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First Sentier Investors
首源投資

Investment Grade Credit in Asia – a long term investment tool for retirement?

We believe bond market demand in Asia represents an opportunity for fixed income investors as well as those who invest for retirement. There are many factors driving this positivity; its high stability and low risk feature, robust return, and Asia's strong growth outlook drive allow it to outshine its peers as we look towards a post-Covid world.

What is investment grade credit?

Investment Grade Credit, sometimes called 'high grade bonds', are issued by corporates of good quality usually resulting in lower risk of default. These bonds receive higher ratings (Baa3/BBB- or above) from credit rating agencies. Non-investment grade bonds, also known as high yield or junk bonds, receive lower ratings reflecting their low quality compared to investment grade bonds.

Why would we consider investment grade credit as an investment tool for retirement?

1. High stability with relatively lower risks

In Asia USD investment grade credit, government related and state-owned enterprises make up the highest market value. Given government ownership, these companies are inherently less risky than general corporates, resulting in higher stability.

Chart 1: Asia IG offers spread premium over US IG spreads

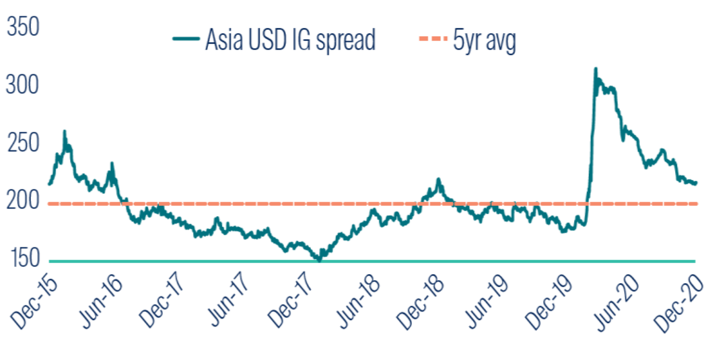
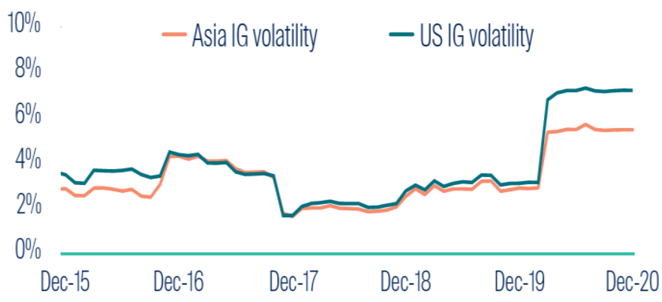


Chart 2: Asia IG volatility is lower versus US IG



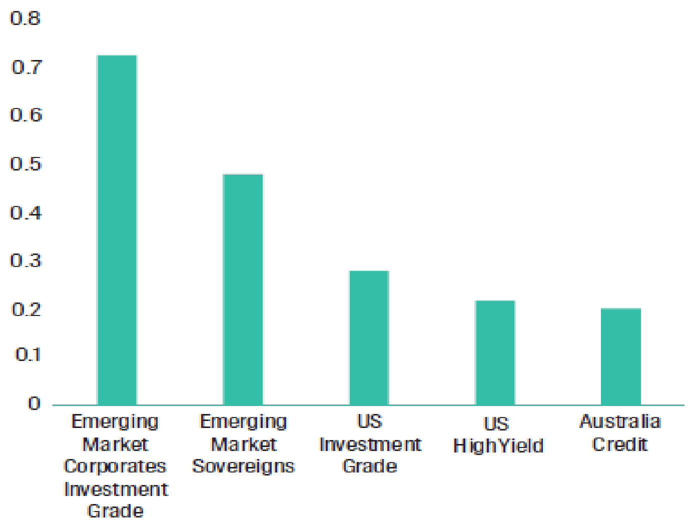
Source: JP Morgan, Bloomberg, Barclays, First Sentier Investors, as of 31 December 2020.

Besides, it is important to note three key observations and trends which are likely to support the growth story of Asian fixed income. First, developed market investment grade benchmarks are typically dominated by financial institutions, due to their need for capital. Asia has fewer financials in the benchmark relative to peers such as US investment grade. The dominant issuers within this sector in Asia are the high quality financial institutions from Singapore, the mainland China and Hong Kong. Secondly, our research has shown that Asian investors are buying Asia. This trend continues with approximately 75% of new issues being invested in by Asia-based investors. Finally when we look at the dominant issuers for the industrials we see high profile, well capitalised, profitable global names that represent diversity and exposure to the growth story of Asia.

2. Attractive return/yield profile

The return of Asian investment grade credit, when compared to other fixed income markets, remain attractive. In a COVID world where central banks in developed markets have slashed interest rates to zero or near zero, Asia still provides yield. Given the stability mentioned above, we believe this translates to an acceptable risk/return profile for investors as per Chart 1 below:

Chart 3: Return correlation with Asia investment grade



Source: Bloomberg, First Sentier Investors, as of 31 March 2021.

Additionally, we considered how Asia USD investment grade credit could fit within portfolios for investors and those who are investing for retirement, considering return correlations to other fixed income markets. Unsurprisingly Asia USD investment grade credit has a high correlation to emerging markets corporates, yet not as high as we instinctively thought. Against global credit constituents namely US investment grade, emerging markets sovereigns, high yield and Australian credit the correlation of returns for these fixed income markets are very low. We attribute this to the dominance of State-owned Enterprises, lower allocation to financials and limited energy and mining exposure (a sector that has been volatile during the COVID period due to global growth and oil price uncertainty).

When we consider the reasons for stability in the context of the return profile, it is not surprising that on a risk adjusted return basis (sharpe ratio), Asia investment grade is a standout. We have presented this as part of our case for Asia USD investment grade credit for many years. Not only does Asia compare favorably against other fixed income markets, but also compares favorably across other asset classes.

3. Investment outlook for Asia

Global growth is suffering in a COVID world as economies have experienced lock down and reopened at different times. This interrupts activities and challenges supply chains. Economic data shows that contraction is occurring across virtually all economies and is negatively impacting the outlook for global growth. Asia is not insulated from this with some countries affected more severely than others from the pandemic.

However, forecasts show that while growth is slowing in Asia, it remains the region having the highest growth in the global economy. Additionally, Asia's share of global GDP has been rising over the last decade and that is forecast to continue. This is supportive for Asian corporate's strength in general. Asian corporates were in good health prior to COVID and are likely to be the corporates best placed to survive future challenges as growth returns. Asian investment grade fixed income is, therefore, a choice for investors who are investing for the long term as well as for retirement.

Source: First Sentier Investors, as of end of 24 May 2021

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First Sentier Investors (formerly First State Investments) is a global asset management group focused on providing high quality, long-term investment capabilities to clients. We invest more than US$180.3 billion (as of 31 March 2021) on behalf of our clients globally. We bring together independent teams of active, specialist investors who share a common commitment to responsible investment principles.

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