

# Asian High Yield: 10 Questions on Strategy

Ross Dilkes, Senior Portfolio Manager for UBS Asian High Yield strategy, answers ten key questions ranging from market prospects to strategy positioning.



**What is your outlook for Asian High Yield for 2020, particularly given the recent market sell-off and concerns over COVID-19 leading to a global slowdown?**

Yields have adjusted significantly and we see Asian High Yield bonds as attractive, benefitting from targeted fiscal policies, more flexibility in central bank policies and broadly sound fundamentals as Asia recovers gradually.

There will be bumps in the road. However with growth, inflation and policy rates so low around the world, we believe investors will be compelled to own attractive yielding assets to generate positive total returns and Asia offers the yields as well as the fundamental resilience which will attract flows to the asset class.

**How is the liquidity in this asset class in view of recent events?**

Liquidity conditions in the Asian High Yield market remain affected by the recent volatility. Generically bid-offer spreads are still wider than pre-crisis, however we have seen liquidity improve considerably in recent weeks.

Given credit divergence over the last few months, bid side liquidity remains constrained in weaker, lower rated segments of the market where sentiment still remains cautious.

Elsewhere volumes have recovered and deploying capital hasn't been an issue. Asia Investment Grade markets have seen primary activity pick up in recent weeks and we expect High Yield issuance to resume in May which will further normalize market conditions and improve liquidity options for deploying capital.

Within the UBS Asian High Yield strategy, we have not had any liquidity issues throughout the COVID-19 crisis and hence no adverse impact on performance from lack of liquidity.

In anticipation of a more difficult and volatile market environment, we have proactively positioned the strategy more defensively on credits with an overweight in duration to benefit from the yield compression in sovereigns where central bank policy action is more likely.

In addition, we have significantly increased our cash position to navigate current liquidity conditions in the market and preserve our flexibility to opportunistically invest into relatively cheaper credit names when we feel comfortable to shift back into higher credit exposure again.

**A main feature that investors look out for when they invest in high yield bonds is the headline yield to maturity. Should this be a key consideration? Why not?**

Yield is important as an approximate guide, but purely relying on it can be equally dangerous.

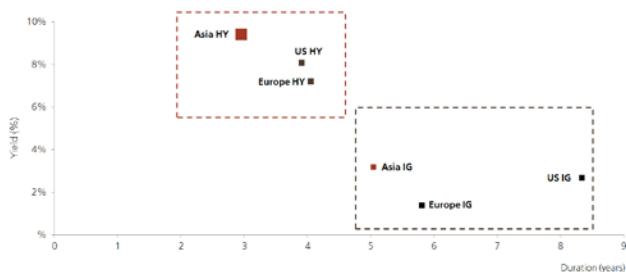
With credit stresses picking up, a significant amount of the yield in an index or a portfolio may in reality be coming from stressed credit with minimal chance of par recovery. Investors therefore need to be careful about basing return assumptions off yields alone.

Active managers have a big opportunity in times of high volatility. Dynamic risk positioning will be a more effective return driver than carry in fixed income over the next two years, which has also been evident through the last year or two as well.

**What are the advantages of investing in Asian High Yield bonds compared to US and European High Yield bonds?**

Valuations in the Asian High Yield space look attractive as investors get a substantial yield pick-up with lower duration.

**Yield/duration ratio for high yield (HY) and investment grade (IG) bonds**



Source: Bloomberg, J.P. Morgan. As represented by Bloomberg Barclays US Aggregate Corporate Index, Bloomberg Barclays Euro Aggregate Corporate index, JACI Investment Grade Index, Bloomberg Barclays US Corporate High Yield Index, Bloomberg Barclays Pan-European High Yield Index, and JACI Non-Investment Grade Index. As of end April 2020

Secondly, we are expecting lower default rates in Asian high yield during the next 18 months compared with US and European markets.

Finally, the Asian high yield sector has less exposure to commodity markets and consumer sectors which will continue to face challenges as the world tries to recover from the COVID-19 demand shock.

That should help reduce volatility even if we see further disappointments in global growth as economies try to reopen gradually.

From a historical perspective, return statistics are in favor of Asian High Yield. Since the JACI index became available in 2005, Asian High Yield has outperformed both US High Yield and Europe High Yield with higher returns and lower volatilities and drawdowns.

One reason for this is that Asian High Yield is mostly held by Asian investors, many in held-to-maturity accounts. The US High Yield market is now dominated by ETFs and index funds which depending on retail flows could introduce volatility to the sector.

**Index Return Statistics (As of 30 April 2020)**

	AHY JACI	US HY JUCO	EUR HY HECO
2006	13.7%	9.4%	8.9%
2007	5.8%	3.6%	-2.1%
2008	-17.7%	-26.0%	-33.5%
2009	43.2%	56.8%	76.4%
2010	15.5%	15.1%	14.7%
2011	2.8%	1.9%	-2.5%
2012	20.4%	18.3%	27.4%
2013	2.0%	7.4%	10.0%
2014	6.1%	2.5%	5.3%
2015	5.2%	-4.5%	0.7%
2016	11.2%	15.1%	9.1%
2017	6.9%	9.3%	6.7%
2018	-3.2%	-2.0%	-3.6%
2019	12.8%	14.4%	11.2%
YTD 2020	-8.1%	-9.8%	-9.6%

Source: Bloomberg, J.P. Morgan. As represented by Bloomberg Barclays US Aggregate Corporate Index, Bloomberg Barclays Euro Aggregate Corporate index, JACI Investment Grade Index, Bloomberg Barclays US Corporate High Yield Index, Bloomberg Barclays Pan-European High Yield Index, and JACI Non-Investment Grade Index. As of end April 2020. Past Performance is not indicative of future results.

## **What's the default forecast for the Asian High Yield market in 2020 and 2021?**

Our current default forecast for the Asian credit universe is 5-6%, compared with a 2-3% range in 2019. This still compares favorably to trends we see in HY markets globally.

We do see diverging trends within the region. We expect Chinese defaults to be around 3% as the space benefits from better starting point fundamentals, targeted support by the government for the corporate sector and a Q2 growth recovery.

Other areas will likely face more refinancing pressure over the next 12 months but as an asset class it's also beneficial that it is not meaningfully exposed to commodity production and exports which we expect to remain under pressure near term.

## **How has the strategy added value over the past three years?**

We believe our UBS Asian High Yield strategy is more dynamic in portfolio positioning, utilizing opportunities across the whole Asia region without structural bias.

The flexibility to complement credit returns with active interest rate and Asian currency strategy has produced a better total return and risk-adjusted outcome for clients.

We also maintain a dedicated focus on Asia which prevents style drift over time and finally we strive to ensure that our strategy capacity appropriately reflects the underlying market liquidity.

Being too large to effectively navigate different liquidity environments can negatively impact strategy performance over time.

## **One key concern when investing in Asian high yield is the concentration in China, and in particular the Real Estate sector.**

We continue to have a positive view on the Chinese property market. The sector is still underpinned by supportive demographics, a growing middle class, ongoing urbanization and continued upgrades in housing.

Sales were temporarily affected after the outbreak but since there has been a steady recovery with the gradual re-opening in China since March.

Many leading developers have already returned to a substantial level of sales activities, and their construction work has also gradually resumed. Fundamentals remained strong and domestic financing channels remain readily accessible for established developers.

Whilst it's the dominant sector, however, Asian High Yield offers more than just access to the China property market.

Growth in the universe has broadened the opportunity set and new sectors have emerged which have generated diversification benefits.

Additionally, as the China property market has evolved, issuers in the space have grown substantially meaning that now they are less sensitive to cyclical market adjustments, unlike in 2011 or 2014 when we saw the property market under pressure in China. This helps to mitigate the impact of a slower property market on the overall outlook for Asian High Yield.

## **What other interesting countries/ sectors are currently in the UBS Asian High Yield strategy?**

There are a number of interesting new industry trends evident in the Asian high yield market. For example we have seen significant growth in renewable energy capacity in the emerging world in recent years.

As the sector grows rapidly it requires capital and we have seen issuers access high yield markets to fund expansion.

We think these types of investments are getting more and more focus from investors as sustainability becomes an increasingly core consideration for portfolios in the future.

## **How are you currently positioned with the strategy?**

In view of the gradual recovery from the economic lockdown and market turmoil through the COVID-19 pandemic, we retain flexibility within the strategy and adjust our exposure tactically as we expect market volatility to remain elevated.

After the sell-off in credit markets in March, we have been adding back credit exposure into sectors and names we like with a focus on higher quality names, China property developers and less cyclical sectors.

Markets rebounded sharply in April, despite the release of bleak economic fundamentals across the map. As such, throughout April we have been tactically managing our credit exposure.

On duration, we are positioned slightly short compared to benchmark as we expect the curve to get steeper and secondly, with recent policy rate cuts we see rates to be range-bound at zero.

We continue to have a cautious view on Asian local currencies as we see continued pressure on markets particularly exposed to the slowdown in economic activities, in particular tourism, travel and commodities.

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**Americas**

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