly for long-term investors.

Valuations in the Asian high yield sector remain at depressed levels, hampered by the Chinese high yield property sector. We continue to look for further signs of stabilisation in this space, which will include a return to the new issuance market for certain developers alongside debt restructuring plans for Evergrande and Kaisa. A rebound in the Chinese high yield property sector could have a positive spillover impact for the broader Asian investment grade market.

As for Asian currencies, we are maintaining a cautious stance given the imminent rate hiking cycles in the US and Europe. The US dollar is likely to remain strong relative to Asian currencies against a background of quantitative tightening by the Federal Reserve, which is expected to start soon. We also see some potential upside in Asian rates in the coming quarter, as markets do not appear to have adequately priced in more aggressive rate hiking scenarios from various Asian central banks.

Source : Company data, First Sentier Investors, as of end of March 2022