Fullerton Insights

Yielding to Asian Bonds in 2020

FULLERTON FUND MANAGEMENT

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Key Takeaways

- The Asian local currency bond market is a high quality investment universe, with all nine key Asian sovereign issuers in the investment grade category.

- Asia's bond markets offer investors compelling nominal and real yields, against an environment of negative/low yielding debt globally.

- Inflationary pressures remain manageable across most Asian countries, keeping real yields firmly in positive territory, allowing regional central banks some flexibility to ease.

- Rising FX reserves provide sufficient ammunition for Asian central banks to support their currencies and moderate FX volatility during periods of capital outflows.

- Looking ahead, duration gains will be more selective next year as compared to 2019, as the pace of interest rate easing slows. We favour selective high yielders in Asia where central banks have further room to ease. As global growth rebounds and the flight to quality premium in the US dollar fades, Asian currencies can also outperform.

Asian bond markets have been in the spotlight, not least because of the strong performance of Asian local currency bonds this year. On a year-to-date basis as at end November 2019, Asian local currency bonds, as measured by the iBoxx Asian Local Currency Bond (ALBI) Index, delivered a stellar return of 7.2%[1] in USD terms. This was supported mostly by carry and duration gains as regional central banks moved to cut interest rates against continuing US-China trade headwinds.

Asia's bond markets offer attractive nominal and real yields, with room for policy easing

The strong year-to-date performance aside, the case for investors to make an allocation to Asian local currency bonds in their portfolios remains compelling, amidst the persistent phenomenon of negative yielding debt globally. Based on estimates by Bloomberg, the value of negative yielding debt is a staggering USD13.4 trillion[2]. Most recently in October this year, Greece sold new three-month debt valued at €487.5 million at a negative yield of -0.02% for the first time[3], which was previously unimaginable, given its past economic woes.

With interest rates in the developed world expected to stay low and the phenomenon of negative yielding debt not going away anytime soon, yield-seeking debt investors are turning their attention to regions such as Asia where fundamentals are stable, while still offering attractive yields. Specifically, Asian local currency bond yields (as measured by the iBoxx ALBI Index), are at 3.2%[4] and offer compelling yield pick-up over most bond markets, such as the Bloomberg Barclays Global Aggregate index, which has a yield of only 1.4% [5].

Inflationary pressures are also at manageable levels across most Asian countries and this will anchor real yields firmly in positive territory, allowing regional central banks some flexibility to ease. A case in point is the Philippines, where inflation has fallen to under 1.0%[6] in October, which is well within the central bank's target. It is worth remembering that only a year ago, inflation in the Philippines was above 6.0%[7]. As such, real yields on a 10-year local currency Philippines note is just under 4%[8], providing some leeway for the central bank to ease, should external growth headwinds materialise.

This stands in sharp contrast with the developed market economies which are plagued by negative, or extremely low, interest rates with limited scope to trim rates further.

Asia's 100% Investment Grade Sovereign Universe

	Asian Countries	Sovereign Ratings *		2019F GDP per capita[2] (based on current prices)	2019F Current account balances # (% of GDP)
		S&P	Moody's		
Developed Asian markets	Singapore	AAA	Aaa	103,717	17.6%
	Hong Kong	AA+	Aa2	66,517	3.2%
	South Korea	AA	Aa2	42,984	4.6%
	Taiwan	AA-	Aa3	55,244	11.4%
	China	A+	A1	19,520	0.4%
	Malaysia	A-	A3	32,455	2.1%
	Thailand	BBB+	Baa1	20,474	7.1%
Emerging Asian markets	Philippines	BBB+	Baa2	9,494	-2.2%
	Indonesia	BBB	Baa2	14,019	-2.7%
	India	BBB-	Baa2	8,484	-2.5%

Vs. major DM markets:
- UK:$46,782
- US:$64,767
- Japan:$45,565
- Germany:$53,854

VS. major DM markets:
- UK: -4.2%
- US: -2.4%
- Japan: 3.5%
- Germany: 7.1%

* Source: Bloomberg November 2019, sovereign rating is based on the foreign currency long-term rating by S&P and Moody's
\# 2019F GDP Source: IMF World Economic Database October 2019.

Sound macro fundamentals with investment grade sovereign ratings

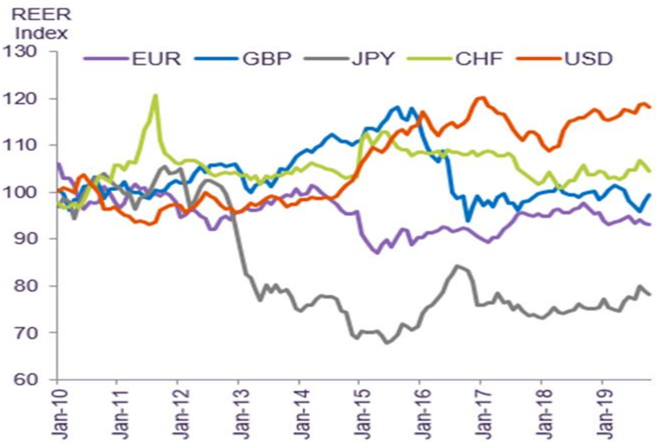
On the macro front, Asian economies have made significant strides towards improving their current account and fiscal positions since the Taper Tantrum episode in 2013. Encouragingly, rating agencies have taken notice and the region's sovereign ratings have markedly improved over the last decade, with emerging Asian markets such as Indonesia, India and the Philippines joining their developed market peers such as Singapore, Hong Kong and South Korea in the investment grade sovereign space. Investors have access to a high quality investment universe, with most Asian countries firmly in the investment grade rating category.

Robust external account surpluses of most Asian economies will also provide ammunition for regional central banks to defend their currencies during periods of adverse capital outflows. On a similar note, current account deficit countries such as Indonesia, India and the Philippines, have also benefitted from rising FX reserves, providing some room to moderate FX volatility as necessary.

US dollar headwinds buoy sentiments towards Asian currencies and assets

Over in the US, the current late-cycle domestic economic expansion is the longest on record in history. We thus expect to see some moderation in US growth to continue. This has implications for the US dollar, which could see some weakness next year, as the rest of the world catches up on growth. Furthermore, the twin fiscal and current account deficits are still looming, while expensive valuation could also pose headwinds for the greenback.

US dollar is expensive versus historical levels on a REER basis



Source: Based on BIS (Bank of International Settlements) REER narrow indices as of 20th November 2019

In contrast, Asian currencies are trading at cheap levels providing a good entry point for long-term investors. The Chinese renminbi also remains a key driver of Asian currency sentiment. The likelihood of a US-China "phase one" trade deal should provide stabilisation to the RMB currency, and in turn, will lift investors' sentiments towards the Asian currency bloc.

Asia is still the fastest growing region globally

On the growth front, Asia remains the fastest growing region globally, according to the latest report by the International Monetary Fund. The growth differential between Asia and the rest of the world will provide long-term support to the Asian currencies, and is positive for bond investors in the domestic markets. We also expect global growth to potentially stabilise in the coming months as central bank easing effectively transmits to the broader economies.

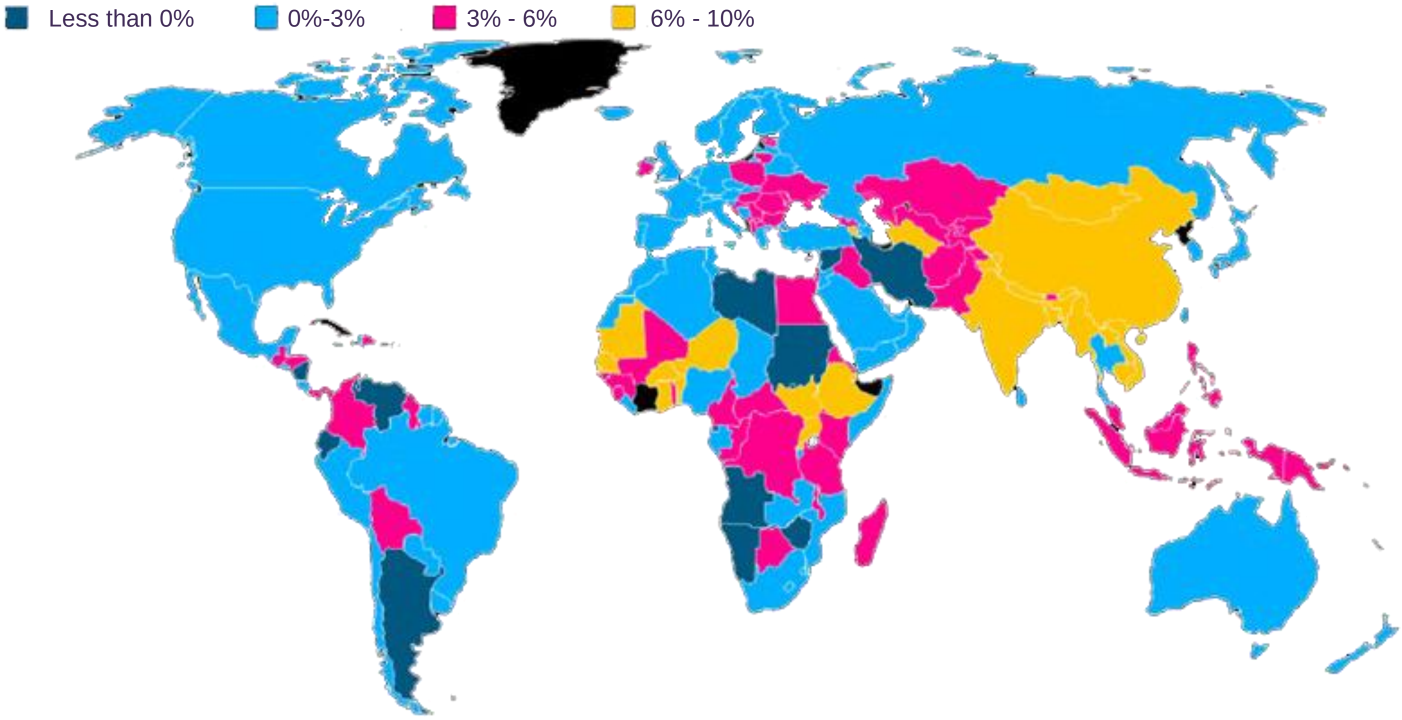
Looking ahead into 2020, Asian currencies can outperform as global growth rebounds and the flight to quality premium in the US dollar fades. Furthermore, Asian central banks have been early in the easing cycle, with much of the easing front-loaded in 2019. That said, duration gains will be more selective next year as compared to 2019, as the pace of interest rate easing slows. We favour selective high-yielders in Asia, such as Indonesia & India, where central banks have further room to ease.

Proven expertise in Asian fixed income

With investment offices in Singapore, Shanghai and Brunei, Fullerton prides itself as an Asian fixed income specialist, given our strong heritage and presence in Asia. We are headquartered in Singapore, with robust, in-depth knowledge of the Asian local currency bond markets.

The Fullerton Asian Currency Bonds strategy provides investors with access to the local currency bond markets in Asia. Guat Cheng ONG, Head of Fixed Income at Fullerton, has been the lead portfolio manager since the strategy's inception. The strategy has delivered consistent outperformance versus its benchmark since inception, steering investors through the various market cycles.

Global growth expectations – Asia is expected to remain home to the world's fastest GDP growth



Source: Bloomberg, IMF

Performance of Fullerton Asian Currency Bond Strategy (As at 31 October 2019)

Gross Returns % in USD	1-year	3-years	5-years	Since Inception [9]
Asian Currency Bond Strategy	13.9	4.4	3.4	3.7
Benchmark [10]	12.7	3.9	2.9	3.0
Relative Return	+1.2	+0.5	+0.5	+0.7

Source: Fullerton
Returns of period 1 year and above are annualised. Base currency of portfolio is in USD. Performance numbers are computed before deduction of all fees in USD terms and deduction of these fees will lower results. Past performance is not necessarily indicative of future performance. The performance experienced by each actual investor may vary significantly. Please refer to the disclaimer on the use of track record.

[1]Source: Bloomberg, 30 November 2019.
[2]Source: Bloomberg Barclays Global Negative Yielding Debt Market Value USD Index, as of 31 October 2019.
[3]Source: Financial Times, “Greece joins club of negative-yielding debt issuers”, 9 October 2019.
[4]Source: Markit iBoxx ALBI Index, as of October 2019. Figure shown is the yield-to-worst.
[5]Source: Bloomberg Barclays Global Aggregate Total Return Index, as of October 2019. Figure shown is the yield-to-worst.
[6]Source: Bloomberg, as of October 2019
[7] Source: Bloomberg, as of October 2018
[8] Source: Bloomberg, as of October 2019. The figure is derived using generic PHP 10-year government bond minus Philippines’ headline inflation.
[9] The strategy was incepted on 31 October 2010.
[10] The benchmark is the Markit iBoxx ALBI Index