First Sentier Asian Quality Bond Fund Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | April 2022

Market review

Asian credit continued to struggle in April, as US Treasury yields moved higher and as credit spreads widened further. The JACI Investment Grade Index returned -2.50% over the month, extending losses in the calendar year to date to more than -7%.

A further increase in Covid cases and the introduction of fresh lockdowns in China dampened risk appetite, given the anticipated slowdown in growth and the potential for corporate earnings to be eroded. Strict lockdown measures introduced in several major cities seems likely to have affected activity levels in April. This was an unwelcome development for Chinese credits and increased rating pressure on consumer names such as Haidilao and Meituan, in particular.

At the same time, commodity prices remained high and seem unlikely to moderate meaningfully in the near term. Western sanctions against Russia will continue to impact energy supplies and Indonesia is expected to ban exports of palm oil products, for example. These developments are expected to keep commodity prices high and, in turn, hamper the economic growth outlook for Asia and elsewhere.

The new mobility restrictions in China also affected the property sector, offsetting optimism regarding the potential issuance of letters of credit from higher-quality developers and an easing in housing rules. Investors' appetite for weaker, high yield property names continued to deteriorate. KWG Property received multiple downgrades from rating agencies, for example. The firm is now rated Caa1 by Moody's and B- by S&P, with a negative outlook on the back of heightened liquidity concerns. Sunac also missed coupon payments due on its offshore bonds.

New issuance premiums remained high, to help support demand against a background of heightened market volatility. The issuance pipeline was dominated by Taiwanese, Chinese, Indonesian and South Korean issuers. Going forward, we expect issuance to remain skewed towards higher-quality, investment grade names and for new issue premiums to remain elevated until the market stabilises.

On the sovereign side, S&P raised the outlook for Indonesia to Neutral from Negative, citing a supportive external balance. Elsewhere, as a net energy exporter, Malaysia continued to benefit from elevated oil prices. Against this backdrop, Asian credit spreads widened by slightly less than those in other emerging regions. In general, adequate fiscal buffers, a supportive external backdrop, and relatively subdued inflation were supportive of Asian sovereign spreads relative to those in Europe and Latin America.

It was a different story in frontier economies, however. Persistently high commodity prices are resulting in double-digit inflation and social unrest in Pakistan and Sri Lanka, for example. These highly-indebted, energy-importing countries with low FX reserves are suffering the most from elevated commodity prices. Sri Lankan bonds performed particularly poorly in April. The country announced a suspension of debt repayments and is currently in discussion with the IMF regarding a possible assistance package.

Performance review

The First Sentier Asian Quality Bond Fund returned -2.63% in April 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 PERTAMINA however our defensive positioning in overall credit helped to offset some of 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.

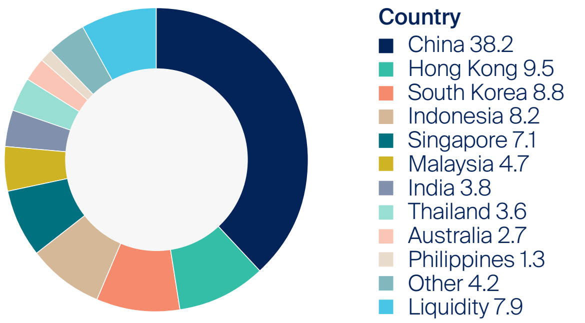
Cumulative performance in USD (%)[1]

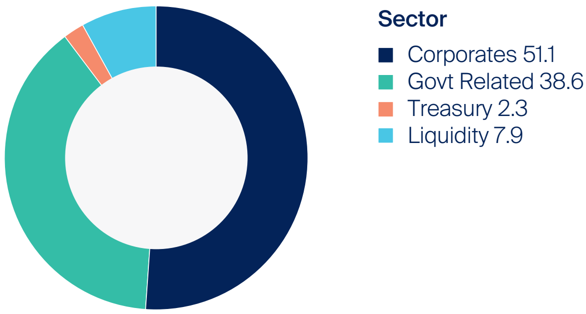
	3 mths	YTD	1 yr	3 yrs	5 yrs	Since inception
Class I (USD - Acc)	-6.7	-8.6	-8.8	0.4	6.8	72.2
Benchmark*	-6.0	-7.8	-6.0	4.7	12.2	129.1

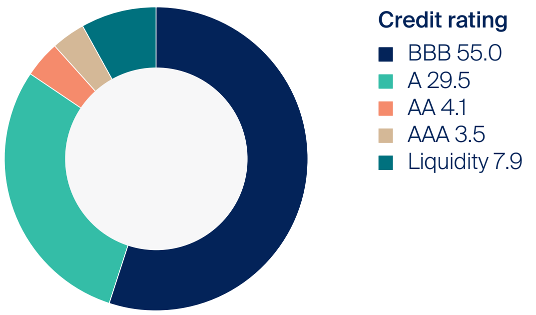
Calendar year performance in USD (%)[1]

	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
China National Offshore Oil Corp	2.8
Indonesia (Republic of)	2.8
China Overseas Land & Investment Ltd	2.7
PCCW LTD	2.5
Korea Investment Holdings Co., Ltd.	2.4
Pertamina Persero PT	2.3
China Mengniu Dairy Company Limited	2.1
United Overseas Bank Ltd	1.9
DBS Group Holdings Ltd	1.8

Fund positioning

The previously-held short position in US rates has been removed, following a prolonged period of rising yields. Among the Fund's credit exposures, we took profits on the holding in Singapore Airlines bonds. Excess cash was deployed in higher-quality names – higher 'all-in' yields have become increasingly appealing and offer good value for long-term investors. The Fund participated in new issuances from TSMC (Taiwan), Bank of East Asia (Hong Kong), and Shinhan Bank (South Korea). These high-quality new issues were offered with premiums relative to comparable bonds trading on the secondary market. Overall, a high level of diversification was maintained to help mitigate default risk.

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 30 April 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 April 2022