

COMMENTARY

Asian fixed-income investment on the ascent

A remarkable development considering it was shunned by investors just 10 years ago

ASIAN fixed income has emerged as an important asset class globally. As at December last year, Asian fixed income made up 7.7 per cent of the global bond market.

This is a remarkable development considering that just 10 years ago in the wake of the Asian crisis, Asian fixed income was shunned by investors.

UOB Asset Management head of fixed income and deputy chief investment officer **CHONG JIUN YEH** shares his views on the investment outlook for Asian fixed-income markets.

The development of the Asian fixed-income market took off in the recovery years after the Asian crisis in the 2000s. During this period, companies in Asia began to diversify away from traditional bank financing and turned to bond markets for their capital needs.

Regulators in Asia opened up their capital markets and foreign investors now have direct access to seven of the 10 main bond markets in Asia.

The issuers of debt in Asia are not only corporates but also governments. Debt securities are typically denominated in US dollars and local Asian currencies.

ANALYSING ASIAN FIXED-INCOME MARKETS FOR OPPORTUNITIES

As an institutional investor, we analyse Asian fixed-income markets at three levels, a process which investors may want to understand and adapt for their fixed-income investments.



The three key levels are:

- Macro overview and analysis;
- Asian dollar credit analysis; and
- Local rates/currency analysis.

At the first level, investing into Asian fixed incomes requires a clear macro overview and analysis of the global economic outlook as well as the individual Asian economies.

Within the Asian fixed-income markets, there are Asian US dollar-denominated corporate bonds, sovereign/quasi-sovereign debts (Asian dollar credits) and Asian sovereign debts denominated in Asian currencies (local rates).

In analysing Asian Dollar Credits, the company's ability to meet its debt obligations, the business model and industry outlook where the company is competing in would be important considerations on whether to invest in the company's issued bonds.

When analysing local rates of sovereign bonds in Asia, investors should be aware that a key determinant of Asian yield curves is the US yield curve as Asia is highly leveraged to the US economy and a majority of Asian currencies are tied to the US dollar.

Also, a significant portion of returns

in local rates market come from currency returns. The critical determinant of Asian currency markets, as with all emerging markets, is the inflation outlook.

For emerging Asia, food and energy are key drivers of inflation as they constitute a large portion of consumer price indices. What ultimately drives Asian currencies are the Asian central banks as Asian currencies are heavily managed.

An important point to remember is that most Asian currencies are managed on a trade-weighted basis and a movement in one Asian currency can trigger a series of movements in other Asian currencies.

Through these three levels of analysis, investors should have a better understanding of how to position Asian fixed-income investments, regardless of whether they are invested directly or through any Asian bond funds.

CURRENT MARKET OUTLOOK

A review of the second quarter of this year shows that the Asian fixed-income market has been hit hard by the Greek crisis.

Asian credit spreads widened to 306 basis points (bps) at the end of last month. At a spread of 306 bps over the US Treasuries, the credit market is pricing in real GDP growth of around 6.5 per cent for Asia based on our internal model.

Given that Asia is likely to grow around 7 per cent to 7.5 per cent over the next year, the fair value spread should be around 230 bps to 270 bps. This makes the Asian credit market moderately under-valued by around 10 per cent to 20 per cent.

However, we believe that sentiment towards the Asian credit market may remain uncertain over the next three months as more evidence emerges to indicate that China's economic growth is decelerating, and other residual risks are emanating from the Greek crisis.

That said, Asia ex-Japan has relatively better long-term economic fundamentals and growth prospects compared to US and Europe. Given that the Asian credit market will be well-supported by Asia's solid economic fundamentals, the market is unlikely to suffer the same extent of selling as in 2008.

The US government yield curve has been flattening, projecting a slower economic recovery in the US. Given this, we believe that in the third quarter of this year, Asian High Grade corporate bonds potentially offer an ideal place for global funds to park their investments for yields pick-up. ■ UOB ASSET MANAGEMENT