

POSITIVE OUTLOOK For Asian Bonds

JOYCE TAN MUI LING, Director at UOB Asset Management, finds attractive opportunities in the USD-denominated Asian bond space.

With investor sentiment still cautious this year, the demand for safer assets, especially in some segments of the bond market, has triggered concerns that there could be a bubble growing. "If investors are concerned about the sustainability of the current high prices of bonds, investors may do well to consider investing in bonds with a 3-year tenor or shorter," says Joyce Tan Mui Ling, Director at UOB Asset Management (UOBAM). In this interview with Fundsupermart, she also explains why she remains positive on the outlook for Asian bonds.

FUNDSPERMART (FSM): What is your investment style?

JOYCE TAN (JT): The investment focus of the United SGD Fund is to invest substantially all its assets in money market and short-term interest bearing debt instruments and bank deposits with the objective of achieving a yield enhancement over Singapore dollar deposits.

Our investment philosophy aims to:

- Achieve consistent performance through rigorous and independent fundamental research to uncover relative value opportunities.
- Adopt diversified strategies combined with active risk management to generate sustainable total return for fixed income portfolios.

Our investment approach embodies two key principles:

- An emphasis placed on adding value through credit selection backed by our strong fundamental bottom-up research that analyses credit quality, security structure and relative valuation.
- This is supplemented by a disciplined top-down strategy encompassing macro-economic and market analysis that includes duration, currencies and country/sector allocation.

FSM: Who is in the investment team and how experienced is the team?



JOYCE TAN MUI LING
Director at UOB Asset Management (UOBAM)

JT: I am currently the lead portfolio manager of the United SGD Fund. I joined UOBAM in 2007 and I am a Chartered Financial Analyst (CFA) charter holder. I graduated with a Bachelor of Business (Financial Analysis and Applied Economics) (Hons) from the Nanyang Technological University of Singapore in 1997. I have over 12 years of industry experience.

I am part of a 16-member team covering issuers across Asia, emerging markets as well as developed markets. Our team

of credit analysts conducts a detailed credit analysis that evaluates industry outlook, business review, financial review, management expertise, strength of ownership and specific debt structure. These findings are summarised into an in-house rating score which will eventually determine the relative valuation of each credit investment.

FSM: What is the outlook for money market instruments and short-duration bonds?

JT: Given the current low interest rate environment and the tighter credit spread, debt financing has become cheap for issuers. Corporations are capitalising on the low interest rate environment to issue long-dated bonds.

In Singapore, Temasek Holdings recently issued a 40-year bond for S\$1 billion at 4.2% coupon rate that was snapped up under two hours (as reported in The Straits Times on 2 August 2010). Other recent SGD deals include Neptune Orient Lines (10-year bond), CapitaLand (10-year bond), CapitaMall Trust (7-year) and City Developments (5-year). We expect this trend to persist.

While there were short-dated SGD bonds issued during the same period, these were mainly from the less es-

tablished Singapore corporates. In addition, overseas issuers, in particular financial institutions from US, Europe and Asia, are also vying for cheap SGD funding through short-dated bonds to gauge market acceptance. However, these issuances are usually smaller in size and are therefore less liquid. As such, credit analysis and selection is key to investing.

Meanwhile, investors' interest and demand for such bonds have also been growing alongside increasing supply. According to ICI, bond funds attracted US\$559 billion over 30 months through June 2010 in the US (reported in Business Times, 25 August 2010). We believe this is a good indication of an overall paradigm shift in preference for bonds over equity by investors. Investors shunned equities and embraced bond funds as the latter is perceived as a safe haven, given the volatility in the equity markets and lingering concerns about European debt crisis and the potential double-dip in the US economy.

We think that the demand for money market instruments and bonds is likely to remain strong as investors seek higher yields over cash deposits and continue to harbour concerns about the health of the global economy.

FSM: What is the outlook for interest rates?

JT: The Federal Open Market Committee statement in August 2010 reflected a more cautious expectation on the economic outlook and indicated that the Fed rate is likely to remain exceptionally low at 0-0.25% for an extended period until recovery is in sight – the same policy stance it has kept since March 2009.

While US property prices are slowly recovering from 2009 lows, housing sales data has remained weak amidst the high unemployment rate. Underlying inflationary pressures are also abating on lower prices of energy and other commodities.

With gloomy US data such as the persistent high unemployment rate, lacklustre consumer spending and stagnant loan growth pointing to a stalled recovery in the US, we do not see the Fed raising rates over the next 6 to 12 months. Till global economic growth recovers, interest rates are expected to remain low for an extended period of time.

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>> **FSM:** Where can you find the most attractive opportunities?

JT: Asian bonds are generally attractive given that many Asian countries enjoy strong economic fundamentals and fiscal positions. Since the Asian Financial Crisis in 1997, Asian corporates have also adopted a more disciplined financial approach for growth. This has contributed to Asia's ability to withstand the financial tsunami led by the bankruptcy of Lehman Brothers in September 2008.

With Asian bonds, we see the most opportunities in the USD-denominated bonds. This market offers a consistent flow of new issuances, greater diversification of issuers and good secondary trading volume relative to Asia local currency bond markets.

Taking the JP Morgan Chase Asia Credit Index (JACI) as a reference, the total market capitalisation for short-duration bonds maturing from now till 2013 currently stands at US\$55 billion (source: JP Morgan Chase Asia Credit Index, September 2010). Of which, 79% or US\$43 billion are rated investment grade. Asian bonds also offer relatively strong liquidity given more market participation and larger issuance size. In the investment-rated space, there are 49 issuers across seven Asian countries and seven business sectors (source: JP Morgan Chase Asia Credit Index, September 2010). Each issuance size is typically larger relative to SGD issuances. Whilst a SGD issuance of S\$50-100 million is considered to be of a good size in the Singapore market, a USD issuance is likely to be within a range of US\$150 million to US\$2 billion in size.

The United SGD Fund itself invests largely in USD-denominated Asian bonds, hedging back the foreign currency exposure into the Singapore dollar. This hedging against the volatility of foreign exchange movements helps provide investors with stable return over cash alternatives such as deposits via careful selection of credits.

In terms of sector selection, we see greater value in Asian banks. While the 2008 Global Financial Crisis has caused some damage to general market confidence in the financial system, Asian banks have emerged relatively unscathed. When compared against corporates, banks also enjoy government support given their systemic im-

portance. The pending implementation of Basel III standards after 2012 will further enhance the fundamentals of banks.

FSM: How should investors position their portfolio in light of the sharp appreciation in the prices of money market instruments and short-term bonds?

JT: Overall bond prices have moved up due to declining interest rates, especially those of longer dated bonds. Market sentiments for bonds are also bullish, driven by the influx of liquidity in search of yields.

If investors are concerned about the sustainability of the current high prices of bonds, investors may do well to consider investing in bonds with a 3-year tenor or shorter.

Even in the scenario should global economy growth surprise significantly on the upside, short-dated bonds are less affected by this mark-to-market risk, where the current market value or prices are used instead of original cost prices, compared to longer-dated bonds. While bond prices move inversely to interest rates, the price effect is greater for longer-dated bonds due to its direct relationship to duration. In short, if interest rates rise, the price decline for short-dated bonds will be less than for long-dated bonds.

We expect interest rates to remain low and any increase in interest rates is likely to be a possibility only after 2011. If you invest in a 3-year bond today in 2010, it will mature in a year's time by 2012. Even if interest rates do move up by 2012, bonds with a one-year tenor are less affected by mark-to-market risk.

Another strategy investors can adopt is to ladder the maturity profile of their bond portfolios. This means there will be some portions of their bond portfolios with differing maturities ranging from one year to three years. In the event that interest rates should increase over time, the monies from the matured bonds may be reinvested at the higher interest rates for the next three years when they mature. In this way, investors will have more flexibility in their bond portfolios to take advantage of the rising interest rates whilst mitigating mark-to-market risk.

FSM: Do you see a bubble forming in the bond market?

Assuming there is a bubble forming in the bond market, what should investors do?

JT: A “bubble” market happens when valuations are no longer justified by fundamentals. At this moment, investors’ risk appetites remain weak amid concerns over a “double dip” scenario. Interest rates are expected to remain low for an extended period of time until global economic growth recovers.

In the event of a bubble forming in the bond market, our advice to investors would be to invest in bonds with short maturities to hedge against rising interest rates.

FSM: In August, McDonald’s Corp became the first non-financial foreign company to sell RMB-denominated bonds in Hong Kong. Do you expect more of such issuances going forward and how should investors look at this new development?

JT: China changed its rule in February 2010 to allow foreign companies to issue RMB-denominated bonds through Hong Kong to fulfill two objectives, namely, to strengthen Hong Kong’s foothold as a financial centre and to promote the RMB for global commerce. This will provide foreign investors greater access to China’s capital markets and may also set the stage as the next potential growth driver for Asia’s capital markets.

McDonald’s Corp bond issue, while small (RMB200 million or US\$29 million), has paved the way for other non-financial companies outside China and Hong Kong to participate in China’s evolving credit markets. For global companies that are planning to enter or further expand their existing businesses in China, issuing RMB-denominated bonds provides access to new funding sources to support growth in China. As such, we expect other corporates to follow soon.

Supply of RMB-denominated bonds is also greeted with good demand from investors who prefer credits of global corporates to Chinese corporates and the opportunity to invest in China’s currency which is widely expected to strengthen.

However, like all developing financial markets, market efficiency and liquidity in corporate RMB debt is likely to take time before the market attains critical mass. In-

vestors should also consider currency convertibility risk of RMB-denominated bonds.

FSM: What are the biggest risks for the bond market going into 2011?

JT: Our base case assumptions for 2011 are that interest rates will continue to remain low and the outlook for credit fundamentals remains stable. In the event that these assumptions are challenged, the valuations of bonds will likely be depressed. **FSM**