

### Market Commentary

The 10-year U.S. Treasury yield closed December at 4.17%, only 2 basis points higher than the prior quarter. The labor market continued to soften amid the longest government shutdown in U.S. history, prompting the Federal Reserve to deliver two 25 basis points (bps) rate cuts in October and December in response to labor market weakness. The US yield curve steepened over the quarter as front-end rates rallied on policy easing, while longer maturities moved higher. The front of the curve rallied strongly while 20- and 30-year yields rose by 8-11 basis points.

**Asia investment grade credit remained resilient.** Asia's banking systems remain strong and well-capitalised, which helps cushion any local market stress. Insurers saw mixed results. In Taiwan, the weaker U.S. dollar hurt returns, but solid capital levels and more flexible rules for foreign exchange accounting helped reduce the impact. Insurers in Korea and Japan benefited from higher local bond yields, which lifted investment income. In Hong Kong, several insurers were upgraded by S&P with stronger capital positions and healthy, profitable growth. China's technology, media, and telecommunications (TMT) sector reported mixed earnings, with food delivery companies facing intense competition that weighed on profits. Investment spending is expected to stay high in the China TMT sector, focusing on innovation led areas. India stood out with a strong economy and net negative bond supply, which supported corporate bond prices. In Indonesia, the recent cabinet reshuffle puts a spotlight on fiscal discipline as the government reviews its deficit limits and spending priorities. Indonesia's state-owned enterprises are likely to be driven by the quality of Danantara mandated projects, and their credit ratings should be broadly stable into 2026. The Philippines faces headwinds from political volatility and a corruption scandal, alongside weaker credit fundamentals. Thailand continues to grapple with slow growth, tight budgets, and political uncertainty, while several state-owned firms announced plans to sell assets and reduce debt.

Performance trends favored higher income strategies in the quarter, with **Asian high yield outperforming investment grade in a yield seeking environment.** The Reserve Bank of India proposed changes to the External Commercial Borrowings framework – removing the cap on borrowing costs, widening

eligibility for borrowers and use of funds, raising limits, and simplifying maturities. If implemented, these steps could boost Indian offshore bond issuance, especially in high yield. In India's renewables sector, earnings improved as capacity grew, though leverage has increased due to heavy spending on new projects. Macau gaming companies continue to generate solid cash flow and maintain good liquidity, helped by new bond issues and bank facilities. China's top 100 property developers experienced weak contracted sales in 2025, and a surprise default by a Chinese high yield property developer on its onshore bonds highlighted ongoing cash flow pressures from weak home sales and tight refinancing conditions – triggering a broader sell off in the sector. By contrast, a distressed Hong Kong property developer undertook a liability management exercise to seek a more holistic solution to its elevated capital structure. In Japan, high yield technology bonds softened amid market concerns about aggressive Artificial Intelligence spending by major U.S. technology firms.

**Technicals in Asian fixed income remained supportive,** with active new issuance absorbed by solid investor demand. The JP Morgan Asia Credit Index (JACI) Investment Grade spreads were rangebound and ended the quarter at 102 basis points – unchanged from endQ2. The investment grade index delivered a positive return of 1.2%, largely driven by yield income, while the broader JACI returned 1.3% for the quarter.

The U.S. experienced a historic 43-day federal government shutdown, driven by a prolonged budget impasse over healthcare subsidies and appropriations. The standoff concluded with a revised funding bill, reigniting debates on fiscal governance. In the European Union, political fragmentation deepened as public confidence eroded – particularly in France, where President Macron's approval ratings fell sharply. Disputes over fiscal discipline, defence spending, climate commitments, and continued support for Ukraine underscored growing intra-bloc tensions ahead of the 2027 electoral cycle. Meanwhile, Japan witnessed a landmark political shift as Sanae Takaichi assumed office in October as the nation's first female prime minister, following her election as Liberal Democratic Party leader and the formation of a coalition with the Japan Innovation Party. This development signals a pivot toward a more conservative, security-oriented policy agenda under a narrow parliamentary majority.

## Performance Review – Asian Credit

The Asian Credit portfolio underperformed its benchmark in 4Q25:

| Positive contributors:  | Negative contributors:  |
|---|---|
| <ul style="list-style-type: none"> <li>Security selection in Hong Kong corporate bonds</li> <li>Overweight US interest rates</li> </ul> | <ul style="list-style-type: none"> <li>Underweight in Indonesian sovereign bonds</li> <li>Overweight in Australian government bond</li> <li>Overweight in Japanese yen</li> </ul> |

### Strategy Positioning

The strategy maintained a cautious approach, keeping an underweight in credit spreads compared to its benchmark. In off-benchmark positions, the strategy took profit in Middle East bond positions in anticipation of a robust pipeline of new Middle East bond issuances at the start of 2026. In interest rates, the strategy reduced its overweight in U.S. rates, and cut its Japanese rates position while maintaining modest exposures to Australian rates. Additionally, a small allocation to euro-denominated credits was maintained.

## Performance Review – Rates and Currency

The Rates and Currency portfolio underperformed its benchmark in 4Q25:

| Positive contributors:  | Negative contributors:   |
|---|--|
| <ul style="list-style-type: none"> <li>Overweight in UK government bond</li> <li>Overweight in Malaysian ringgit</li> </ul> | <ul style="list-style-type: none"> <li>Overweight in Australian government bond</li> <li>Overweight in Japanese yen</li> </ul> |

### Strategy Positioning

The rates strategy reduced the overweight in US, Japanese, UK, and Malaysian government bonds to neutral vs its benchmark. The currency positioning, the strategy maintained the underweight position in the US dollar, increased the overweight exposure to the Japanese yen and Turkish lira, and reduced the overweight exposure to the Euro, Australian dollar, Malaysia ringgit, and Indonesian rupiah relative to the benchmark.

## Performance Review – Asian Total Return

The Asian Total Return portfolio delivered positive performance in 4Q25:

| Positive contributors:   | Negative contributors:  |
|--|---|
| <ul style="list-style-type: none"> <li>Allocation in Asia convertible bond</li> <li>Allocation to Hong Kong corporate bond</li> <li>Allocation to Asia financials</li> </ul> | <ul style="list-style-type: none"> <li>Long position in the Japanese yen</li> <li>Long position in Australian government bond</li> <li>Allocation in China Real Estate</li> </ul> |

### Strategy Positioning

In light of a more cautious outlook for the U.S. economy, the strategy adopted a more defensive stance. Specifically, it increased exposure to investments that benefit from a weaker U.S. Dollar, while maintaining positions that are aligned with the expectation of stable or lower U.S. interest rates.

The overall credit quality of the portfolio improved from average portfolio rating of BBB- last quarter to BBB+, with a preference for higher-quality issuers that offer attractive income potential. During Q4, the strategy trimmed positions in China real estate amid heightened volatility triggered by a surprise default in the high-yield property space. The strategy continues to selectively identify opportunities in Asian convertible bonds, which offer a unique blend of income and potential upside.

The strategy continues to hold positions in Australia government bonds, based on the view that current valuations remain attractive. A long position in the Japanese yen was maintained, as any unwinding of carry trades could support yen appreciation – particularly if global growth slows and safe haven demand strengthens.

## Q1 2026 Outlook

### Global / US

After years of U.S. economic exceptionalism, we approach an inflection point. We expect tepid growth in the US, with weakening consumption trends on the back of job cuts and the US government shutdown. Declining Consumer Price Index (CPI) components – particularly shelter – will likely anchor and prevent any sustained rebound in inflation. We expect a disinflationary environment to persist, supported by softer commodity prices – oil has corrected sharply, and developments in Venezuela could push prices even lower. Barring a supply shock, prices should not move higher.

Prior to the Fed's initial rate cut in 2024, our base case anticipated at least 200 bps of cumulative easing. With 175 bps already delivered, that view is largely playing out. If the labor market weakens further – amid tariff uncertainties and job losses following the government shutdown – the Fed could cut another 100 bps beyond our initial forecast. The front end of the curve, particularly the 2-year, could rally more. Longer-dated yields may stay elevated on fiscal concerns, but we expect the long end to increasingly reflect weaker growth and inflation expectations. Coupled with the US Treasury's fiscal management, we continue to see opportunity in the long end as incoming data reinforces slower growth and increased duration demand.

Equity valuations remain elevated, leaving markets vulnerable to sharp corrections if macro data disappoints. A lagging Fed policy response could amplify volatility, especially if investors question its ability to manage a deeper slowdown. Meanwhile, the dedollarisation narrative continues to gain traction, positioning non-USD currencies to benefit as U.S. growth underperforms. For fixed income investors, current rate levels offer compelling carry, making disciplined credit allocation – focused on quality and avoiding stretched segments—critical.

## Asia

The Bank of Japan remains the only major central bank on a tightening path, though it moves cautiously. Should inflation hold near current levels, policy rates could move toward 1.5–2%, and 10-year Japanese Government Bonds (JGB)s could settle between 2–2.5%. The 30-year Japanese government bonds remain attractively valued as Japan's curve remains steepest among developed markets rates. Persistent inflation continues to support gradual normalization despite domestic political uncertainties.

China's recovery is gaining traction but remains fragile. Growth momentum is weak, employment subdued, and deflationary pressures linger. Ongoing U.S.–China trade tensions have reinforced expectations for fiscal stimulus, as monetary easing alone has proven insufficient to revive activity. We maintain that additional fiscal measures will be critical to stabilise growth.

Broadly, Asia has shown resilience against tariff and geopolitical headwinds, supported by benign inflation, accommodative monetary policies, and favorable demographics. While fiscal discipline concerns persist in Indonesia, other economies — such as Malaysia — are benefiting from rising foreign investment flows.

## Credit

2025 was another year of strong performance for Asia credit spreads. The risk-reward profile for credit remains asymmetric, underscoring the need for selective positioning and close monitoring of economic indicators. Asian credits have shown remarkable resilience. With credit spreads trading range-bound on

the tight end, carry has become the dominant driver of returns. As a result, we have adopted a more discerning approach to risk and placed greater emphasis on credit fundamentals. We remain highly selective, focusing on idiosyncratic names that offer compelling risk-adjusted returns.

## Currencies

The U.S. dollar is expected to weaken as rate cuts progress and real economic data proves softer than headline figures suggest. Trump's preference for a weaker dollar reinforces this bias. The euro should be the main beneficiary if U.S. outflows accelerate, supported by Europe's commitment to fiscal expansion. While our base case remains a long-term structural weakening of the U.S. dollar, there is a tail risk that a sharp global recession could trigger a flight to quality, temporarily strengthening the USD.

The Japanese yen presents a more nuanced outlook. Although U.S.–Japan interest rate differentials are narrowing, the gap still supports carry trades for now. Any unwinding of these trades could lead to yen strength, particularly as global growth slows and safe-haven demand rises. We therefore see scope for yen appreciation over the medium term, even though near-term dynamics remain driven by rate differentials.

Investor sentiment is expected to continue favoring emerging market rates and currencies. We maintain a constructive view on select local currency bonds and continue to favor diversified exposure across emerging and developed markets, with an emphasis on quality and liquidity.

Source: First Sentier Investors as at 31 December 2025.

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