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Investors need to look at the Asian credit market during this crisis*The potential advantages of Asian economies and funds*

For investors searching for pockets of stronger certainty, the Asian credit market is proving to be more resilient than other markets and asset classes, particularly in the high yield space due to a confluence of factors.

Solid fundamentals in Asia credit and relatively low default risk

On the whole, Asian economies have proven to be more stable than their counterparts in other parts of the world. Gross domestic product growth in Asia for example has been, and is expected to remain, stronger than other regions in the world. This is largely attributable to the underlying economic robustness as well as strong and coordinated government policy support.

While China remains the key engine of growth in Asia; the region is also supported by a number of dynamic, well run economies throughout North and Southeast Asia. The combination of a well-educated, motivated workforce, sensible economic policy, low external debt and generally decent infrastructure has created a formula of stable economic growth for the region. North Asia, furthermore, enjoys a “first in – first out” position.

Amidst the current pandemic situation, governments across Asia have also been swift and sure-footed in implementing their economic stimulus measures, including interest rate cuts, extra liquidity injections and tax cuts. Malaysia, for example, has been especially proactive, launching a series of fiscal and monetary measures aimed at helping the local communities and companies to weather the current economic storm.

Whilst many investors will be rightly concerned with the potential for default in these turbulent times, we feel Asia corporates will be comparatively more shielded from these vulnerabilities.

First and foremost, Asia generally has a lower exposure to the most badly impacted sectors like oil and gas production. In addition, many large energy companies, such as those in China, are state-owned Enterprises and as such can expect some measure of support by the government. Finally, a large portion of Asian high yield bonds are comprised of issues from Chinese property developers, and most of the top 30 issuers have already raised funds to meet their near-term financing needs. The reduced refinancing pressure means that the chance of default risk in the market is slimmer.

As such, Asia credit may be subject to idiosyncratic risk of individual names rather than systemic risk of industries, which is a contrast to the situation in the oil and retail sectors in the US. Even in light of the current COVID-19 pandemic, Asia high yield default rate for example, is forecasted at 4.0% for 2020, which is still relatively low and one of the lowest compared to the forecasted default rates for the rest of the world.

There has also been an improving trend in the fundamentals of Asian issuers since 2016, after going through several years of deterioration. EBITDA and net income margins have improved, leverage has declined, interest coverage continues to improve, and liquidity remains adequate with rising profitability ratios. All of these factors collectively indicate that a lot of the Asian high yield issuers are more equipped to brave the uncertainties in the current investment environment.

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Asian bonds are trading at Improved Valuations versus the historical average

In light of the current volatility brought on by the pandemic, adjustments in the Asian credit market in late March has made valuations a lot more attractive than in previous years for both high yield markets and investment grade markets.

The stability of Asia credit is also further enhanced by a much lower average duration than other global credit markets. Investment Grade Asian Corporates have on average a duration of just over 4 years, compared to the US at about 7.5 and Europe at 5. While Asian high yield bonds also have a duration at least a year shorter than their global counterparts. In the context of the view expressed above that Asia will experience a relatively low rate of default, this seems particularly note-worthy.

The potential diversification benefits of Asian Bonds

In general, Asian bonds exhibit low correlation to other asset classes and thus they have the potential to improve returns and potentially lower the volatility of a global high yield bond portfolio, thus offering good diversification.

In addition, the Asian investment grade universe – which makes up around 80% of the Asia credit market – is mainly made up of bonds issued by very large, stable and often government related institutions. This is also a universe which includes a significant proportion of issuers from markets which would not usually be considered ‘emerging’ such as South Korea, Singapore and Hong Kong (which together make up around 30% of the market) as well as the strong credit from China (around 50% of the market) which includes some of the largest companies, banks and government related institutions in the world. This gives the Asian investment grade universe good diversification within itself- being made up of at least 11 countries – but also adds potentially attractive diversification qualities to a global portfolio.

Attractive yields in Asian high yield bonds

After the substantial adjustment in Asian dollar bonds earlier in the year, Asian high yield bonds have become more attractive, with the average yields currently at around 7.7%, which creates good investment opportunities in the Asian high yield bond market.

This is where picking the right bonds can make all the difference. With lower prices, investors have the opportunity to purchase assets at a significantly lower price. If they are able to avoid the bonds that might default, they will be rewarded with attractive potential returns later when the market recovers. And the recovery is underway.

However, there are certain pitfalls to look out for. A common issue facing bond markets is liquidity - the ability to buy and sell securities at will without excessive bid offer spreads. Bonds are generally not traded on exchanges and are transacted bilaterally between independent counterparties.

So when the market has more people intending to sell with very few investors wanting to buy, it is difficult to match up buyers and sellers to ensure a good two-way flow. This means that valuation prices can get marked down substantially as the clearing price in the market can be much lower than the fundamental value of the security.

The need to remain selective

Meanwhile, if investors cannot sell their riskiest bonds, they may be forced to sell some of their safer holdings. Therefore, from a credit risk perspective, a strong credit selection process is important to avoid bonds with the highest risks in the market and to concentrate on bonds with a combination of attractive yields and likelihood of capital preservation.

However, there are ways to create a cushion. During the height of investor concern in March, we increased the exposure to highly liquid US treasury bonds in our managed funds to not only

dampen volatility, but also to provide a cushion of liquidity in case we faced mass requests for redemption. As it turned out, we didn't face significant redemptions and were able to return the funds to more conventional positioning in April.

While the pandemic has undoubtedly brought along with it an era of uncertainty and volatility, the combination of relatively high yield but lower duration of Asian credit markets, which are also bolstered by a historically lower default rate than virtually any other major region, makes the Asian credit markets, and its high yield segment in particular, a beacon of light for investors who are looking for a steady ship amongst the turbulent seas of the current economic climate.

“On top of that, the US Federal Reserve’s decision (as showed in the [Federal Reserve’s economic projection](#)) to keep interest rates near zero for a longer period plus the various cut in Overnight Policy Rate by Bank Negara Malaysia would be important factors too,” said **Jon Chivers, Head of Wealth, Wealth and Personal Banking, HSBC Malaysia**

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Note to editors:

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