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Asia IG offers a smoother way to ride the stimulus wave

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Investor exuberance over the latest raft of stimulus measures has perhaps been most obvious in Chinese equities. But volatility can cut both ways and fixed income offers a way to gain exposure to this potential policy game changer in a more tempered fashion that can steady portfolio returns. We think Asia IG offers meaningful exposure to this latest round of monetary policy easing, without falling victim to the drag from the property sector. We see this segment returning 5-6% over the next 12 months and maintain a preference for South Korean and Indonesian IG credits.

Chinese equity markets have been the main beneficiaries of China's surprise policy stimulus. The CSI 300 and MSCI China indices are up 25% and 21% since 23 September respectively, with short-covering likely playing a role. The debate about how to respond to China’s policy stimuli has thus mostly centered on Chinese equities.

But equities in general, and Chinese equities in particular, have a high level of volatility. Since early 2021, the MXCN has seen two 12-month declines of 35% and 55%, as well as another 37% fall over just 3 months. It is in that context that fixed income also has an important role to play, and Asia credit can offer a less volatile avenue to gain exposure to the improving sentiment across Chinese and Asian assets.

Asia investment grade is still the place to be. China IG accounts for a 34.5% of Asia IG overall and beyond that, China’s aggressive policy push could spill over and boost broader risk sentiment in Asia, allowing spreads to grind tighter. Within China IG, financials are the largest segment, at 12.5% of Asia IG. This in turn is composed mainly of banks and non-banking financial institutions (NBFIs), and quasi-sovereigns (10.9% of Asia IG). We expect all three to benefit to varying degrees from the monetary stimulus.

For banks, their profitability should be shielded by the commitment from policymakers to keep loan rate cuts aligned with deposit rate cuts, while the potential capital injections for the 6 state-owned banks would be an outright positive. NBFIs as well could see their asset valuations improve if the authorities are successful in stabilizing the property market; we will thus be watching out for implementation success in reducing the property inventory overhang.

The outlook for quasi-sovereigns is a bit mixed, given that they already have access to easy funding and their structural overcapacity will remain a drag. Overall, China IG should benefit, and we expect to see that translate to modest spread compression of 5-10bps for Asia IG, which should see this segment return 5-6% over the next 12 months. We maintain a preference for South Korean and Indonesian IG credits.

China high yield property not yet turning the corner. Notwithstanding the Politburo's explicit pledge to "stop the property market from falling," we would remain cautious about the prospects of a swift resolution to the problems weighing on the sector. The plan to convert property inventory into affordable housing is conceptually promising, but plagued by implementation complexities that are not easily untangled. Additionally, a slowing economy means job security concerns are going to remain a drag on household spending and consumer confidence, and an organic recovery in demand will likely remain slow and halting at best.

Asia HY at best offers select opportunities. The lingering problems in China's property sector mean that the strong 13% year-to-date returns in Asia HY are not sustainable. Indeed, this might instead be an opportunity for those looking to reduce exposure to Chinese property HY bonds. We see room for some spread tightening for select HY issuers, but the impact on index returns probably won't exceed 1-2% as the sector is now only around 7-8% of the HY index. Returns for Asia HY will likely primarily come from carry of around 7%. One segment that might provide an opportunity for outperformance is Macau gaming, which offers a fundamentally improving story. The sector has shown unique resilience within the discretionary consumption space amid the myriad of macroeconomic challenges in mainland China.

In this same vein, investors should also remain selective on Chinese equities. Even though we are recommending adding quality internet and consumer stocks to the growth side of a balanced barbell approach, investors should also retain their exposure to high dividend yielding and SOE-heavy sectors like financials, utilities, energy, and telecoms.

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