

UOBAM's Chia favours high-grade Chinese credits, Philippine government bonds

| STORIES BY KEVIN TAN |

UOB Asset Management (UOBAM)'s portfolio manager Chia Tse Chem, who helms the United Asian Bond Fund, made a clean sweep in the Bond Asia Pacific category, winning all three awards over three, five and 10 years at last week's *The Edge-Lipper Singapore Fund Awards 2013*. His fund was the top-performing Singapore-registered Asia bond fund over three and five years, delivering gains of 26% and 55% respectively as at March 22. The good performance of United Asian Bond Fund is the result of the "total return" approach Chia uses to manage the unit trust, which has assets of around \$210 million. "We focus on achieving outperformance, not just from credit selection but also from managing interest-rate and foreign-exchange risks," Chia says. Read on for more about his winning ways, fixed-income strategies and outlook for Asia bonds.

The United Asian Bond Fund, which has an outstanding long-term track record, also did well last year, turning in gains of 12.8%. Tell us which bonds contributed to your strong performance in 2012?

We were overweight Chinese high-yield bonds in 1H2012, as our analysts indicated that the market was pricing an excessive default rate for this sector at the beginning of 2012. Bond yields in this sector were trading at high double digits in early 2012. We also bought several long-duration bonds at the beginning of the year, which benefited from the rally of US Treasuries [UST] in 2Q2012.

Through the course of 2012, we also managed to buy companies with strong balance sheets, although these were temporarily de-rated by the market because of certain non-financial reasons. In addition, we managed to avoid credit defaults in this fund with our stringent credit selection process. We steered away from buying companies with credit issues and poor balance sheets.

What is the outlook for Asian bonds over the next 12 months?

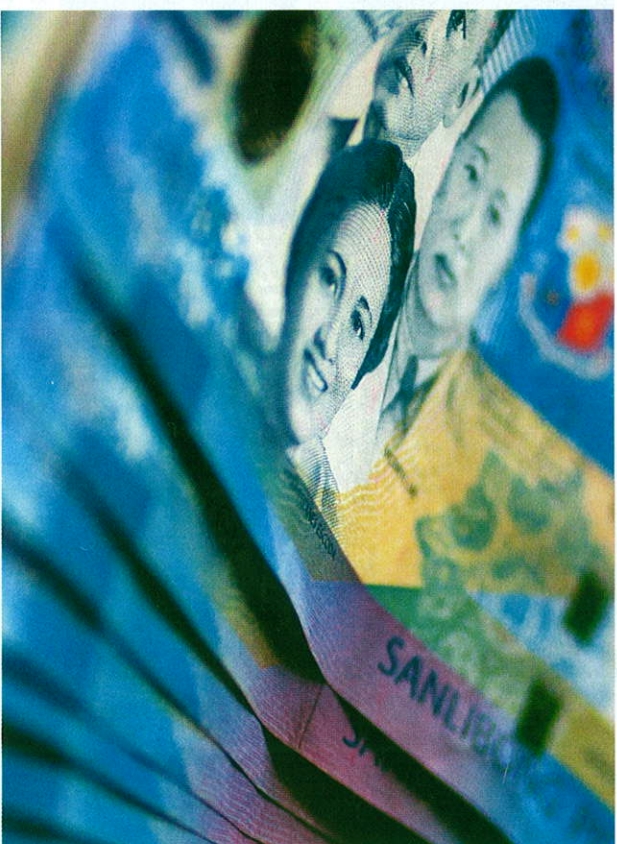
It is quite unlikely we will enjoy the same rate of returns that we saw in 2012. Given the prevailing low yields, the Asia US dollar [USD] credit market should return 4% to 6% annually to investors over the next 12 months. Nevertheless, we continue to be bullish on this asset class over the long term. Asia's growing affluence, coupled with its rapidly ageing population, will drive investments into bonds. Bonds, as an investment asset class, are likely to play a bigger role in the next few decades, especially when Asians are generally still underinvested in fixed-income products. Movement in interest rates is likely to be the key driver of Asian bond performance over the next 12 months.

Are you expecting most of the bond returns to come from coupons over the next three quarters?

We expect interest rates to be on an upward trend, which means capital gains for Asian bonds over the next three quarters are likely to be muted. The bulk of the return will come from coupons in 2013.

What is your current strategy for your fund and how are you positioning it to deliver alpha?

We currently have a barbell strategy in terms of credit selection, holding bonds of both short- and long-term maturities. Given our expectations



Chia (below) believes the Philippine peso will do well over the next 12 months

that interest rates are likely to be on an upward trend, our strategy is to invest in credits that are less sensitive to interest rates such as short-duration bonds and high-yield bonds.

We are overweight short-duration, high-grade renminbi (CNH) credits with less than three years of maturity remaining. [Chinese renminbi traded offshore is known as CNH.] At the same time, we are overweight Asia USD high-yield credits with five to 10 years of maturity remaining. The short-duration nature of the CNH high-grade credits and the relatively higher yield of the Asia USD high-yield credits will offer good protection in an environment of rising interest rate. At the same time, we are overweight sovereign and quasi-sovereign bonds, as these two sectors are rich in valuations and also have higher interest-rate risk, given that most of these bonds have relatively longer maturity.

Since currency gains are an active component of returns for your fund, which Asian currencies do you think will do best against the greenback over the next 12 months?

Active currency management is a key driver of returns for the fund. We have to actively man-

graded the Philippines' long-term foreign currency-denominated debt to investment-grade status from BBB- to BB+.]

There are quite a lot of China and Hong Kong bonds in your fund. What are their attractions and are they mainly corporate bonds?

We think the risk-versus-return equation is positive for Chinese and Hong Kong credits. Many of the Chinese and Hong Kong bonds are CNH credits and these credits carry limited-duration risks, given their relatively short maturity of two to three years.

Which Asian government bonds are you still positive on?

The Philippine local currency government bonds appear decent, given the prospect of a strengthening peso. Within the USD space, we favour the 10-year Mongolian sovereign bond, as it currently offers an attractive yield of almost 6%. We are mitigating interest rate risk by buying short-duration CNH bonds and Asia USD high-yield bonds that have higher coupons.

What are the main risks that could affect the performance of Asian bonds for the rest of the year?

There are two key risks to the performance of Asian bonds in 2013. The first is interest-rate risk. A potential rise in interest rates by a further 100 basis points in the next three quarters of 2013 will affect negatively the performance of Asian bonds. That said, we think interest rates are unlikely to rise more than 100bps for the rest of the year and our view is that 10-year UST yield may end the year at 2.5% compared with 2.05% currently.

The second risk is a potential hard landing for the China economy. This is probably a bigger risk than the interest-rate risk, as Chinese credits now dominate the Asian fixed-income market. However, we believe the probability of a hard landing scenario in China is not high. To mitigate this risk, we intend to keep our exposure to China bonds to less than a third of our net asset value. ■

Top five holdings of the United Asian Bond Fund (as at Feb 28, 2013)

BOND	YIELD (%)	MATURITY DATE
Champion MTN Ltd	3.7	Jan 17, 2023
Hainan Airline HK	3.6	Feb 7, 2020
Longfor Properties	6.7	Jan 29, 2023
Cosco Pacific Finance	4.3	Jan 31, 2023
Leighton Finance Ltd	5.9	Nov 13, 2022



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