

# ▶ LOOKING FOR BRIGHT SPOTS IN ASIAN CREDIT

**Asian credit yields are approaching levels last seen during the 2013 “Taper Tantrum”. Given healthy economic growth and improving corporate profitability, investors may want to pay attention to the emerging opportunities.**



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Investor re-pricing of more rate hikes by the Federal Reserve and fears of a trade war weighed on Asian and Emerging Market bond performance year to date (see Fig.1). While the higher London Interbank Offered Rate (LIBOR) dampened investor appetite for leveraged bond exposure, specific developments in China lifted overall risk aversion to Asian credit.

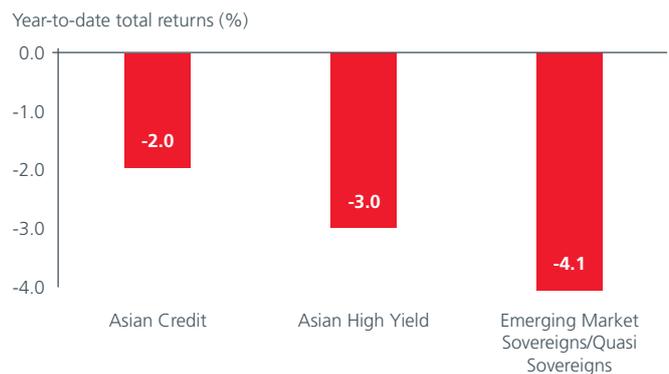
A clampdown on wealth management products in China weakened demand for Chinese credit, including high yields, Chinese bank Additional Tier 1 (AT1) bonds and corporate perpetuals. Heavy issuance in the Chinese credit market, a continuation of 2017’s trend, did not help.

The Chinese government, during the year, implemented new rules to prohibit implicit government guarantees for local government financing vehicles (LGFVs). This sparked concerns of a potential wave of defaults in the onshore bond market and the potential spillover effects on the offshore market. The unexpected default by a Chinese state-owned company in late May further stoked investor fears.

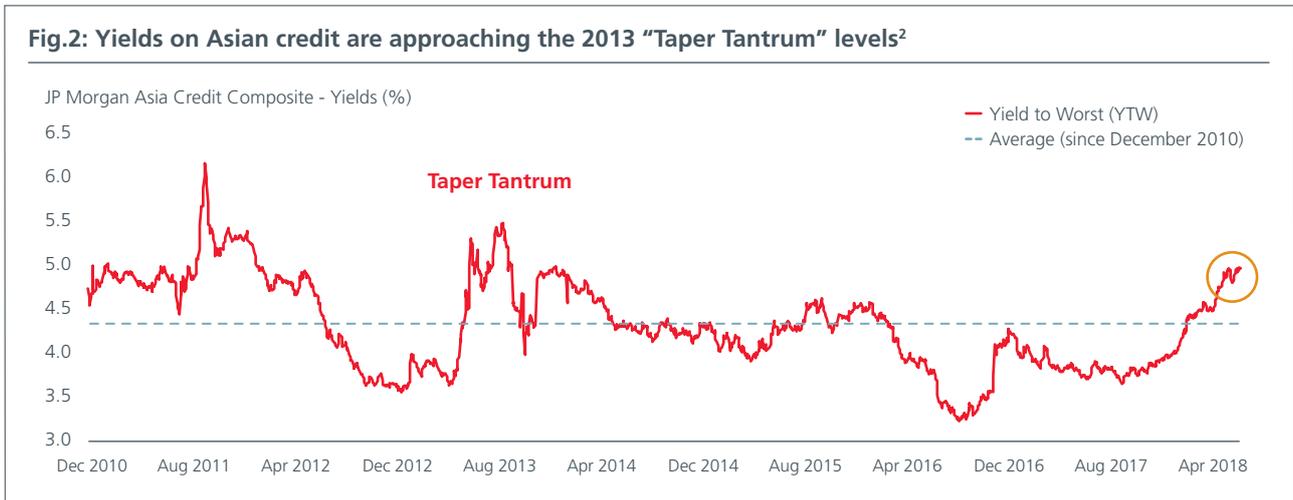
## VALUE EMERGING

There are bright spots, despite the challenges we have seen this year. The fundamentals remain resilient - global leading indicators still point to continued healthy economic growth.

**Fig.1: Asian bonds under pressure – 2018 year-to-date performance<sup>1</sup>**



**Fig.2: Yields on Asian credit are approaching the 2013 “Taper Tantrum” levels<sup>2</sup>**



Rising Asian corporate profitability has lifted debt servicing ability and improved leverage ratios. Asian high yield issuers, notably, enjoyed a net credit rating upgrade in the quarter ending March.

While credit spreads appear tight from a historical perspective, this fails to take into account the growth in breadth and depth of the Asian bond market. Asian high yield credit spreads are currently pricing in a significantly higher level of defaults than what we expect.

Importantly, value is emerging in Asian credit following the large upward move in US Treasury yields. The 10-year US Treasury yield has risen 54<sup>3</sup> basis points year-to-date. The yields on the

JPMorgan Asia Credit Index are approaching levels where they were last seen during the 2013 “Taper Tantrum” (see Fig.2).

We see pockets of opportunity in selected China non-bank financials, higher-quality LGFVs, as well as in certain subordinated Asian bank bonds. Within high yields, selected China property bonds as well as specific credits in the Indonesia commodity sector appear attractive, although Indian high yields still look expensive. Local currency bonds, particularly in Indonesian Rupiah and Indian Rupee, can also enhance returns, given their higher coupons.

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Sources: <sup>1</sup>Bloomberg, returns in US dollars, from 31 December 2017 to 31 May 2018. Asian Credit – JPMorgan Asia Credit Index Composite. Asian High Yield – JPMorgan Asia Non-Investment Grade Index. EM Sovereigns/Quasi Sovereigns – JPMorgan EMBI Global Diversified Index. Past performance is not a guarantee of future returns. <sup>2</sup>Bloomberg, from 31 December 2010 to 18 June 2018, JP Morgan JACI composite Yield-to-Worst (%). <sup>3</sup>Bloomberg, from 31 December 2017 to 21 June 2018.

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