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# EASTSPRING INVESTMENTS

## NAVIGATING THE CROSSWINDS IN THE ASIAN BOND MARKET

MARCH 2022



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Client Portfolio Manager

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MARKETING COMMUNICATIONS

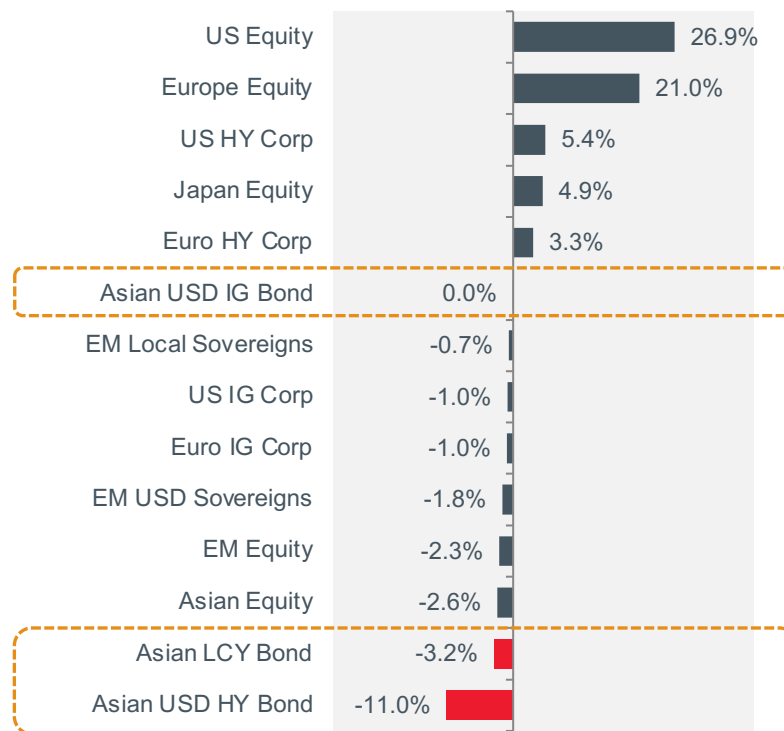
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# Asian bond markets

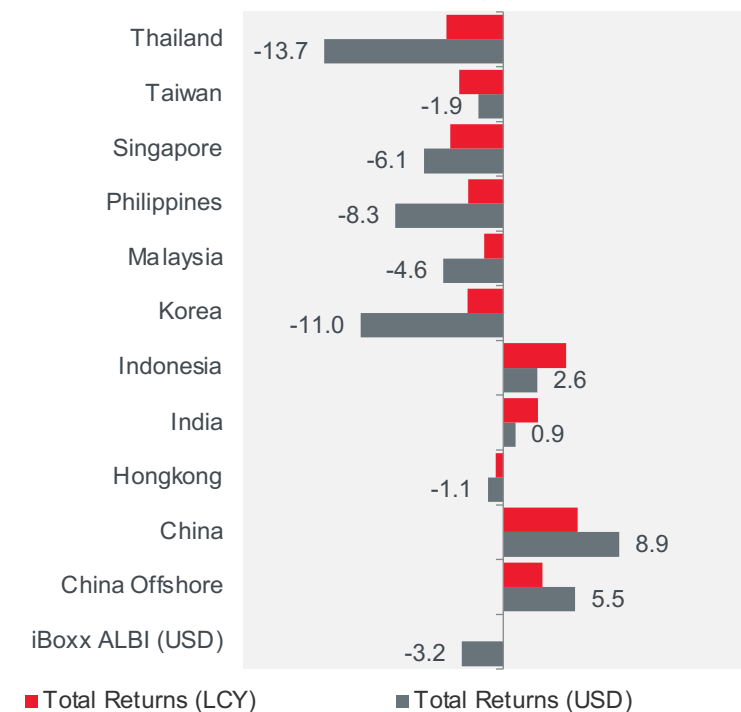
## Challenging market condition 2021

- ▶ Asian US bond markets lagged other regions due to sell-off in China High Yield property.
- ▶ Asian local bond markets suffered from higher domestic govt bond yields and broad weakness in Asian currencies

### 2021 PERFORMANCE RETURNS



### ASIAN LOCAL BOND & CURRENCY YTD RETURNS (%)

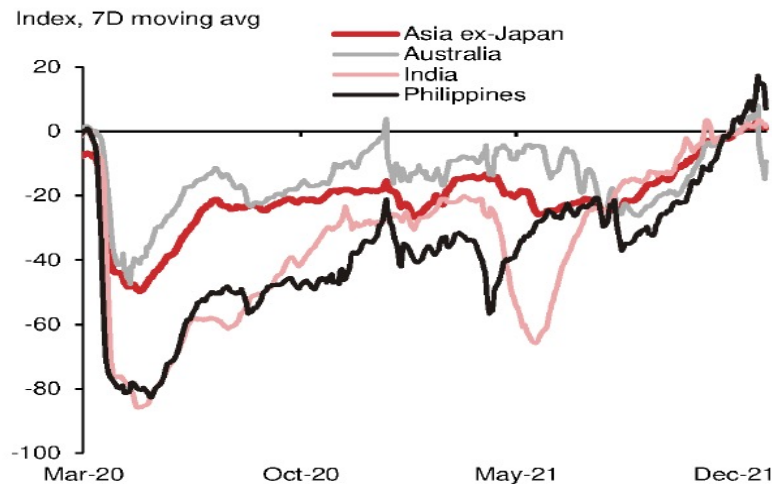


Source: Bloomberg, 31 December 2021. Past performance is not necessarily indicative of the future or likely performance of the portfolio.  
HY = high yields; IG = Investment Grade.

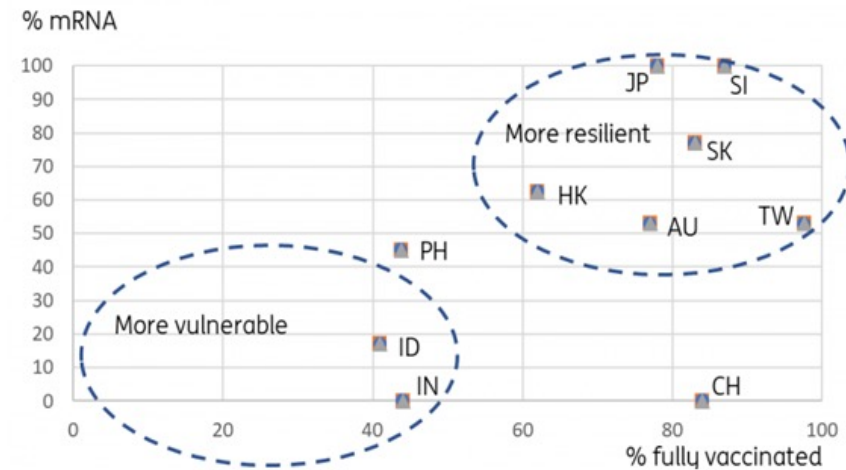
## Transition to endemic

- ▶ Pandemic transition to endemic appears to have accelerated with emergence of a much more transmissible yet less deadly variant of covid (Omicron). The recent spike in Omicron infections, accompanied by stable hospitalization and ICU occupancies, provides comfort to policy makers.
- ▶ Vaccination rates have improved dramatically in Developed Market and most parts of Asia. Preliminary studies suggest existing vaccines remain effective. This implies majority of the population will be protected from severe illness, hospitalization and death.
- ▶ This should pave the way for meaningful economic reopening, consumption recovery and normalization, which had originally been expected in 2021 but delayed by the onset of Delta variant and sets the global economy on a more certain path to recovery.

MOBILITY INDEX (RETAIL & RECREATION) BY COUNTRY



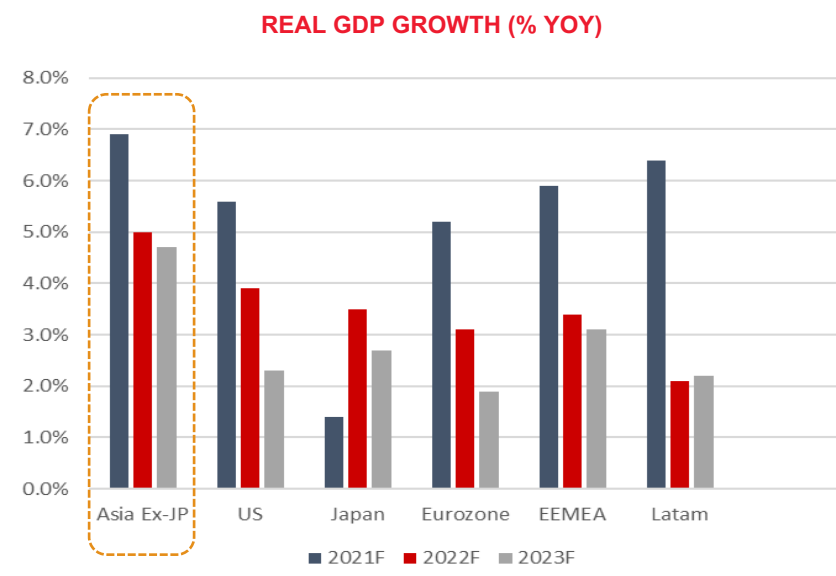
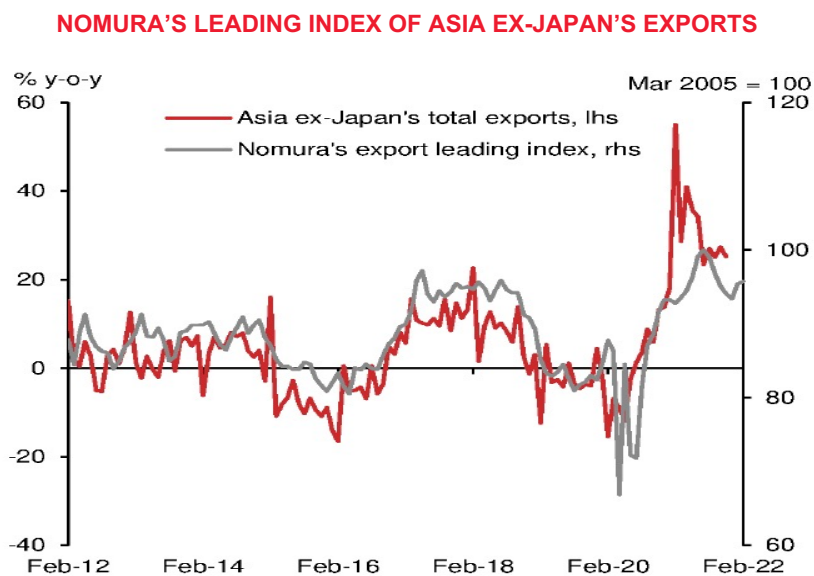
OMICRON VULNERABILITY IN ASIA



Left Chart Source: CEIC, Google and Nomura Global Economics, January 2022. Note: Google calculates changes in mobility data for each day compared to a baseline value for that day of the week. The baseline is the median value, for the corresponding day of the week, during the 5-week period Jan 3 – Feb 6, 2020. Right Chart Source: Our World in Data, Wikipedia, Local Sources, January 2022.

## Growth catching up

- ▶ Although Asian countries have seen a surge in COVID-19 cases due to the highly contagious Omicron variant, the region's manufacturing sector continues to power ahead.
- ▶ Globally, growth forecasts has been revised downwards for 2022. However, Asia ex Japan region still expected to experience highest growth this year.
- ▶ Within Asia, India is expected to have another year of high growth. The Philippines and Malaysia expected to catch up in 2022 as well, after a relatively disappointing 2021.
- ▶ China's recent easing moves also lessen its growth risks.



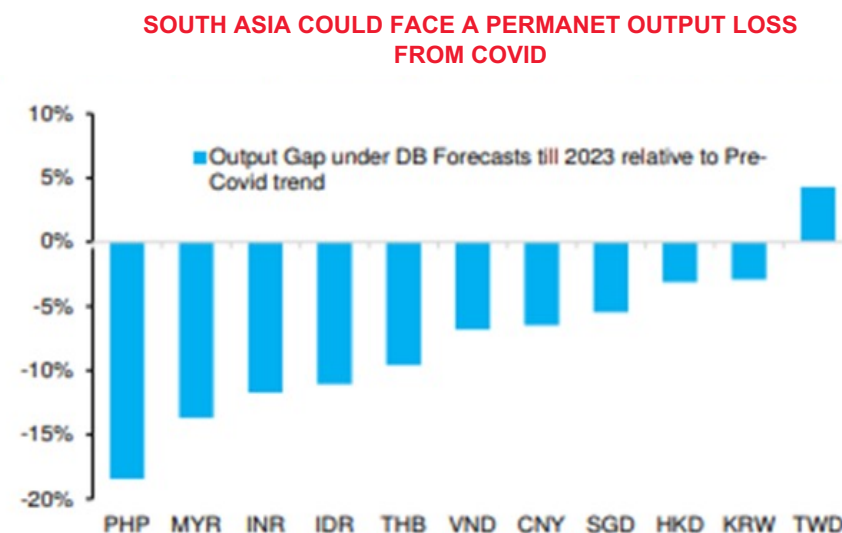
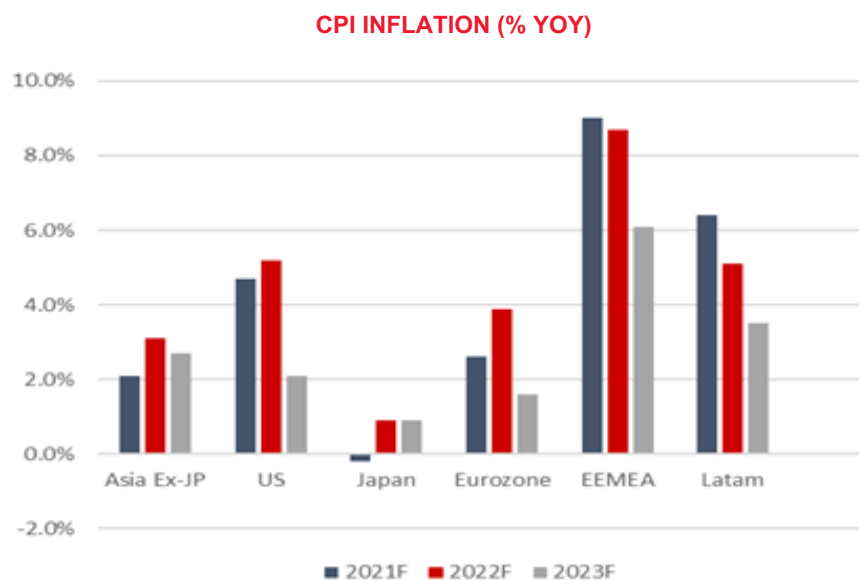
Left Chart Source: Nomura, February 2022. Right Chart Source: Nomura, Jan 2022 & Citi Velocity, Jan 2022. The chart above is included for illustrative purposes only and may not be indicative of the future or likely performance of the markets.

# Inflation pressures

## Benign in Asia

- Inflation expected to be a global issue, but the inflation situation in Asia ex Japan region is likely to be relatively better contained
- Unlike in the Developed Market (DM), the Asian consumption basket appears relatively unaffected by supply-chain related price shocks.

- Economic recovery for the region had been hampered in 2021 by Delta variant, and economic reopening had not taken place as fast as DM markets.
- This has contributed to continued negative output gaps in several Asian countries, providing room for central banks to remain patient.



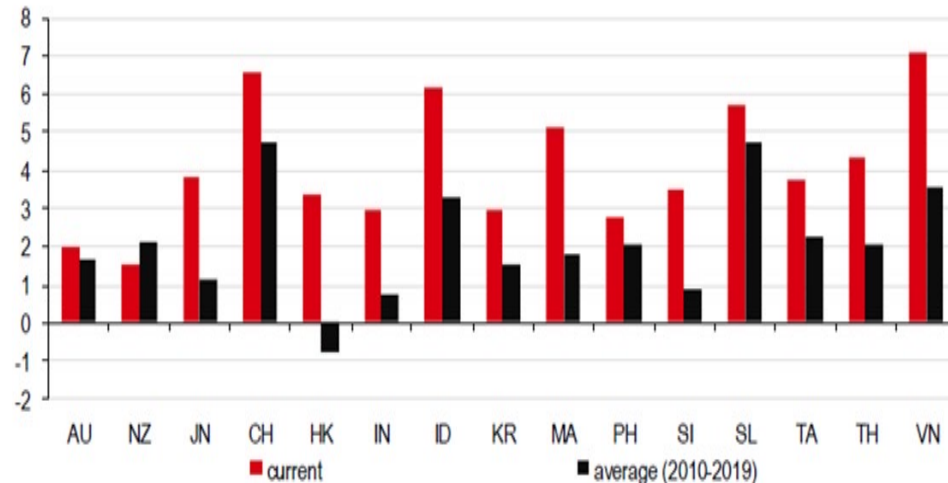
Left Chart Source: Nomura, Jan 2022 & Citi Velocity, Jan 2022. Right Chart Source: Deutsche Bank, CEIC, Haver Analytics, February 2022. The chart above is included for illustrative purposes only and may not be indicative of the future or likely performance of the markets.

# Real rates

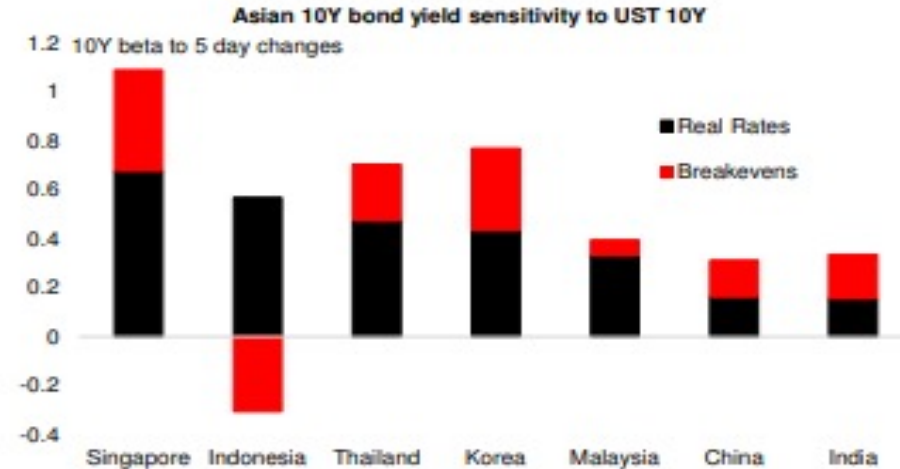
## In favour of Asia

- ▶ Given the high current inflation rates in the US, real policy rate differences between Asia local vs US have increased.
- ▶ This is expected to narrow as US inflation moderates through 2022-23, raising US real rates.
- ▶ Even so, the difference between Asian local and US policy real rates is expected to remain well above pre-pandemic averages.
- ▶ We see value in Asian domestic bonds where inflation is of less concern, and central banks have little need to follow the Fed.

**DIFFERENCE BETWEEN LOCAL & US REAL POLICY RATES \*  
(%, CORE CPI DEFLATED)**



**ASIAN BONDS ARE TWICE AS SENSITIVE TO REAL RATE-DRIVEN  
SELL-OFFS THAN BREAKEVEN-LED ONES**



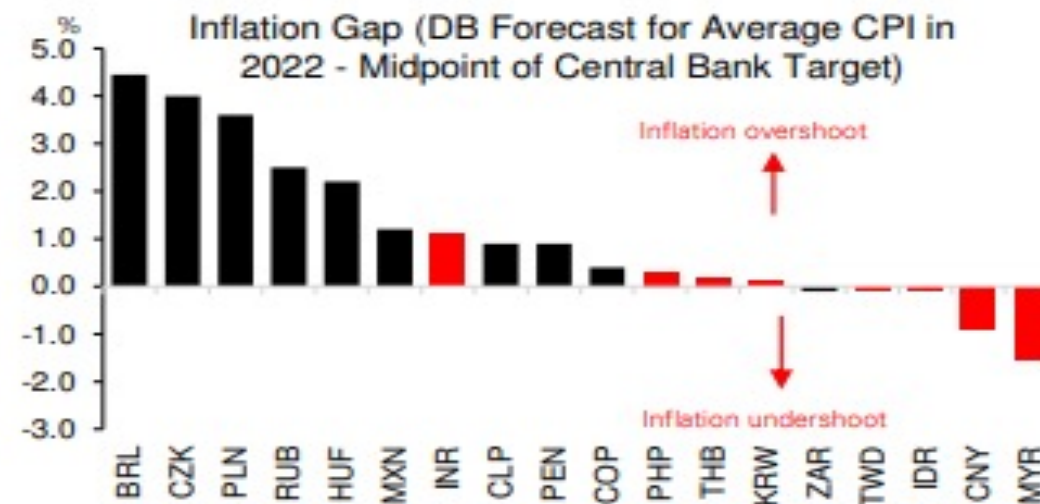
Left Chart Source: CEIC, HSBC, February 2022. \* Core CPI deflated. Right Chart Source: Deutsche Bank, Bloomberg, January 2022. The chart above is included for illustrative purposes only and may not be indicative of the future or likely performance of the markets.

# Asia policy and rates

## Outlook

- ▶ Asian Central Banks have lagged tightening in other Emerging Market and will likely remain so in 2022. Inflation will likely remain below targets, economies largely still operate below potential, and recovery will only be gradual with private sector credit growth benign.
- ▶ Asia is expected to straddle the policy divide between Fed tightening and PBoC easing.
- ▶ Asian rates will not be immune to higher USD yields, as already evidenced from 2021. In addition, bond supply is set to remain heavy across most regions for the coming year.
- ▶ The anchor of monetary policy accommodation, together with PBoC's easing bias, suggests Asia rates would remain poised to outperform USD rates generally.
- ▶ Pace of Fed rates normalization remains a wild card. Only a gradual, well telegraphed, trajectory of hikes can prevent Asian rates from selling off disorderly as in previous episodes of Fed hikes.

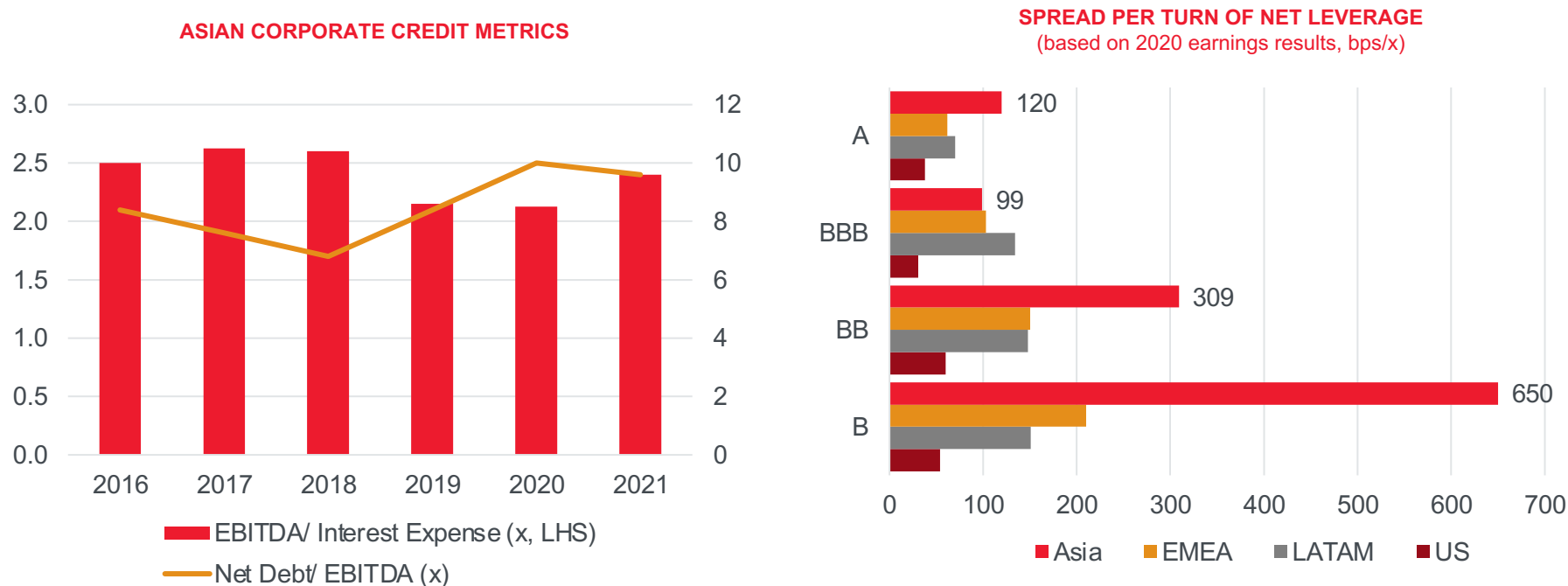
**INFLATION IS GENERALLY EXPECTED TO COME IN LINE WITH OR BELOW CENTRAL BANK TARGETS IN ASIA NEXT YEAR**



# Asian credits

## Overall fundamentals are broadly stable

- ▶ Asian corporates saw more modest deterioration in credit metrics during 2020 but experienced robust recovery in 2021, with net leverage, margins and coverage metrics improving. Current net leverage metrics also remain over a turn lower than similarly rated Developed Market credits.
- ▶ This puts Asian issuers on a relatively strong fundamental footing going into 2022.



LHS Source: JP Morgan, January 2022. RHS Source: BankofAmerica Merrill Lynch, January 2022. The historical performance or forecast presented in this slide is not indicative of and should not be construed as being indicative of or otherwise used as a proxy for the future or likely performance.

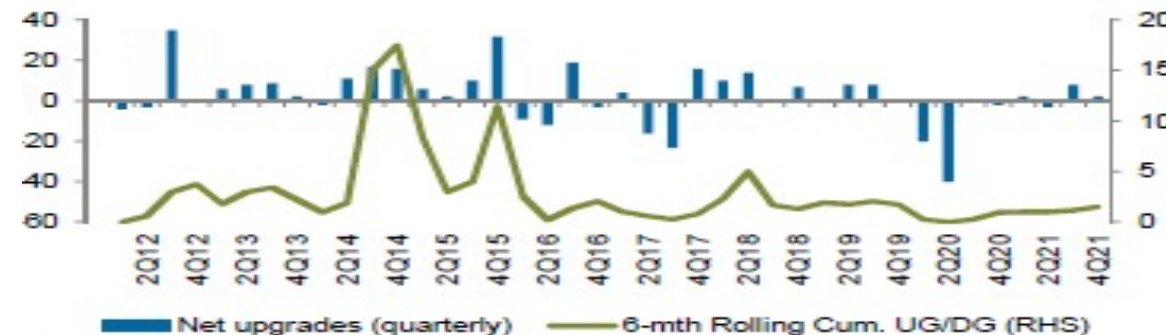


# Asian credits

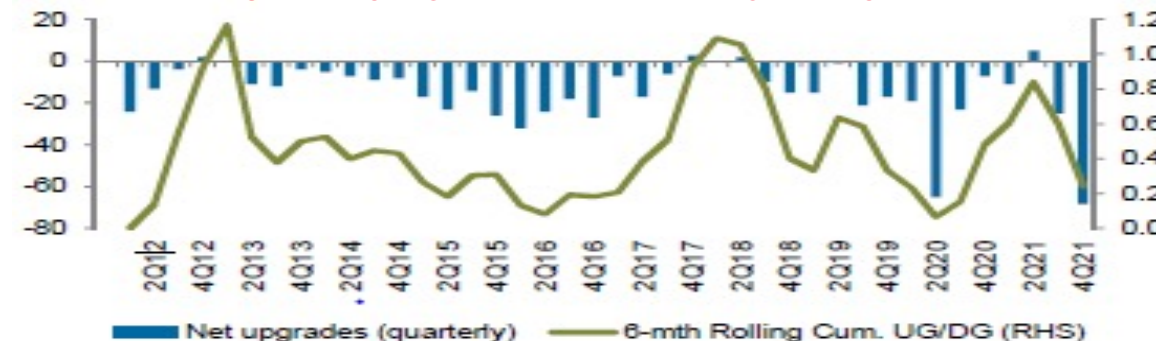
## Rating trends have diverged

- Credit migration trend in the investment grade sector has turned positive.
- But Asian HY credits have been on a negative rating migration trend due to ongoing liquidity squeeze in China property sector.

ASIAN IG SECTOR HAS SEEN MORE UPGRADES THAN DOWNGRADES



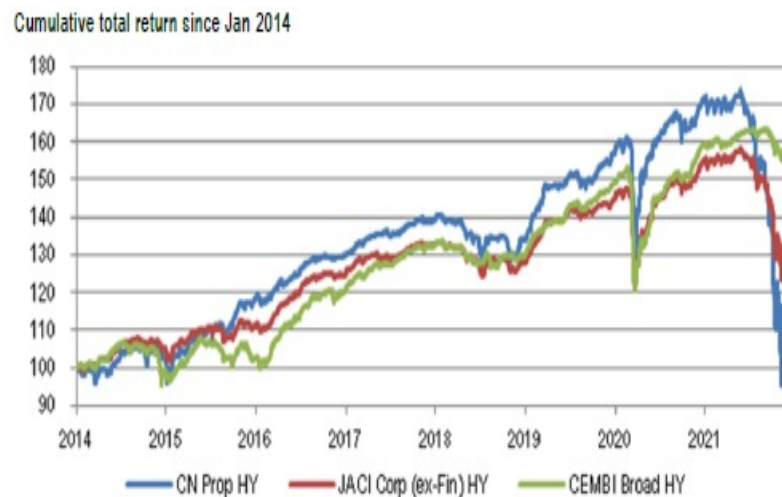
ASIAN HY DOWNGRADE TREND DRIVEN BY CHINA PROPERTY



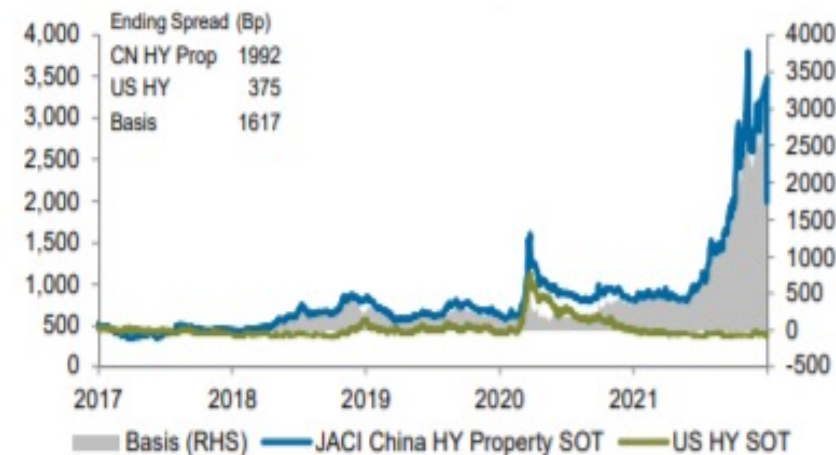
## Rating trends have diverged

- ▶ China real estate high yield (HY) bonds suffered the worst setback on record in 2021.
- ▶ While volatility in the China real estate sector is expected to remain high in the near term, we believe the market has priced in an excessively high default rate, especially considering the forthcoming policy easing that we are expecting.
- ▶ The overall regulatory tone suggests that the government will take more actions to ease the industry's liquidity crunch and limit contagion.
- ▶ Valuations have already priced in an extreme case scenario; China HY property bonds are offering good pick up over US HY.

CHINA HY PROPERTY PERFORMANCE



CHINA HY PROPERTY TRADES WIDER THAN US HY



Source: JPMorgan, January 2022

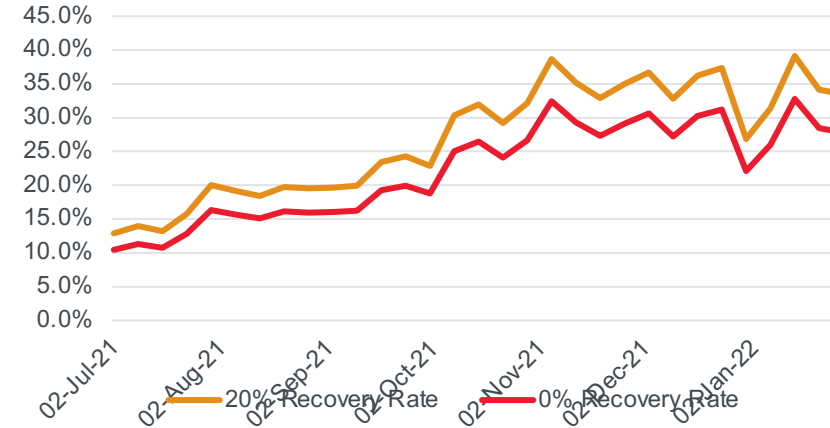
# China real estate sector

## Outlook

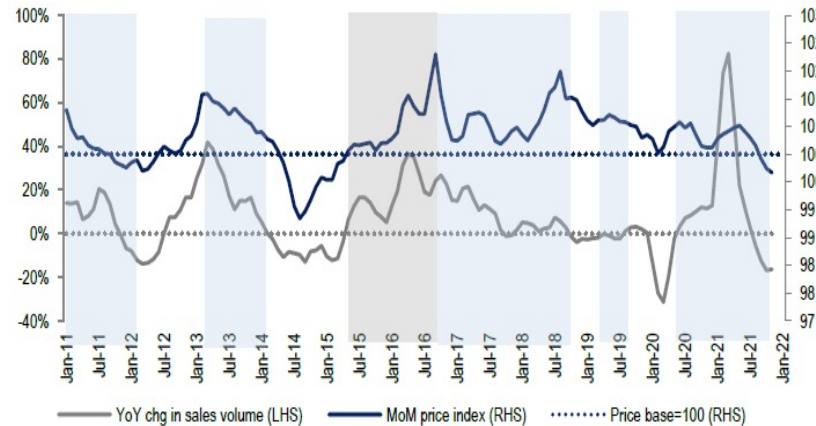
**CHINA HY MAY HAVE PEAKED OR COULD PEAK IN A FEW MONTHS**  
(At 7.5 months of spread widening it is reaching point of extremity experienced with other sector blow-ups)



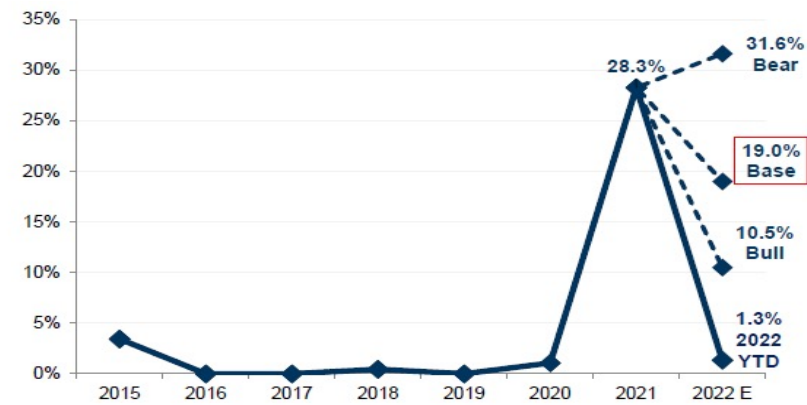
**IMPLIED DEFAULT RATE OF CHINA HY PROPERTY SECTOR**  
(EXCL EVERRE, KAISA, FTHDGR)



**IN THE PAST PROPERTY CYCLES, POLICY BECAME MORE SUPPORTIVE AFTER THE YOY GROWTH IN NATIONAL PROPERTY SALES TURNED NEGATIVE AND MOM GROWTH IN 70-CITY HOME PRICE MODERATED**



**CHINA PROPERTY HY DEFAULT RATE (WEIGHTED BY OUTSTANDING AMOUNT)**



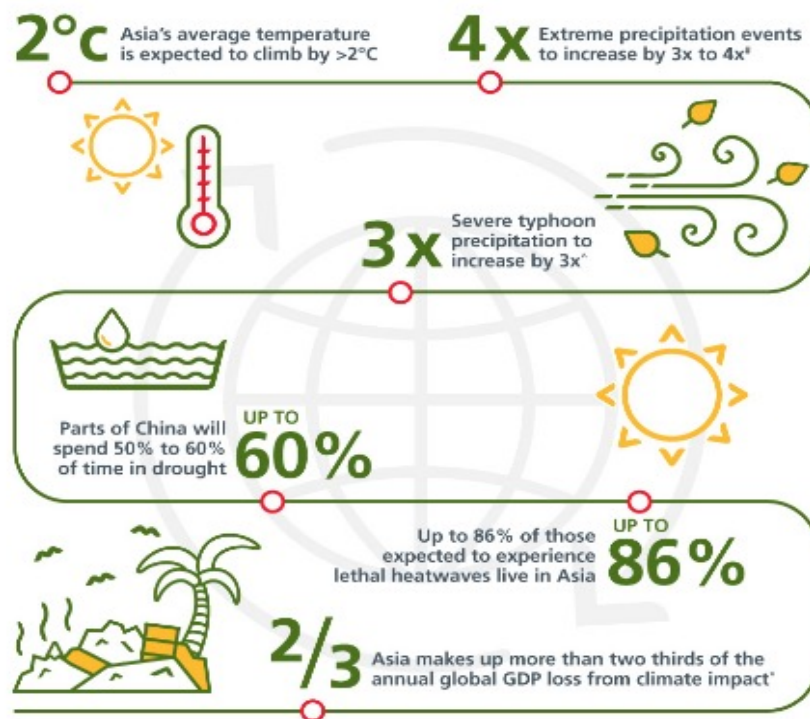
LHS Source (top): Bloomberg, Yield Book, Morgan Stanley Research, January 2022. For China HY total return is used as a gauge of spread peaked due to larger mismatch between total return and spread; LHS Source (bottom): Company data, Bloomberg, CEIC, Credit Suisse estimates, January 2022. Light blue represents periods of property tightening. For the period from Jul 2015 to Sept 2015, the policy was more of "one city, one policy" with tightening in some top-tier cities; RHS Source (top): Bloomberg Port, Eastspring investments estimates, using OAS of JACI – Non investment Grade index as proxy; RHS Source (bottom): Bloomberg, Moody's, S&P, Goldman Sachs Global investment Research January 2022

# Asia waking up

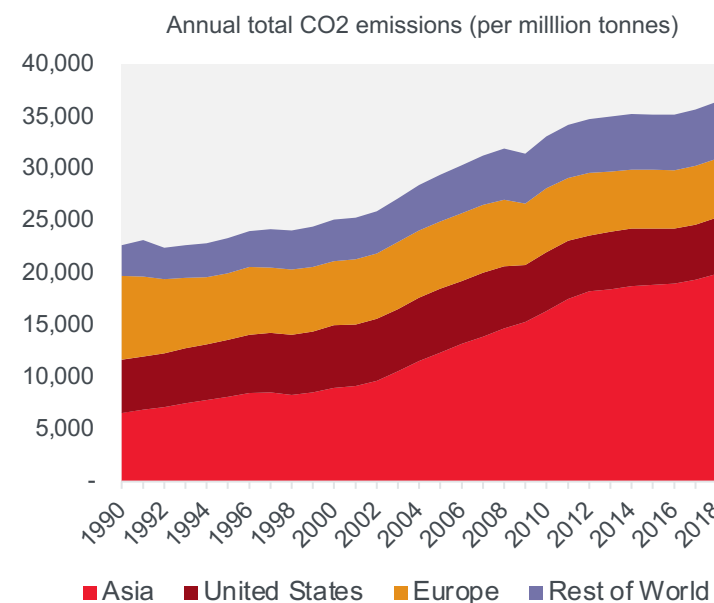
## To ESG investments

- ▶ According to McKinsey & Company, climate change is expected to hit Asia the hardest. For that very reason, the urgency to undertake effective responses suggests that there will be greater opportunities for investors, and for ESG outperformance.

### POTENTIAL CLIMATE IMPACT ON ASIA GROWTH



### ASIA IS THE BIGGEST CARBON EMITTER OF THE WORLD



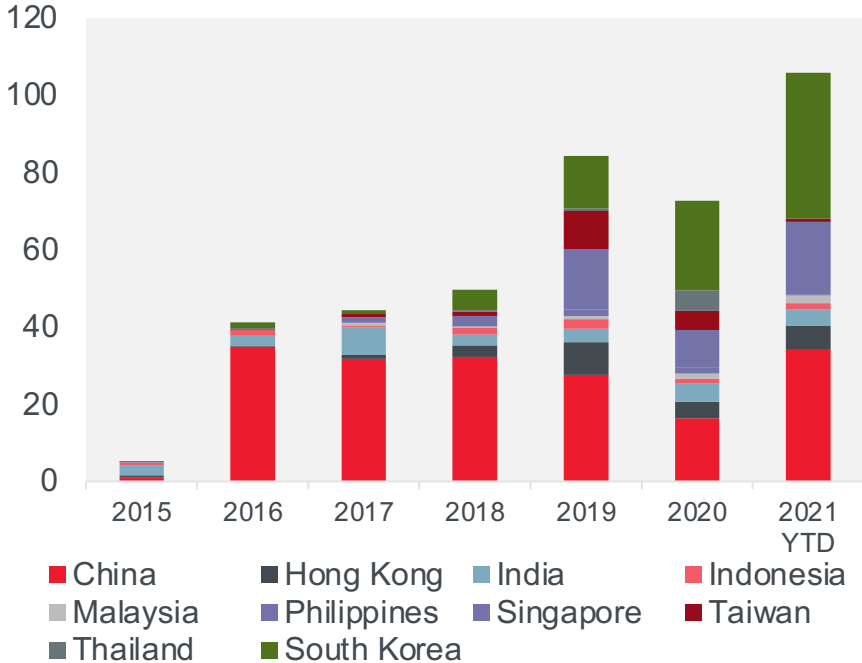
LHS source: Climate risk and response in Asia. McKinsey Global Institute. November 2020. Based on the RCP 8.5 scenario. #Areas including, for example, eastern Japan, central and eastern China, parts of South Korea and Indonesia. ^By 2040 in some parts of Asia, including coastal areas of China, Japan, and South Korea. \*Due to effective loss of outdoor working hours because of increased heat and humidity; RHS Source: Global Carbon Project, July 2021; Note : This measures CO<sub>2</sub> emissions from fossil fuels and cement production only – land use change is not included. 'Statistical differences' (included in the GCP dataset) are not included here.

# Growing universe

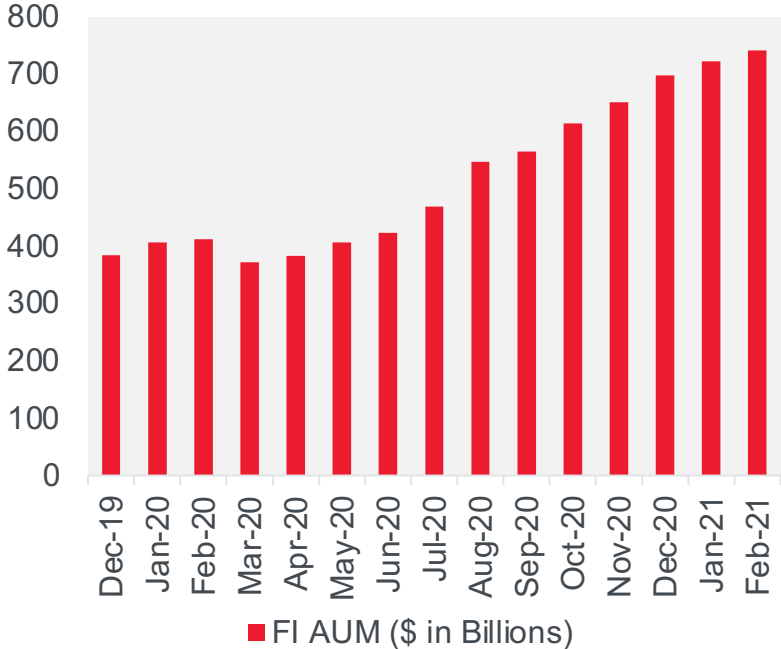
## Sustainable bond investments

► **Green, Social and Sustainability (“GSS”)** bond issuance has been very strong in Asia this year, with year-to-date supply already surpassing the 2019 peak.

GSS BOND ISSUANCE BY COUNTRY (USD BN)



ESG-DEDICATED FI AUM HAS GROWN MORE THAN 100% SINCE MARCH 2020



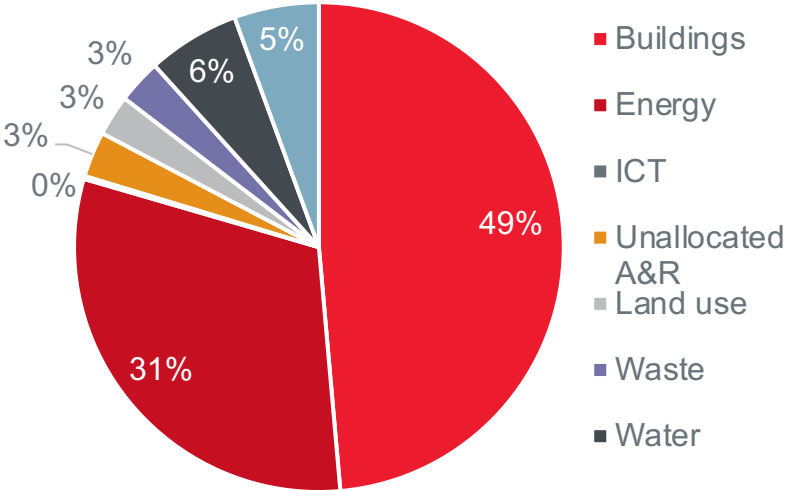
LHS Source: Bloomberg Finance, July 2021. RHS Source: JP Morgan report, as of 31 March 2021. Based on publicly available self-identified fund data from Lipper Invest Management.

# Green investment potential in Asia

## Growth of green buildings in Singapore

- In Singapore, there is a strong industry and regulatory drive to build a low carbon, energy-efficient city-state. Singapore has set itself the goal to get 80% of its building stock (excluding logistics and industrial facilities) certified with its Green Mark tool by 2030.
- Singapore’s industrial real estate investment trust, Ascendas REIT issued two green bonds for financing green real estate projects in 2020. These bonds were well-received and channeling funds to green and sustainable certified buildings is expected to gain traction among REITs.

ENERGY AND BUILDINGS REPRESENT THE MAJORITY OF GREEN INVESTMENTS IN ASEAN



Buildings are currently responsible for **39%** of global carbon emissions



Green Buildings can achieve energy savings of **50%** or more



Green Buildings helps to meet **9/17** of the UN’s Sustainable Development Goals

LHS Source: Climate Bonds Initiative, December 2020. A&R stands for Adaptation and Resilience. RHS Source: World Green Building Council, August 2021

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