Asian Credit Strategies

As 2021 begins, market risks favour HY

- Potential for rising rates, low overall yields, and a large spread differential with HY limits IG appeal
- Wide dispersion of spread within HY underscores a high level of idiosyncratic risk
- Careful credit selection along with a significant spread cushion justifies HY positioning over IG

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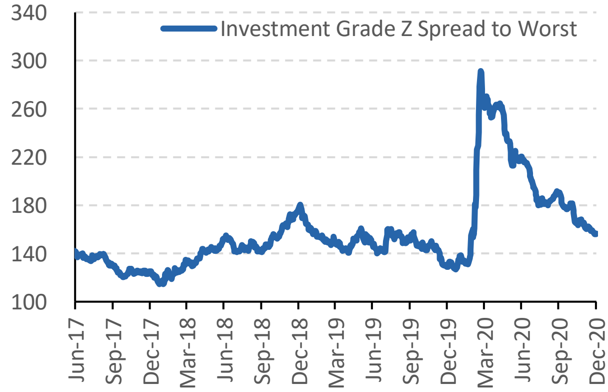
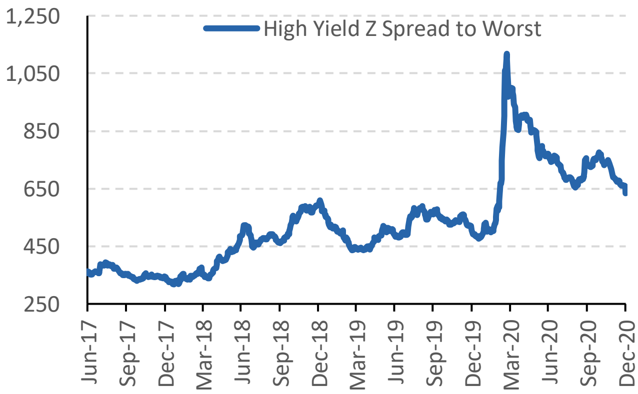
What's happening?

The J.P. Morgan Asia Credit Index (JACI) ended the tumultuous year in positive territory, delivering +0.64% of total return in December. A total of 10 bonds from 7 issuers defaulted within the JACI that closed the year with a default rate at 1.24%. As of 31st December, the index was represented by 612 issuers, with a market capitalization amounting to US$ 1.20 trillion. December's good performance was driven by tighter spreads, which outweighed weaker interest rates. Credit wise, HY names (+1.96%) significantly outperformed their IG counterparts (+0.20%), benefitting from more spread compression, as well as more cushion against rising interest rates, owing to shorter structural duration. The Sovereign segment bottomed the performance chart, dragged by the worst mover Sri Lanka (-3.56% on December). The year-end also saw the JACI's Yield to Worst falling below the psychological barrier of 3% - a record-low - driven by the drop in Interest Rates, while Biden's strong fiscal stimulus plan suggests higher rates for 2021. The JACI's spread level ended the year around 28 bps above its January level, most sectors have fully recovered with spreads trading near their pre-Covid marks, particularly on the IG space. Heading into 2021, there seems to be more room for spread compression on HY, credit differentiation will be key amid a fragile outlook.

Asian Credit Market* Valuation





Monthly Returns:

J.P. Morgan Asia Credit Index (JACI) +0.64%

*Refers to the J.P. Morgan Asian Credit Index
Source: J.P. Morgan, as of 31/12/2020

Investment Grade +0.25%			High Yield +1.96%		
Corporates +0,39%	Sovereign -0,08%	Quasi-Sov +0,14%	Corporates +2.30%	Sovereign -0.98%	Quasi-Sov +0.46%

Portfolio positioning and performance:

Key Strategies		Performance
Country /Sector:	OW exposure on China Property and Indonesia was beneficial, as well as UW on Frontier Sovereign. Our neutral Indian positioning was helped by a positive selection effect , driven by VEDLN's rally.	+
DTS:	Maintained neutral DTS for AHY and reduced DTS for ASD. The short duration biased was helpful amid rising interest rates	+
Bottom-up:	Selection effect was slightly negative on balance, mainly dragged lower by our UW on EVERRE that saw some retracement in December, costing 16 bps of relative performance. OW positioning on VEDLN and THSCPA was beneficial.	-

Outlook

The year has begun with quick reminders to both investment grade and high yield investors what risks need attention in 2021. A quick surge in UST yields on the heels of victories for Democrats in Georgia's runoff U.S. Senate races has created losses for investment grade bonds, particularly those of longer duration. Much less sensitive to rising UST yields, Asian high yield bonds are off to a positive but choppy start. Higher yields mean higher risks both in the form of fundamental challenges and sentiment driven volatility, both of which have been on display early in 2021. Low nominal yields and a potentially rising interest rate environment have clearly diminished the appeal of investment grade bonds and pushed more investors into high yield exposures where there is a 400 to 500 basis point spread pickup. This provides a lot of cushion for periods when bond prices fall and, conversely, offers the opportunity for total return enhancement credit trends improve and an issuer's bond spreads compress. High yield China property developers and Indonesia corporates maintain attractive yield levels but idiosyncratic risks as a result of high leverage, poor governance, liquidity challenges and operational challenges exacerbated by the pandemic require careful consideration. In such an environment, investor sentiment as well as supply and demand technical factors should not be overlooked for investors with limited loss tolerance. With careful credit selection, we remain in favour of high yield exposure over investment grade with portfolios positioned for shorter duration. With a weak to stable USD unhedged, higher yielding local currency can be considered.

No assurance can be given that the Asian Credit Strategy will be successful. Investors can lose some or all of their capital invested. The Asian Credit Strategy is subject to risks including Credit risk, Liquidity risk, Derivatives and leverage, Investments in specific countries or geographical zones, Sovereign debt, Emerging markets, High yield debt securities, Contingent convertible bonds.