Keep Calm and Carry On for Fixed Income Investors

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FUND
MANAGEMENT

Executive summary

- Economic impact of a virus outbreak such as COVID-19 tends to be transitory, with a significant rebound in business and industrial activities once the outbreak has passed. Sectors which will see a direct and more pronounced impact form a small part of the entire Asian credit market. The impact on growth would have wider implications, which will be partially offset by strong policy responses.
- We remain comfortable with the names we hold in our Asian credit portfolios, as they have stable credit metrics and sufficient cash buffers. Within SGD credit strategies, we have been extending duration in our portfolios. Positive coupon carry will also help to anchor returns.
- Within the Asian local currency strategies, we have closed our modest short USD position, given the near-term flight to safety. We are also underweight currencies that are most vulnerable to the negative spill-over effects from lower tourist numbers from China and supply chain headwinds.

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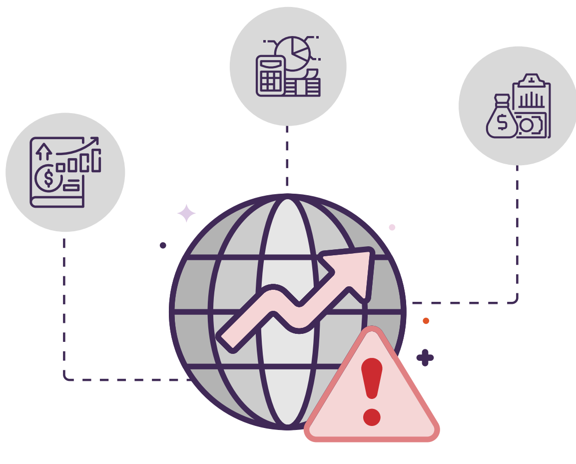
Markets have been grappling with the recent COVID-19 outbreak.

With China at the epicentre of the outbreak, the responses from the Chinese government to date have been swift and strong, reflecting lessons learnt from the SARS episode in 2003. Typically, there are three stages that occur – an initial period of uncertainty followed by a period of stabilisation and thereafter, a period of sharp market rebound. Given the strong policy responses from the Chinese government so far, the current period of uncertainty could be shorter compared to the SARS outbreak in 2003 when it lasted for about five months.

Economic impact of virus outbreak likely to be transitory

Drawing on the experience from the past episode, the global economic impact of a virus outbreak tends to be transitory, with a significant rebound in economic activity once the outbreak has passed.

For now, sectors which will see a direct and more pronounced impact include the services sectors – such as gaming, tourism, retail, transportation. For Asian fixed income investors, these sectors form a small part of the entire Asian credit market. The second order impact on growth would have wider implications. We expect to see some reversal in Q1 2020 growth data, following the better than-expected Q4 2019 GDP figures in Asia.



Central banks in Asia stand ready to support growth

Central banks in Asia also stand ready to respond via a combination of monetary or fiscal policy measures should growth surprise on the downside. The Bank of Thailand cut its benchmark interest rate recently to a record low of 1.0% in a bid to bolster the economy. Furthermore, China is expected to unveil additional measures to cushion the economic blow from the COVID-19 outbreak. The People's Bank of China is set to keep liquidity ample and the Chinese government is likely to step up spending. Entering into 2020, market valuations were at rather elevated levels and therefore also more vulnerable to any market corrections.

Investment case for China's Top 30 property names remain intact

The Chinese real estate sector is likely to register lower property sales year-on-year in Q1 2020 as sales offices nationwide are mostly closed. That said, Q1 2020 is traditionally a lull period for property sales in China given the Lunar New Year holiday period and winter weather. To counter the slowdown in sales, developers are likely to take or have taken some key steps – firstly, to preserve liquidity by slowing down land acquisitions and construction activities; secondly, some developers have migrated to online sales platforms, albeit it is still early days to assess the efficacy of such sales channels.

On a more positive note, assuming that the COVID-19 virus outbreak is not protracted, we think that there may be an unleashing of pent-up demand for Chinese property in Q2 2020, which is traditionally a strong quarter for property sales. In addition, we think there may be some moderation in mortgage rates, if need be, as the Chinese authorities are likely to step in to lower interest rates to cushion the economic blow.

Our exposure to Chinese property credits is concentrated in the top 30 nation-wide developers whom we believe have the financial flexibility to withstand any near-term liquidity crunch. In fact, many issuers had adopted an aggressive pre-emptive refinancing approach to issue bonds before Chinese New Year given the favorable funding conditions, which puts them in reasonable stead to withstand the COVID-19 driven slowdown.

Most of the top 30 developers are also better diversified geographically to avert any regional concentration risk arising from the COVID-19 virus.

Positioning our Fixed Income portfolios to weather near term volatility

Within our credit strategies, the rally in US Treasury yields will buffer the investment grade bond holdings from the widening of credit spreads. The high yield sector may come under some pressure as investors become more discerning and look to take some profits following the recent rally. That said, we remain comfortable with the names we hold within the sectors most impacted by the COVID-19 outbreak. The names we hold have stable credit metrics and sufficient cash buffer to withstand the ongoing market headwinds. Within SGD credit strategies, we have been extending duration, and that should put us in good stead while positive coupon carry will help to anchor returns.

Overall, we are also taking the opportunity to trim our positions in holdings where valuations are looking stretched, identify issuers which have suffered indiscriminately, and put in place hedges where appropriate. Within the Asian local currency strategies, we have closed our modest short USD position, given the near-term flight to safety. We are also well-positioned given our underweight to the Korean won, Thai baht and Singapore dollar which are amongst the Asian currencies most vulnerable to the negative spill-over effects from lower tourist numbers from China and supply chain headwinds.

Looking ahead, investors should expect some market volatility in the near term and the developments over the coming weeks will be important to monitor.