Asian Credit Strategies

Election's over, virus is not

- Benign election outcome, limited policy impact now expected but a positive change in tone
- Positive risk sentiment and risk to the upside for UST suggests adding HY credit, remaining short/UW duration, and incrementally adding unhedged local currency exposure
- Recent virus surge and post-election loose ends in the Georgia US Senate race pose risks to macro portfolio positioning

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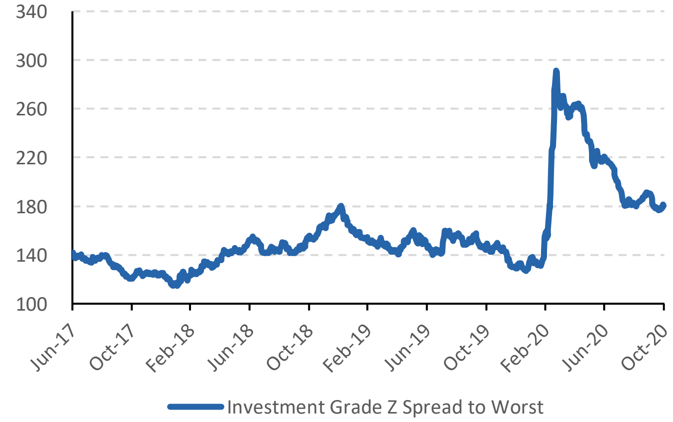
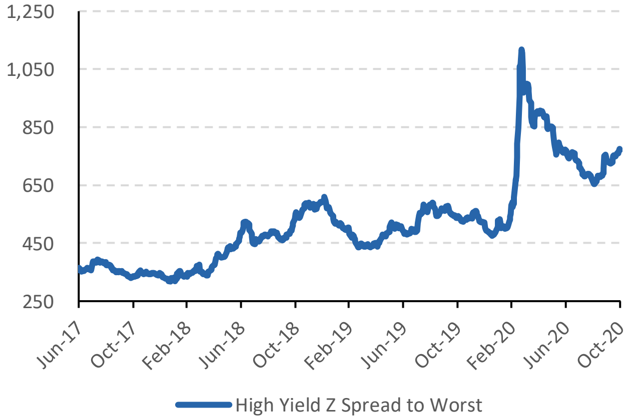
What's happening?

Ahead of the US election, the J.P. Morgan Asia Credit Index (JACI) ended the month in negative territory (-0.1% of Total Return) for the second successive month. As of 31st October, the index was represented by 600 issuers, with a market capitalization amounting to US$ 1.16 trillion. Credit spread tightened 9bps on average, the positive spread contribution was more than offset by rising interest rates, which drove the overall performance slightly negative. The contribution by credit rating was mixed: HY-rated names edged lower by 49bps over wider spread (+38bps), while IG chalked up a modest 2bps total return as spread tightened 11bps. The single-B segment was a significant drag and somewhat distorted the overall HY performance. The risk remained mainly concentrated in some specific HY names (Vedln, Tsingh, Everre), as well as the HY sovereign sector, hit over distressed Sri Lanka (-19.65%). Macro indicators continue to trend positive in Asia, helped by the efficient virus containment in the region, while the number of daily cases is paradoxically reaching record high numbers globally. Technicals have shifted less supportive, with a stronger supply and waning demand from onshore investors. Credit metrics overall remained intact in the region; the downward rating ratio seems to have bottomed in 2Q and is now reverting upward.

Asian Credit Market* Valuation





*Refers to the J.P. Morgan Asian Credit Index
Source: J.P. Morgan, as of 31/10/2020

Monthly Returns:

J.P. Morgan Asia Credit Index (JACI) -0.10%					
Investment Grade +0.02%			High Yield -0.49%		
Corporates -0,01%	Sovereign +0,03%	Quasi-Sov +0,06%	Corporates +0.20%	Sovereign -10.39%	Quasi-Sov +0.63%

Portfolio positioning and performance:

Key Strategies		Performance
Country /Sector:	Recovery in China Property and continued UW (albeit slight) in frontier sovereigns (notably Sri Lanka) drove the performance. Continued repositioning in portfolios in favour of diversification but starting to anticipate improved recovery sentiment, so some gaming exposure was added toward month-end; no performance impact yet	+
DTS:	Slight increase in credit risk/carry and spread duration, short bias retained in rate duration exposure.	+
Bottom-up:	Exposure to Tsingh, VEDLN, and PBRXIJ dragged on performance. Profitable trades were closed in SDHMK and IDASAL, though most positive performance already reflected in previous months. Active in primary market, though no particular single-issue impact	-

Outlook

After a tremendous build-up in expectations the overall market reaction to the election outcome was generally benign, that there will be limited policy impacts but a positive change in tone or rhetoric. Initial global equity strength and USD weakness had been carrying over positively into Asian credit spreads and FX, which was further bolstered by positive vaccine headlines. In an Asian credit context, generally positive risk sentiment and a tendency for risk to the upside for UST suggests adding HY credit (which had been recently weak and offers some RV), remaining short/UW duration, and incrementally adding unhedged local currency exposure (rates and/or credit). While this may be the post-election base case, it is not high conviction and comes with some caveats. While all eyes were on the election, the virus has been rampaging and threatens to derail what economic recoveries may already be underway. It's almost certain that this surge will have a negative impact on global economic growth. It's just unclear how big and how protracted. Markets are only now refocusing on this development and that could cause some unwinding of recent gains and increasing volatility. Not necessarily a negative risk, but one that would cause a fair amount of repositioning, is the runoff for Georgia US Senate positions. This could swing the Senate Democratic and would put all the stimulus and legislative scenarios back on the table. This is not a low probability outcome, either, so even the runup to the event will likely cause market volatility as polls fluctuate around likely outcomes. So, any base case positioning should allow flexibility to react nimbly to changing market circumstances, especially with respect to UST yields and local FX markets.

No assurance can be given that the Asian Credit Strategy will be successful. Investors can lose some or all of their capital invested. The Asian Credit Strategy is subject to risks including Credit risk, Liquidity risk, Derivatives and leverage, Investments in specific countries or geographical zones, Sovereign debt, Emerging markets, High yield debt securities, Contingent convertible bonds.