

Asia Conference 2023: Asia Strategy

Research 21 Jul 23, 01:24 AM Analysts: Sandra Chow, CFA Co-Head of Asia-Pacific Research

Executive Summary

- CreditSights held its Asia Conference 2023 in Hong Kong and Singapore earlier this month.
- This is the transcript for the presentation on Asia Credit Strategy.
- We have a Market weight allocation to Asia investment grade (IG) credit; spreads look tight compared to US IG but stable credit fundamentals and limited new issuance should support secondary spreads.
- Our favourite sectors within Asia IG include non-bank financials, insurance and China tech.
- We do not expect Asia high yield spreads to normalise soon, given the ongoing stress in China's property sector. Investors will need to pick their spots in Asian high yield carefully; our favourite names include selected Indian renewable energy and Macau gaming issuers.

Relative Value

Please see [Asia Credit Recommendations: July 2023](#)



Asia Credit: Stay at Home or Explore the World?



1 Source: CreditSights

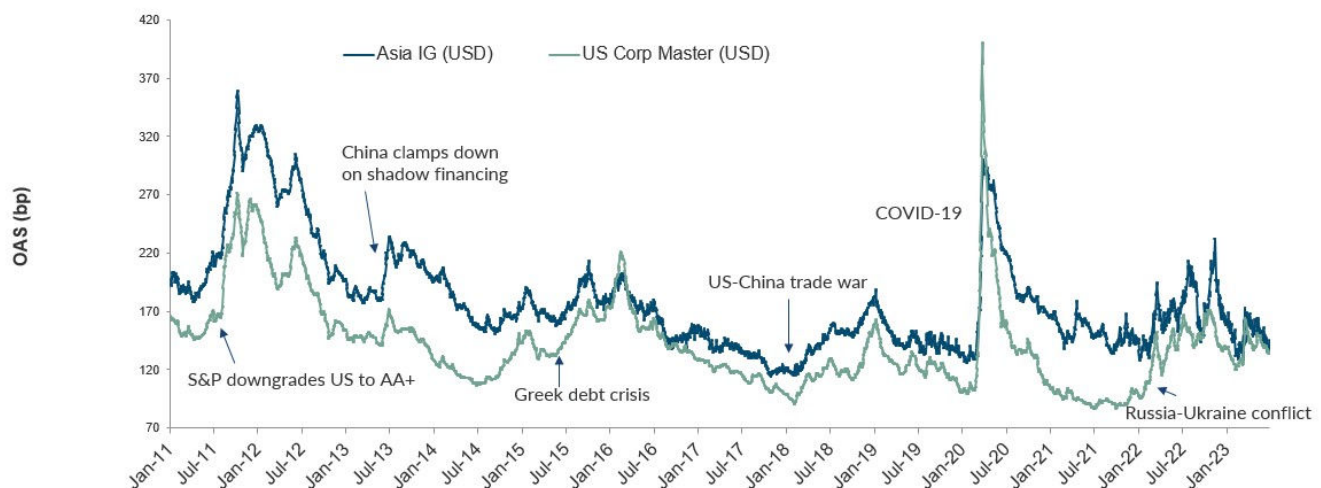
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Given our constructive view on US credit (see [Asia Conference 2023: US Strategy](#)), how should we view Asia credit? How do valuations look when we compare Asia to the rest of the world?

The Disappearing Asia Spread Discount: Market Weight Asia IG

Asia ex-Japan \$ Investment Grade Index (ex-sovereign) vs. US Corporate Index



2 Source: BAML, FactSet, CreditSights

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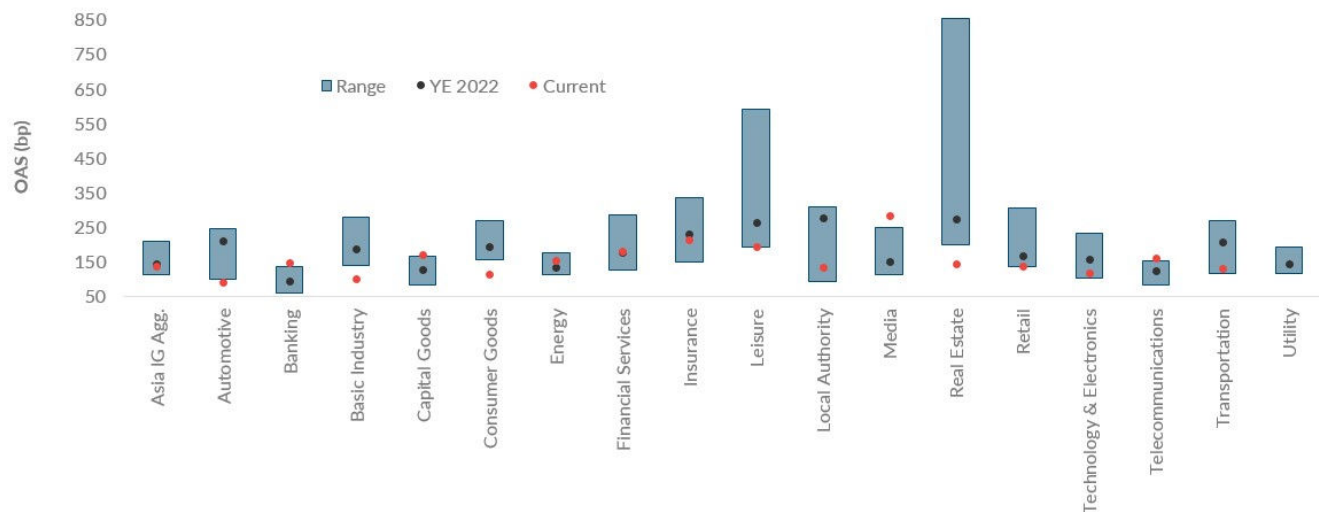
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Compared to US investment grade (IG) credit, we think Asia IG looks expensive at current levels. Historically Asia IG has traded at a significant spread differential to US credit - as much as 90 bp wider - reflecting the higher perceived risk for emerging markets. It has also tended to sell off more during market routs, reflecting greater risk aversion towards Asia. However this "Asia discount" has almost disappeared and the Asia IG index is now trading very close to the spreads of US IG corporates. We have assigned a Market weight allocation to Asia credit as a result - I will explain later why we remain constructive about the outlook for Asia IG spreads (i.e. not Underweight) despite the expensive valuations.

Many Sectors at the Tight End of the Range

Asia ex-Japan \$ Investment Grade Sectors: YE22-Present Spread Ranges



3 Source: CreditSights, FactSet, ICE Data Indices, LLC. Note: 31 Dec 2021-28 June 2023

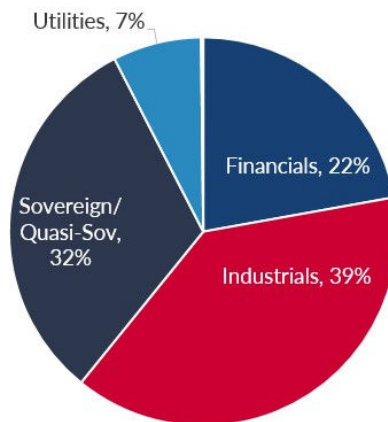
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This chart breaks down the sector composition of the Asia IG index - you can see that on a sector-level basis most sectors are also trading at the tight-end of the trading ranges YTD.

State Benefits Make Asia IG Expensive but Defensive

Industry Composition of Asia ex-Japan \$ Investment Grade Index



Source: CreditSights, FactSet, ICE Data Indices, LLC

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As I mentioned earlier, we have a Market weight allocation to Asia IG. While spreads are tight compared to US IG, the composition of the Asia IG index is also very different to the US: nearly a third of the Asia IG index comprises sovereigns or quasi-sovereigns, while many of the other constituents (e.g. banks, utilities, certain state-owned industrials) are either government-owned or enjoy some degree of government linkage. These issuers tend to benefit from good access to domestic funding as a result and would be more likely to benefit from direct or indirect state support in the event of financial distress. As a result, we believe most Asian IG credits should have more stable credit profiles and lower downgrade risk than most of their US IG peers.

Supply Drought Protects Secondary Spreads

Asia ex-Japan New \$ Issuance



Source: Dealogic, CreditSights. Note: 2023 to 14 June 2023

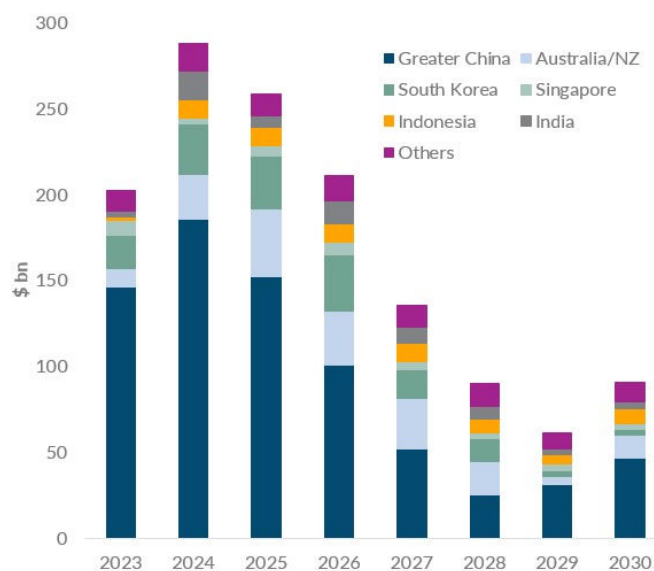
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From a technical standpoint, the lack of new issuance should also be supportive for secondary spreads. This chart shows Asia ex-Japan \$ bond issuance from 2004 to today - as you can see the drop in supply since the China property crisis began in late 2021 has yet to recover. This may not be good news for bankers and those seeking to deploy fresh funds, but it does mean that the supply/demand dynamics are likely to hold in secondary spreads.

Various Refinancing Options for \$ Bonds

Asia ex-Japan \$ Bond Maturities



6 Source: Bloomberg, CreditSights

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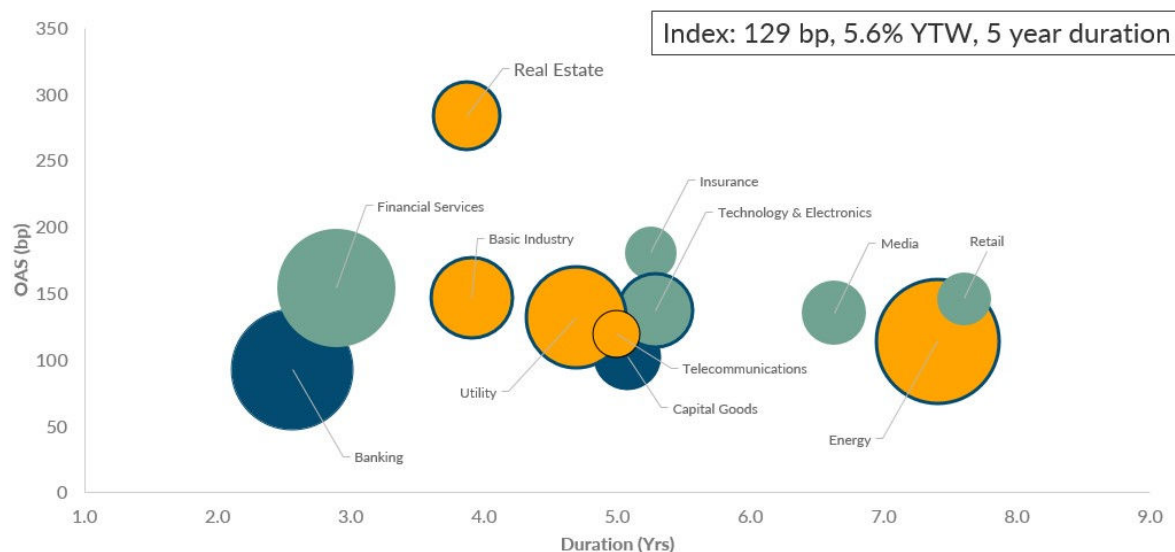
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Looking ahead too, while there are large \$ bond maturities ahead, we expect these to be well absorbed by the market. These charts show the upcoming Asian \$ bond maturities. Not all of these will be refinanced in the \$ markets: issuers are increasingly opting for other, cheaper types of financing too such as local currency loans or bonds, or private placements. There are some large near-term \$ bond maturities for Chinese SOEs, Indian energy firms and China tech companies, but we doubt this supply will present significant risk to secondary spreads.

Asia IG Sector Strategy: Outperform Tech, NBFIs, Insurance

Asia ex-Japan \$ Index by Sector



7 Source: BAML, Factset, CreditSights. Note: spreads as of 28 June 2023.

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This chart gives a snapshot of our sector recommendations within the Asia ex-Japan HY index. The x-axis shows the average duration of that sector within the index, the y-axis shows the average spread and the size of the bubble represents the size of the sector weight within the index. The green bubbles show sectors which we have Outperform recommendations on, the yellow are Market perform and the blue are Underperform. Our favourite sectors include non-bank financials, insurance, media, retail and tech (note that some of the Chinese tech names are grouped under retail and media under the index classifications). We will publish more detailed Asia sector strategy reports over the coming weeks.

Asia High Yield: Wide for a Reason

Asia ex-Japan \$ High Yield Index



8 Source: BAML, FactSet, CreditSights

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Asian high yield is a very different story. After trading in tandem with US high yield for many years, the China property crisis caused Asian high yield to decouple from the US. While spreads have recovered somewhat, we do not expect them to normalise soon given the ongoing distress in the China property sector.

Asia HY: Pick Your Poison Carefully

FY18	FY19	FY20	FY21	FY22	YTD
Asia Inv Gde Fin 1.1%	MSCI Asia ex-Jpn 18.2%	MSCI Asia ex-Jpn 22.7%	US High Yld 5.4%	Asia High Yld Fin -5.7%	Asia High Yld Sov 7.3%
US Treasury 0.8%	Asia High Yld Crp 14.7%	US Inv Gde 9.8%	Asia High Yld Fin 5.3%	Asia Inv Gde Fin -6.5%	US High Yld 4.9%
Asia Inv Gde Crp -0.5%	US High Yld 14.4%	Asia High Yld Crp 9%	Asia High Yld Sov 3.1%	US High Yld -11.2%	MSCI Asia ex-Jpn 4.6%
Asia Inv Gde Sov -0.6%	US Inv Gde 14.2%	Asia Inv Gde Sov 8.5%	Asia Inv Gde Fin 0.4%	Asia Inv Gde Sov -12.3%	Asia Inv Gde Crp 3.9%
Asia High Yld Fin -1.3%	Asia High Yld Sov 13.9%	Asia High Yld Fin 8.3%	Asia Inv Gde Sov -0.2%	Asia Inv Gde Crp -12.4%	Asia Inv Gde Sov 3.3%
US Inv Gde -2.3%	Asia Inv Gde Sov 13.1%	US Treasury 8.2%	Asia Inv Gde Crp -0.2%	US Treasury -12.9%	US Inv Gde 3.2%
US High Yld -2.3%	Asia High Yld Fin 12.1%	Asia Inv Gde Crp 7.7%	US Inv Gde -1%	MSCI Asia ex-Jpn -15.1%	Asia High Yld Fin 2.7%
Asia High Yld Sov -3.2%	Asia Inv Gde Crp 11.8%	Asia Inv Gde Fin 6.3%	US Treasury -2.4%	US Inv Gde -15.4%	Asia Inv Gde Fin 2.6%
Asia High Yld Crp -3.7%	Asia Inv Gde Fin 9.2%	US High Yld 6.2%	MSCI Asia ex-Jpn -2.8%	Asia High Yld Crp -22.6%	US Treasury 1.9%
MSCI Asia ex-Jpn -12%	US Treasury 7%	Asia High Yld Sov -13.4%	Asia High Yld Crp -23.6%	Asia High Yld Sov -36%	Asia High Yld Crp -0.9%

9 Source: BAML, FactSet, CreditSights

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There are bright spots within Asian high yield, but the asset class is much smaller and more concentrated than it used to be. Macau gaming, Indian renewables, commodities firms and sovereigns are the more popular sectors: the drivers of these credit tend to be idiosyncratic and returns can vary widely. The heatmap above shows that different components of Asian high yield were both the best and worst performers YTD, with a total return of over 7% for Asian HY sovereigns outperforming, but -0.9% for Asian HY corporates.

China Property: Buyer Beware

Unfinished Properties in Shenzhen and Kunming



Source: CreditSights

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You will hear from our China analysts later in the Greater China panel (see [Asia Conference 2023: China Macro](#) for the transcript). These photos were taken by our analyst Zerlina during a recent visit to Shenzhen and Kunming: clearly there are still several problems in China's property sector. While many China property bonds may look cheap at current levels, we would advise against being too greedy!

Asia Credit: Pick Your Destinations Carefully



- Market perform Asia investment grade.
 - Favour tech, insurance, non-bank financials
- Pick your spots in Asia high yield
 - India, Macau
- Seek yield but don't be greedy!

11 Source: CreditSights

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