First Sentier Asian Quality Bond Fund Monthly review and outlook

First Sentier Investors

Monthly Review and Outlook | February 2024

Market review

Firmer than expected US economic data pushed US Treasury markets higher during the first half of February. Much of the rates sell-off was buffered by tightening credit spreads, which helped prices remain relatively steady. Nevertheless, USD Asian Investment Grade bonds ended the month marginally underwater with returns of -0.25% even as JACI Asian Investment Grade (IG) credit spreads tightened by 16bps.

Market liquidity was thin in the lead up to the Lunar New Year. Nevertheless, despite the bearish rates environment, strong supply-demand technicals helped Asian Investment Grade bonds to maintain resilience. High beta names' saw some spread compression. Thailand credit outperformed, with Bangkok Bank and Thai Oil leading the rally. China TMT also tightened by 10-20bps. In Indian credits, the Adani group were the better performers on easing refinancing concerns. Business recovery continued for Macau gaming, and Fitch upgraded Sands China to BBB- from BB+, signifying the Sand China's transition into investment grade rating category by all three global rating agencies. Late in the month, news circulated about Vanke seeking to extend some non-standard debts and encountering roadblocks in talks with some insurance companies, causing it to be the main underperformer in the Chinese property space. Onshore China sentiment remained poor on the back of the tepid economy and property crackdown, and investors saw China's onshore equity market sinking to 5-year lows. Chinese regulators then vowed to help stabilize markets and equity markets recovered some lost ground after some buying action by stated-owned institutions and the change in the chairman appointment for the China Securities Regulatory Commission (CSRC).

Spreads in quasi-sovereign names in Indonesia saw mixed performance as longer dated issues experienced low double digits in spread widening due to the sell-off in rates, while shorter dated names went along with the spread compression of the market in general. Outflows in emerging markets added to unfavorable technicals, but fundamentals in the sovereign space remained robust.

The primary market was closed for the Lunar New Year period. In Asian USD Investment Grade credit, issuance was mostly from South Korean names, such as Korea Development Bank's USD 3 billion dollar issuance.

Fund positioning

After witnessing attractive tightening in spreads, the Fund took profit on select credits while maintaining an overweight in duration positioning relative to its benchmark. Properties exposures were also trimmed slightly on recent price rallies.

Performance review

On a net-of-fees basis, the First Sentier Asian Quality Bond Fund returned -0.56% in February, underperforming its benchmark by -0.31%.

The Fund's overweight in duration challenged performance as Treasury rates sold off over the month. An underweight in sovereign bonds from Indonesia and the Philippines added to performance, but these returns were eroded by an overweight in Indonesian quasi-sovereigns and security selection. Exposure in local currency bonds and the Japanese yen detracted from performance as the US Dollar strengthened on resilient US economic data.

- The Fund invests primarily in debt securities of governments or quasi-government organization in Asia and/or 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.

	We thought that...	Therefore, we...	And the results...
US rates	With the Fed having communicated its pivot, the US rates have peaked. The likelihood of rate cuts would increase as the US economy starts to show signs of weakening in the months ahead	Maintained an overweight bias for US rates in the portfolio, with a tactical approach in light of the recent volatility in rates	The Fund's overweight in US rates versus the benchmark detracted from returns as US rates sold off during the month as economic data pointed towards a resilient US economy
Asian IG	Fundamentals remain sound in Asian Investment Grade (IG) corporates, but spreads have reached extremely tight levels	Remained focused on high quality names that are deemed more resilient should the market enter a risk-off mode	An underweight in sovereigns in Indonesia and the Philippines contributed to returns, but the overweight to Indonesian quasi-sovereigns vs the benchmark detracted from the Fund's performance

Q1 2024 investment outlook

2023 has not been for the faint-hearted. The euphoric mood from China's post-Covid reopening that highlighted the start of 2023 revealed its alter ego as the year progressed with a slew of turbulent events, such as the regional banking crisis and Israel Hamas war. Adding to that, Asian Credit was dealt a challenging hand – the persistent increase in US rates, a struggling Chinese property sector as well as China's economic slowdown. Thankfully, the resilience of the Asian Credit market came through, with the index as a whole still chalking almost 5% in total returns year-to-date.

Entering 2024, we expect global growth, in aggregate, to be slower than in 2023. Our earlier views that US economic conditions were bleaker than hard data suggested was arguably early, but as Covid-era savings run dry, jobless claims rise and retail sales weaken, we are beginning to see the sobering reality of an economy under strain due to the prolonged high interest rate, high inflation environment. We now expect the Federal Reserve (Fed) to adopt a wait-and-see approach over the next few months before deciding on their next move. Barring a re-acceleration of inflation in 2024, we believe the Fed has reached the end of the current rate hike cycle.

In Europe, sustained high prices continue to depress economic growth. Even as headline inflation trends lower, stronger European countries such as Germany are grappling with faltering growth as manufacturing and services activity continue to contract. Unless inflation cools off significantly enough to meet the European Central Bank (ECB's) 2% target, we expect the ECB risks not cutting rates soon enough to cushion the effects of the slowdown in growth in the EU. We believe that growth in Europe in 2024 would be subdued, at best.

China's policies have been turning highly accommodative even though they stop short of a massive stimulus like the one in 2008-2009. By allowing budget deficit to widen to above 3%, it is a very strong indication of China's commitment to prop up growth. However, despite the political commitment to stabilise growth in China, the multilayered problems causing China's slowdown means that we don't expect a quick recovery. The property sector and weak consumer sentiment will remain weak links that need to be addressed. In other words, we still need actual gross domestic product (GDP) numbers and pre-sales in the property sector to pick up on a sustained basis before market confidence can be restored. Nevertheless, we are of the belief that the Chinese economy will emerge much stronger from this consolidation process and maintain a positive long-term outlook for the economy.

Asian economies have been resilient thus far, but effects from China's slowdown are not negligible. The growth outlook in Asia is showing signs of weakness especially for exports oriented countries including Singapore, South Korea and Taiwan, caused not only by China's slowdown, but also reflective of the lackluster demand from developed economies. We believe that this trend is likely to stay. Within the Asian region, countries with a stronger domestic story, such as India and Indonesia, are likely to fare better. Against this weakening external backdrop, most Asian central banks have paused rate hikes as inflation moderated and shifted attention to supporting growth. We remain constructive on the region's longer-term growth prospects as Asian economies continue to move up the value chain in the global economy.

Thus far, the rising inflation in Japan has been insufficient to convince Japanese regulators to normalise monetary policy. However, the Bank of Japan's next move should be closely watched as any signs of change to their Yield Curve Control policy will have significant implications for the course the dollar's strength. We see higher certainty of the Euro and other Asian currencies continuing its appreciation against the US dollar, a trend that is largely driven by the Fed's move. Asian local currency bonds may perform well should the Fed cut interest rates in 2024, as this will likely lead to further dollar weakness versus Asian currencies, further boosting Asian local bond returns.

We remain constructive in Asian IG credit. Fundamentals are now mixed but technicals will likely remain a tailwind during the early part of 2024. Even as credit spreads are almost at post-GFC tights, high all-in yields well above 5% does makes this asset class attractive from an income carry perspective. Our bias is to focus on higher quality names that have the liquidity and resilience to withstand a hard global landing, should such a scenario emerge.

Source : Company data, First Sentier Investors, as of end of February 2024