First Sentier Asian Quality Bond Fund
Monthly review and outlook

First Sentier Investors

Market review

The highly anticipated disinflation narrative gathered traction over the month as economic indicators showed signs of the US economy losing steam. US Consumer Price Index (CPI) numbers came in below expectations, real disposable income growth slowed and the job market showed signs of cooling – suggesting that even as the Fed has proven its patience in cutting rates citing the needs for a sustainable fall in inflation, a first rate cut in September might still materialize. The 10-year benchmark Treasury yields rose and fell double digit basis points (bps) as markets reacted to data suggesting any strength or weaknesses in the US economy. Downward pressure on rates prevailed more strongly, as benchmark US Treasuries moved 10bps lower over the month, ending at 4.40%.

Asia Investment Grade (IG) spreads widened by 11bps month on month (MoM), ending the month at 131bps as the increased credit supply in the primary market caused spreads to leak wider. However, buffered by positive returns in rates, Asian IG still produced 1.21% in monthly total returns.

India's election surprise at the start of the month that saw its incumbent ruling party, Bharatiya Janata Party (BJP) losing its single party majority jolted Indian equity markets, but credit markets remained largely stable as the nation's pro-growth, pro-infrastructure policy continuity looked to remain in place at least for the near future. S&P revised India outlook from Stable to Positive, citing sound economic fundamentals. China state-owned enterprise (SOE) China National Offshore Oil Corporation (CNOOC) accepted a total of c. USD951mn in tender offer and paid 5pts premium to investors who tendered bonds. Supply in the telecommunications, media and technology (TMT) market continued in the convertible bonds (CB) space and Trip.com issued USD1.5bn new CBs. There were reports of Meituan considering an issuance of USD1bn in bullet bonds instead of CBs for refinancing purposes, which caused Meituan bonds to widen 5-10bps on supply risks. Primary supply picked up in June, especially for financials, and Korea IG.

Investment grade quasi-sovereign bonds saw some spread widening, but total returns remained positive due to the decline in interest rates. The Asian USD credit primary market activity was lively during the second half of the month, especially among financials as well as Korean investment grade issuers, suggesting that Asian issuers are coming to terms with the higher interest rate environment, and were taking advantage of record tight spreads. Among the notable issuances, South Korea printed issued USD 1bil of 5-year notes, the country's first dollar bond since October 2021.

Fund positioning

As primary issuance activity picked up during the later part of the month, the Fund participated in new issues that offered attractive premiums. In the secondary market, select credits in financials were trimmed where spreads were deemed tight. The Fund closed its exposure in the Japanese yen.

Performance review

On a net-of-fees basis (SGD terms), the First Sentier Asian Quality Bond Fund returned 0.95% in June, underperforming its benchmark by -0.13%.

The Fund's overweight in duration was positive for performance as Treasury yields moved lower over the month. Credit positioning were positive for performance as high quality credits performed well. An underweight in sovereigns in Indonesia and the Philippines detracted from returns. This was offset by the overweight in Indonesian quasi-sovereigns as well as positioning in high quality credits. Exposure in local currency bonds and currencies also added positively to returns as the USD was weaker over the month.

	We thought that...	Therefore, we...	And the results...
US rates	At current levels of interest rates, even with US economic data still holding up well, a slowdown is still on the cards. Barring a reacceleration in inflation, the likelihood of rate cuts would increase as the year progresses.	Maintained an overweight bias for US rates in the portfolio, with a tactical approach in light of the recent volatility in rates.	The Fund's overweight in US rates versus the benchmark was negative for returns, but this was mitigated by tactical trades in US interest rates.
Asian IG	Fundamentals remain sound in Asian Investment Grade (IG) corporates, but spreads have reached extremely tight levels.	Remained focused on high quality names that are deemed more resilient should the market enter a risk-off mode.	An underweight in sovereigns in Indonesia and the Philippines detracted from returns. This was offset by the overweight in Indonesian quasi-sovereigns as well as positioning in high quality credits.

Q3 2024 investment outlook

As history has it, the mechanics of monetary policy transmissions can be opaque and accompanied by varying degrees of time lags. Last year, we underestimated the time it would take for Covid-era financial stimulus to unwind and were arguably early in our views of a slowdown in the US economy. This last mile of disinflation has indeed been bumpy, but our bearish views of a weakening US economy are of late finding resonance in the latest economic data releases. While we may not see inflation fall below 2%, the Fed has lowered the bar required to shifts gears to rate cuts, particularly if other economic data do not throw hawkish surprises to the downward economic momentum.

We maintain our long bias in US interest rate duration with a higher conviction that we have seen the peak in US policy rates. With uncertainties and cracks in economic indicators getting more pronounced over the past year, there is a good possibility that the first cuts could commence by September. Downside risks to our base case include further increases in US treasury issuance, a US debt crisis, and a re-acceleration in inflation, any of which could challenge the team's long US duration positioning. Should any of these scenarios pan out, the sanguine outlook that markets have priced in for credit spreads could also be at risk. That said, the building election rhetoric and geopolitical events remain wildcards that would warrant a dynamic approach to managing our duration exposures.

The European Central Bank (ECB)'s rate cut was largely within expectations, and the European economy's outlook is looking less depressed despite subdued growth, with manufacturing coming off its lows and inflation broadly trending lower from lower energy prices. It remains to be seen if the ECB can afford to stagger its cuts in policy rates should consumption falter and inflation remain sticky in the services sector. Added complexities from the global trade war and geopolitics may further hinder EU's fiscal consolidation plans.

China's policies have been highly accommodative and recent policy measures aimed at destocking excessive property inventory have seemed to gain positive traction. In undertaking an ambitious growth target of 5% for 2024, allowing a continued budget deficit of 3%, and issuing special treasury bonds, China is sending a strong signal in committing to growth. However, the multilayered problems causing China's slowdown means that we don't expect a quick recovery. The property sector and weak consumer sentiment will remain weak links that need to be addressed. In other words, we still need actual consumer confidence and pre-sales numbers in the property sector to pick up on a sustained basis before market confidence can be restored. Nevertheless, we are of the belief that the Chinese economy will emerge much stronger from this consolidation process and maintain a positive long-term outlook for the economy.

Asian economies have been resilient thus far, but effects from China's slowdown are not negligible. The growth outlook in Asia is showing signs of weakness especially for export-oriented countries including Singapore, South Korea and Taiwan, caused not only by China's slowdown, but also reflective of the lackluster demand from developed economies. We believe that this trend is likely to stay. Within the Asian region, countries with a stronger domestic story, such as India, are likely to fare better. Against this weakening external backdrop, most Asian central banks have paused rate hikes as inflation moderated and shifted attention to supporting growth. We remain constructive on the region's longer-term growth prospects as Asian economies continue to move up the value chain in the global economy.

The Bank of Japan's (BoJ) exit from its negative interest rate policy (NIRP) and yield-curve control (YCC) policy has not come easy after 7 years in a negative interest rate environment. We expect monetary conditions to remain very accommodative in Japan as the BoJ monitors the long anticipated virtuous cycle – for higher wages to translate into higher spending, for the economy's ability to sustain inflation at its 2% target. In the meantime, the course of the dollar's strength remains largely driven by the Fed's monetary policy. When the first rate cuts are implemented, Asian local currency bonds may perform well, and this will likely lead to further dollar weakness versus Asian currencies, further boosting Asian local bond returns.

While Asian Credit fundamentals have remained stable, demand-supply technicals has been, and will still be, the bigger driver of credit performance in the near term. In line with broad expectations, the scarcity in bond supply has also rendered new issuance premium to be increasingly small. At this juncture, we remain constructive in Asian IG credit as high all-in yields well above 5% does makes this asset class attractive from an income carry perspective. That said, with spread levels at record tights, a risk-off scenario could occur very swiftly at current valuation levels. Our bias is for higher quality names and to ensure sufficient diversification in portfolios as the market rides this rally in credit spreads. We prefer issuers with the liquidity and resilience to withstand a hard global landing, should such a scenario emerge.

Source : Company data, First Sentier Investors, as of 30 June 2024

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