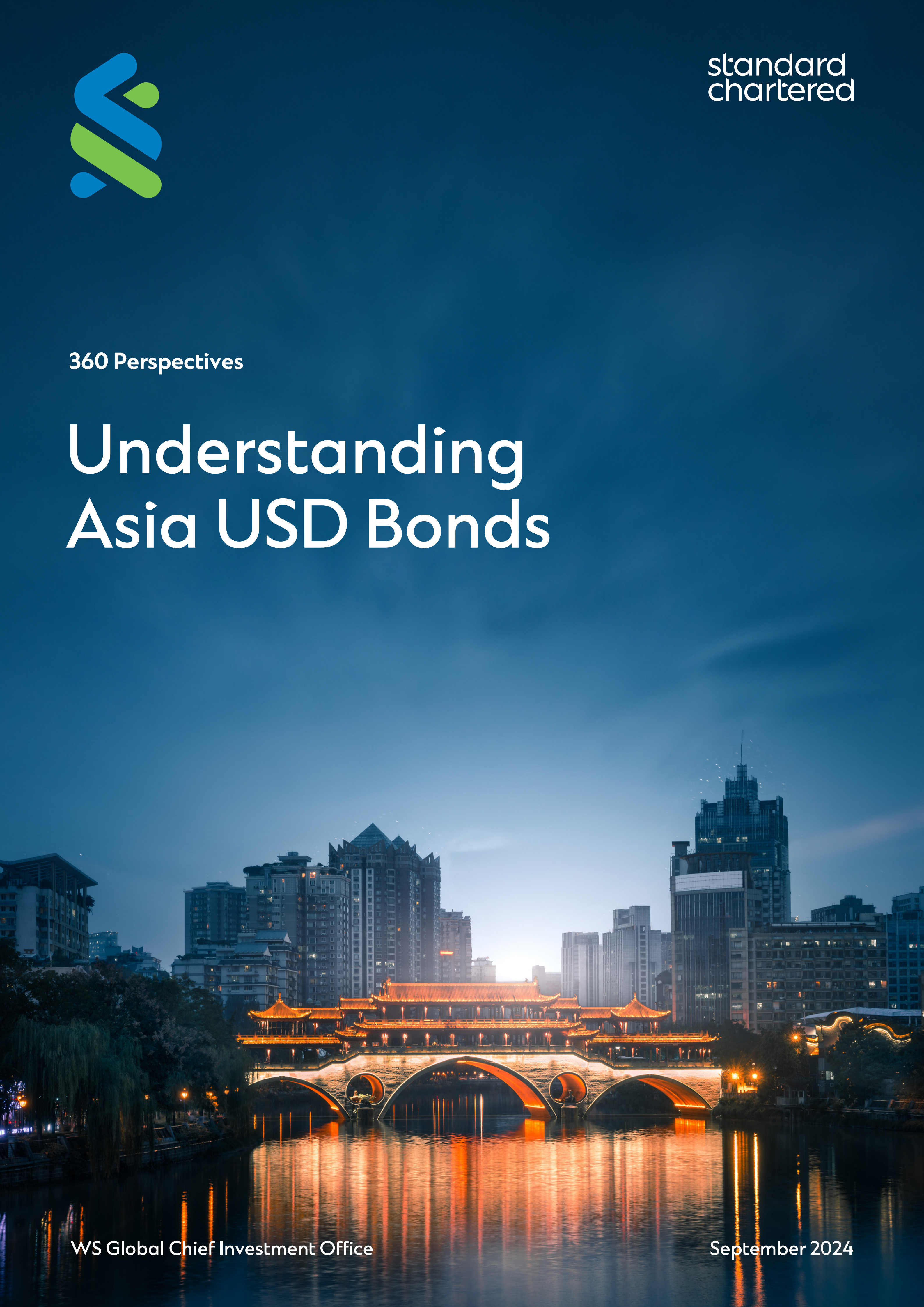


360 Perspectives

Understanding Asia USD Bonds

WS Global Chief Investment Office

September 2024

Understanding Asia USD bonds

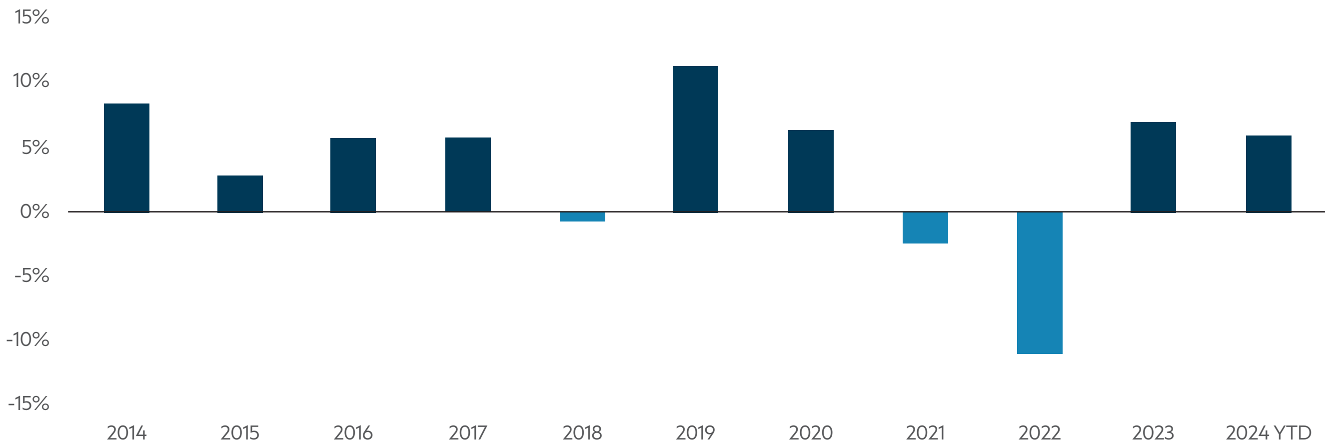
The Asian USD bond market has experienced remarkable growth since its inception in the early 2000s, reaching USD 500bn in 2014 and surpassing USD 1trn in 2020. Over the past decade, it has generated positive returns in 7 out of 10 years.

Recent interest in the Asia USD credit space has surged, driven by its recovery from Covid-19 lows and the rebound after the China property crisis. Supportive spread differentials and other key attributes make this asset class appealing for fixed income and multi-asset portfolios, especially for investors willing to take on more risk.

Fig.1

Asian USD bonds have delivered positive returns in 7 out of the last 10 years

Annual total returns of Asian USD bonds since 2014



Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

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Chief Investment Officer, Africa, Middle East & Europe (AMEE)

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Portfolio Strategist

In this paper, we lay out:

1. The history of the Asian USD bond market,
2. Breakdown of the composition of the Asian USD bond market,
3. The attractiveness of this asset class, and
4. How it can be integrated into investors’ portfolios

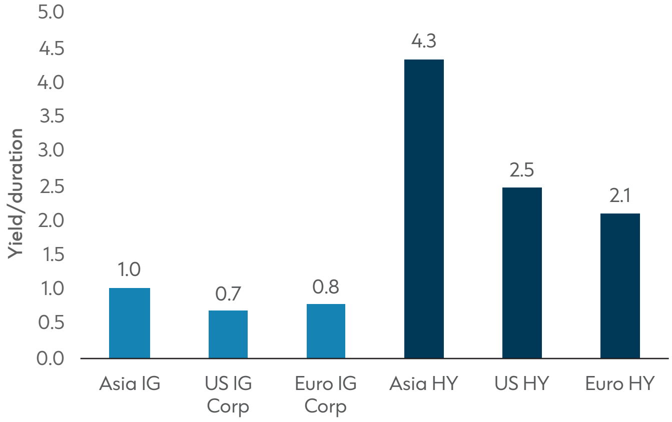
Additionally, we will compare the performance of Asia USD bonds to global USD and EUR corporate credit. Key insights reveal that Asian USD bonds:

- generally offer higher yields and spreads with relatively shorter duration
- Asia IG bonds have delivered stronger risk-adjusted returns compared to their US and Euro IG peers (0.89 vs. 0.46 and 0.68 respectively)
- Serve as a good diversification tool, with lower correlation to global bonds and equities than their developed market counterparts

Fig. 2

Asia bonds offers higher yield per unit of interest rate risk

Yield-duration ratios of Asian, US and Euro bonds as of 31 August 2024

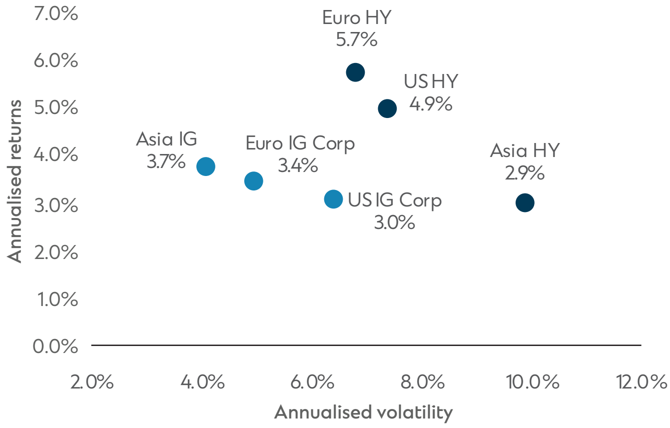


Source: Bloomberg, Standard Chartered

Fig. 3

Asian IG bonds offers higher returns with lower volatility compared to US and Euro IG bonds

Annualised risk and returns of Asian, US and Euro IG and HY bonds since 2014



Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

History of Asian bond markets

In the early to mid-1990s, the East Asian experienced high rapid growth, which was disrupted by the Asian Financial Crisis in 1997. The crisis began with the sharp depreciation of the Thai baht, leading to a loss of investor confidence and impacting financial markets across the region.

The crisis was partly due to Asian corporations' heavy reliance on bank financing, as regional bond markets were underdeveloped. The de facto peg of local currencies to the US dollar, combined with a large difference between local and foreign interest rates, led many borrowers to take on foreign currency loans.

This resulted in a 'double mismatch', where companies faced both currency and maturity risks, borrowing short-term in foreign currencies to fund long-term domestic investments. Following the currency depreciation, many corporates found it difficult to access credit to continue funding their investments.

This crisis highlighted the need for a stronger regional bond market, with policy makers concluding that a more robust primary and secondary bond market in the region would reduce dependence on bank financing and help mitigate maturity mismatch risks.

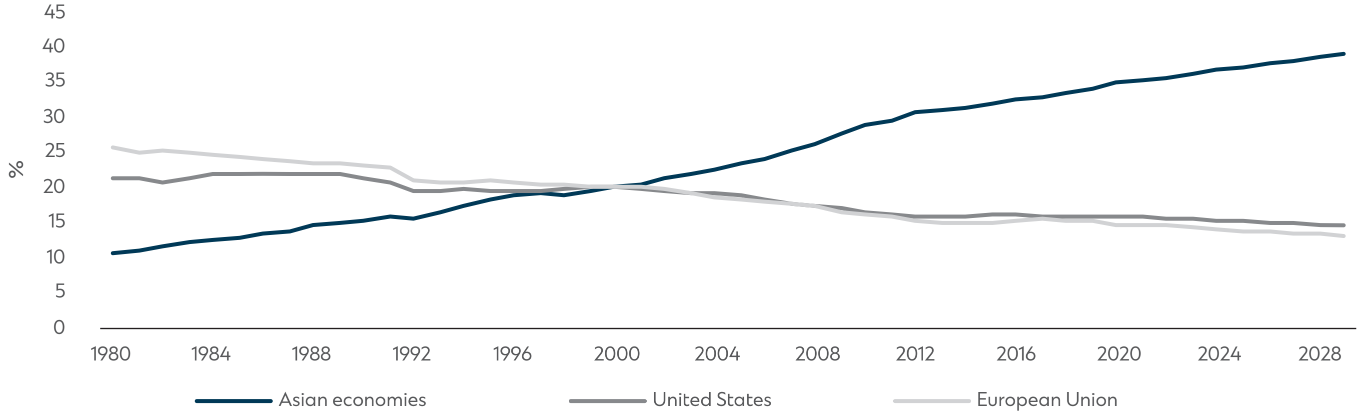
Strong growth in Asian GDP has been a supportive driver for the development of the Asian bond market

Globalization and increased world trade since the 1990s have also contributed to the rise of Asian economies, which now accounts for 35% of global GDP (in Purchasing Power Parity terms), as of 2023. As economic growth in Asian region continues to outpace Developed Markets, demand for Asian USD bonds is expected to remain strong.

Fig. 4

The growing share of Asian* economies within global GDP and trend is set to continue through 2029

GDP based on PPP as a share of world, forecasts till 2029



Source: IMF, Standard Chartered

* Asian markets include China, Hong Kong, India, Indonesia, Korea, Malaysia, Philippines, Singapore and others.

Understanding the composition of the Asian bond market

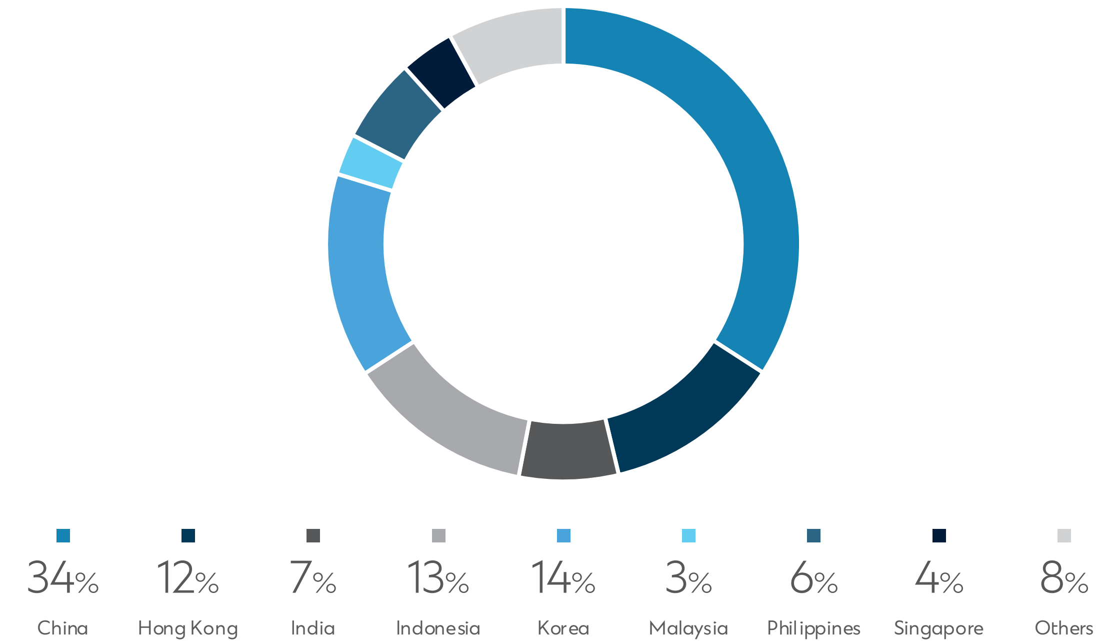
The following sections illustrate the characteristics of the Asian bond market, offering insights to market diversification, sectors distribution, and overall credit quality.

The Asian USD bond market currently includes exposure to 16 markets across Asia. Mainland China is the largest issuer country, although its share has declined from over 50% in 2020 to around 34% currently, primarily due to a contraction in its real estate sector. Hong Kong, South Korea, and Indonesia are the next largest markets, collectively making up nearly 40% of the asset class.

Fig. 5

Asian USD bond market offers geographical diversification with exposure to high growth economies

Breakdown of the market by country*



Source: Bloomberg, Standard Chartered

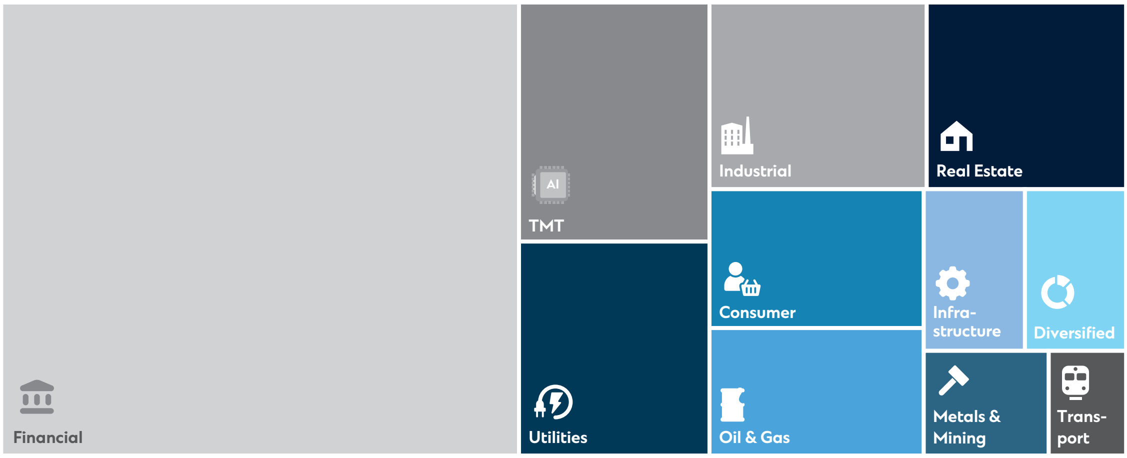
* Others comprise Macau, Mongolia, Pakistan, Sri Lanka, Taiwan, Thailand and Vietnam.

Sector diversity is also notable, with 11 sectors being represented. Like many developed markets, the financial sector makes up the largest share, followed by Technology, Media, Telecommunications (TMT), Utilities and Industrials.

Fig. 6

Asia offers a diverse opportunity set across 11 sectors, although a significant share is concentrated within Financials

Breakdown of the index by sectors



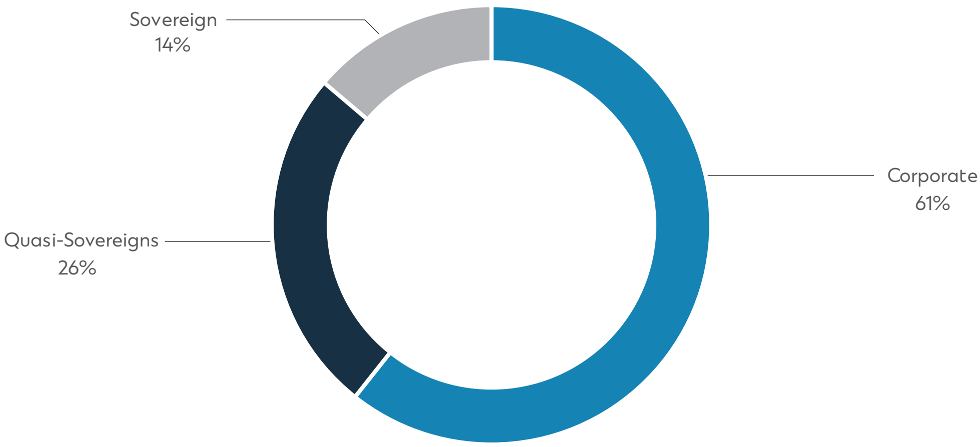
Source: Bloomberg, Standard Chartered

In terms of credit quality, the Asian USD bond market is predominantly investment grade (IG), with IG bonds making up over 80% of the market. The largest share of IG bonds falls within the BBB rated bucket. The high yield (HY) market has shrunk due to lower supply and defaults. Nonetheless, the high concentration of investment-grade bonds underscores the quality of the asset class, particularly when compared to Developed Market peers.

Fig. 7

Strong quality tilt with 40% allocation to Sovereigns and Quasi-Sovereigns

Breakdown of the market by segment



Source: Bloomberg, Standard Chartered
Note: Allocations may not add up to 100% due to rounding

Rating trajectory looking more optimistic

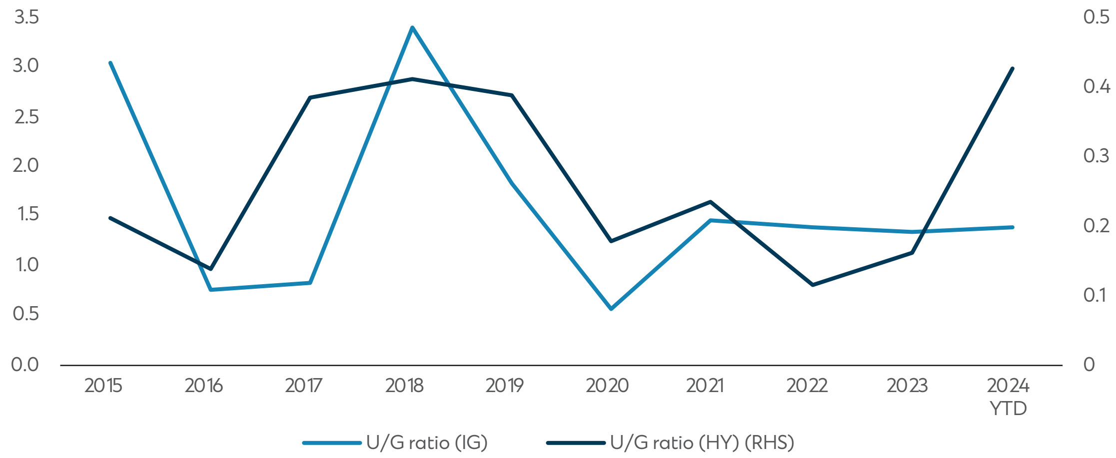
A review of credit rating trend reveals that the ratio of upgrade to downgrade by credit rating agencies peaked in 2018 for both Asia USD IG and HY bonds. However, ratings slipped in 2020 due to the Covid-19 pandemic, with HY bonds – especially in China's real estate sector – being more significantly impacted. Despite recent challenges, particularly in the HY segment, ratings have remained largely stable for IG, while HY ratings have marginally improved as defaulted names have been removed from the asset class.

Default rates have trended higher in the recent few years especially within the HY space. However, it is important to note that prior to the start of the Chinese property sector crisis in 2021, the default rate for Asian HY was relatively benign and had compared well to US HY and EM ex-Asia HY peers. The default rate in 2024 is widely expected to be lower than that of 2023 as we move past the peak of the real estate sector's default cycle in China.

Fig. 8

Rating trajectory looking optimistic for Asian bonds, with upgrade to downgrade ratio seeing an uptick for HY and stabilising for IG bonds in recent years

Upgrade/Downgrade ratios for IG and HY bonds since 2014



Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

Attractiveness of Asian bonds

Yields and duration highlight the lower interest rate risk of Asia USD bonds relative to their US and European counterparts

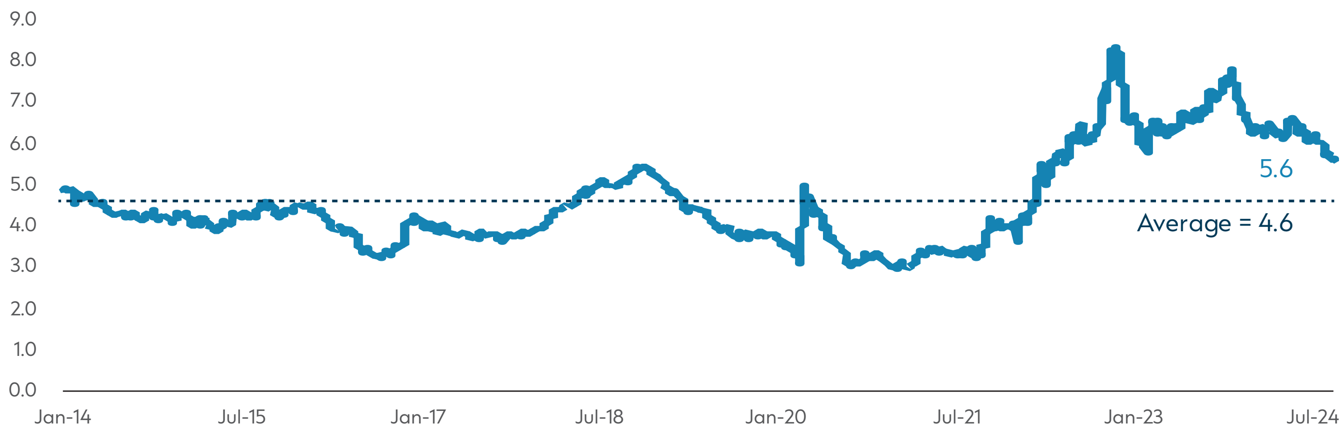
An important feature of fixed income assets is their yield and duration. The former refers to the income that investors receive from investing in bond in the form of periodic coupons, while the latter refers to the interest rate risk as measured by the change in the bond's price given a change in interest rates.

In this section, we compare the yield and duration of Asian USD bonds against US and European alternatives. Standalone, the yield on offer on Asian USD bonds remains not far from its long-term average of approximately 5%, making it attractive from an income perspective.

Fig. 9

Asia USD bond yield remains above its long-term average

Yield on offer for Asia credit benchmark (%)



Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

Compared to the US and Europe markets, Asian USD bonds offer higher yields and have shorter duration, suggesting less sensitivity to interest rate changes. Within the HY segment, Asian USD HY duration has been trending lower since mid-2017. The yield per unit of duration for Asian IG and HY bonds are particularly attractive relative to the other markets. This additional "carry" would enable Asian USD bonds to absorb a greater degree of either higher base rates or wider credit spreads.

Asian USD bonds have demonstrated strong absolute and relative performance

Historical performance data can offer another lens to view asset class performance. Our analysis looks at the last 10 years of data – this period covers market events such the outbreak of Covid-19 as well as the China property market crisis in 2021.

Over this period, Asia IG and HY indices have shown solid absolute performance at a time when cash yields were largely very low. On an absolute level, Asian USD bond performance tends to fall between that of US and Euro bonds. However, when looking at risk-adjusted returns, Asia IG bonds stands out with the highest ratio of 0.89.

Asian HY bonds, on the other hand, have lagged US HY corporate bonds. This was due to higher volatility during the Chinese property crisis in 2021.

Fig. 10

Asia IG bonds have displayed the highest risk adjusted returns of 0.89

Annualised risk and returns of Asia, US and Euro IG and HY bonds since 2014

Asset	Asia IG	Asia HY	US IG	US HY	Euro IG	Euro HY
Annualised returns	3.7%	2.9%	3.0%	4.9%	3.4%	5.7%
Annualised volatility	4.1%	9.9%	6.4%	7.4%	5.0%	6.8%
Risk adjusted returns	0.89	0.29	0.46	0.66	0.68	0.83

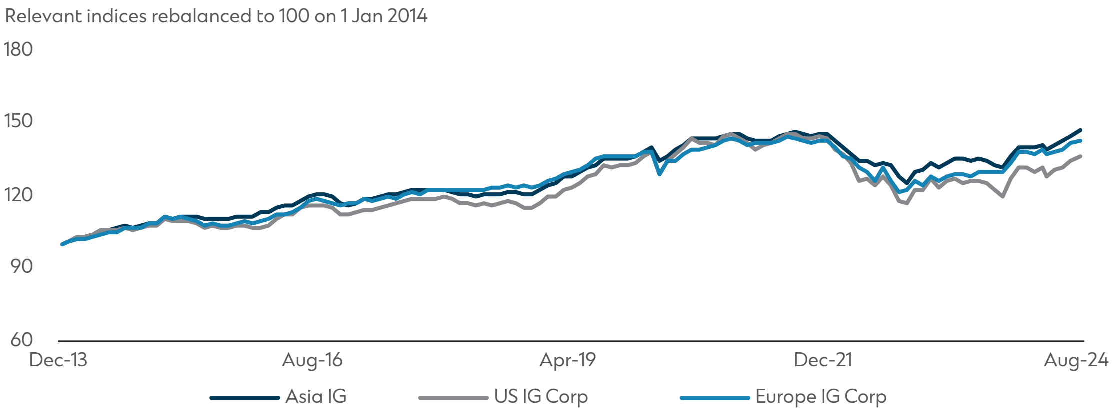
Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

From a relative perspective, Asia USD bonds have also delivered returns similar to US and Euro peers. In terms of IG rated bonds, Asia IG bonds have tracked closely to US IG corporates, although it has started to eke out higher returns in recent years. On the flip side, Asia HY bonds saw higher returns from 2014. However, that turned when the China property crisis became a drag on performance in 2021. It is, however, important to note that the performance drag by Chinese property was arguably an idiosyncratic event. Nonetheless, market confidence is slowly returning to this segment and performance has been catching up.

Fig. 11

Asia IG bonds outperformed their US and Euro peers by an average of c.8% since 2014

Performance of Asia, US and Euro IG Corporate indices

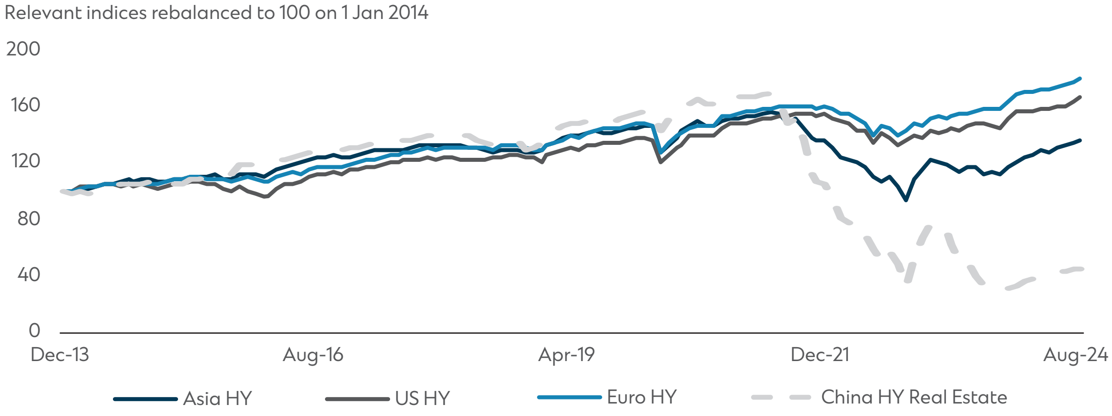


Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

Fig. 12

Asia HY bonds have trailed their DM peers since 2021, but this was driven almost entirely by the Chinese property sector

Performance of Asia, US, Euro HY Corporate and China HY Real Estate indices



Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

Asia USD bonds have fared well during past Fed policy decisions

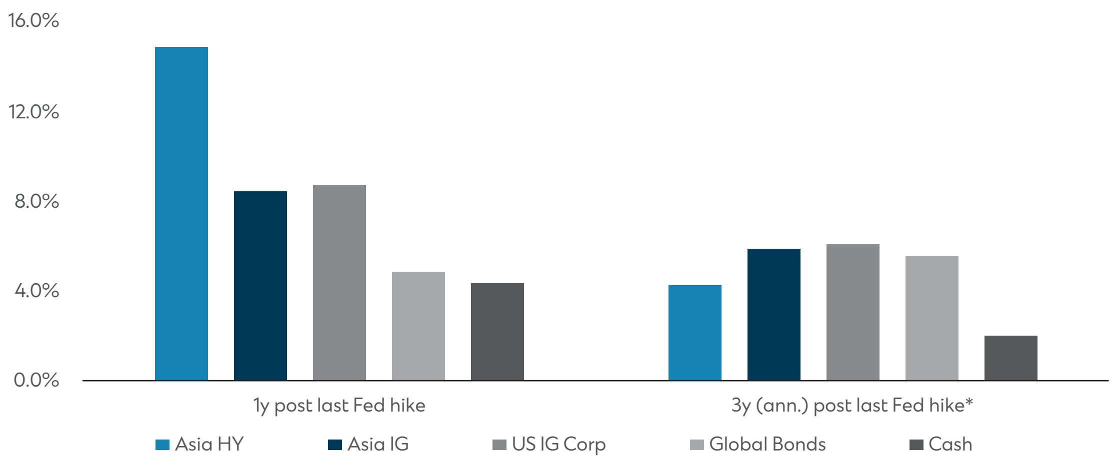
There is a common misperception that Asia USD bonds underperform in a rising rate environment. On average, Asia IG bonds have delivered strong returns during the latest 3 rate hike cycles, outperforming Global Bonds. Asia IG bonds also outperformed Euro IG Corporate and Global bonds by c.1-4%, while performing on par with US IG Corporate bonds, on average 1 year after the last Fed hiking cycle.

Asia HY bonds, on the other hand, delivered the highest average returns 1 year after the peak in the Fed fund rate, while performing worse relative to US HY Corporate and Euro HY Corporate when looking at the 3-year annualised returns.

Fig. 13

After the Fed hikes ended, Asia USD IG and HY bonds delivered strong absolute and relative returns

Average performance of selected assets following the final Fed rate hike in the last three rate hiking cycles



Source: Bloomberg, Standard Chartered
* Accounts for the first 2 rate hikes since 2005 only.

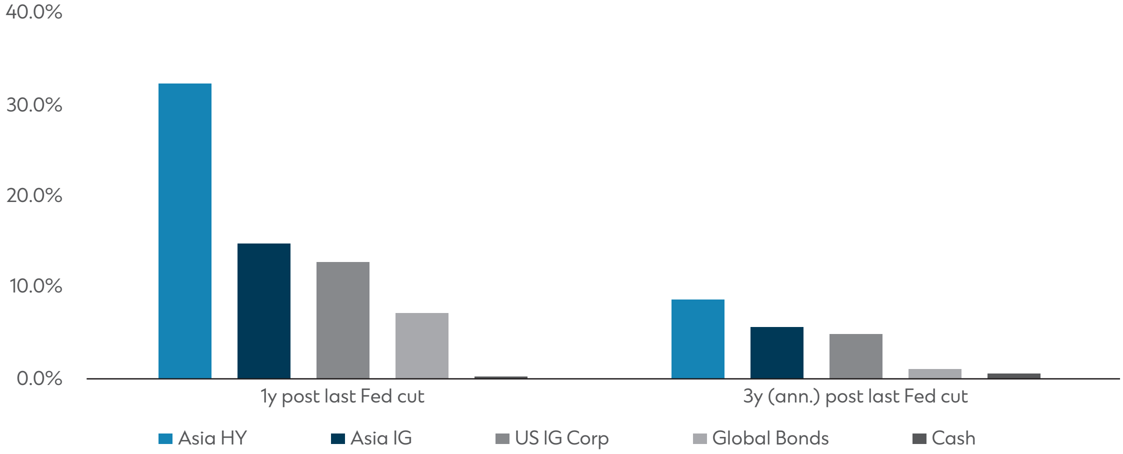
We also reviewed returns during the recent two rate cutting cycles in September 2007 - December 2008 and July 2019 - March 2020. On an absolute basis, Asia HY bonds saw double digit negative average returns of c.-12% while Asia IG delivered slightly negative returns of -1.6%. However, Asia HY beat US and Euro alternatives by over 8% each while Asia IG bonds underperformed US IG bonds by 1% and outperformed Euro IG Corporate bonds by a 2.6% margin.

Post Fed rate cutting cycles, performance across the board saw a pick-up. Asian HY bonds recorded strong average returns one year after the last rate cut, outperforming IG bonds and even global bonds and cash. Within the IG bonds space, Asia IG bonds were the clear outperformer on a 1-year average returns and 3-year average annualized returns basis.

Fig. 14

Asia IG bonds was the clear outperformer within the IG bond space after the last Fed rate cut

Average performance of selected assets following the final Fed rate cut in the last two rate cutting cycles



Source: Bloomberg, Standard Chartered

Although the history is short and primarily reflects rate hiking and cutting cycles since 2005, it is important to note that this period includes the Global Financial Crisis of 2007-2008, which significantly skewed market performance. As a result, the data may not be fully representative of the future. However, despite these limitations, the analysis still offers a good perspective on how Asian USD bonds are likely to react during future rate hiking and cutting cycles.

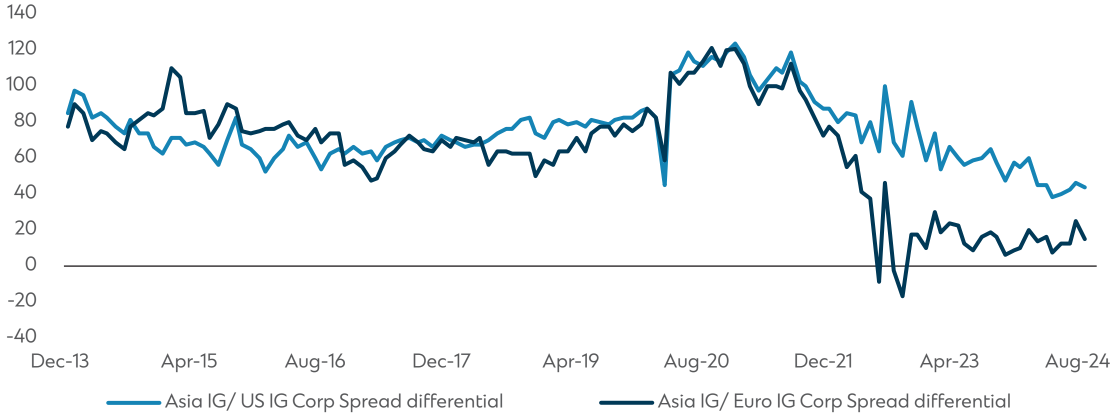
Asian credit spreads offer an attractive pickup vs counterparts

Another lens we use to analyse the attractiveness of Asian USD bonds is that of spreads, which is an indication of how much investors are compensated for the risk they are taking over other credits of similar ratings. Both IG and HY bonds have offered an attractive pickup relative to US and Euro peers. Asia IG bonds provide, on average, an excess spread of around 75bps against US IG Corporate bonds, while the average against Euro IG Corporates is slightly lower about 64bps.

Fig. 15

Asia IG offers a positive yield spread over DM peers

Asia IG spread vs US and Euro Corporate IG



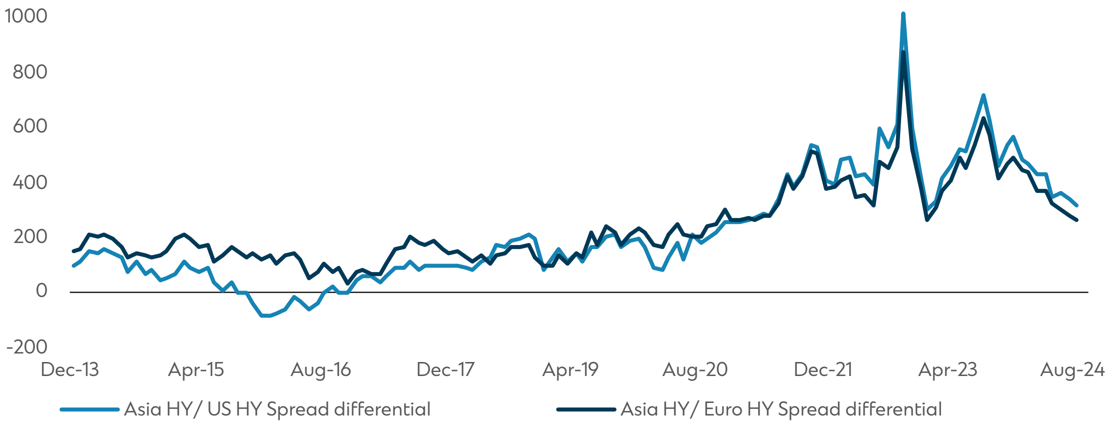
Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

Since Covid-19, spreads differential between Asia HY and US and EU HY bonds have widened, particularly due to stresses in the China HY property sector, but have since improved. The average spread post Covid-19 between Asia HY against US HY and Euro HY, lies at 485bps and 428bps, respectively.

Fig. 16

Spread differentials between Asia and US/EU HY have narrowed post pandemic

Asia HY spread vs US and Euro HY



Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

Asian bonds as an attractive addition in portfolios

We analyse the impact of including IG bonds across the different regions to the widely referenced 60/40 Equity/ Bond portfolio.

We also look at the correlations between different asset classes since it provides a perspective on diversification benefits. As a simple guide, if two asset classes are correlated, that would indicate that both assets tend to move in the same direction. As the table in Fig 17 illustrates, the long-term correlation between Asia USD bonds and global bonds and equities has been relatively modest. This suggest there could be good diversification potential adding them to a portfolio of global bonds and equities. In addition, the relatively high correlation with US peers also suggest that Asian bonds can serve as a potential complement for investors who are more focused on US credit to increase their opportunity set and overall yield.

Fig. 17

Low correlations help provide diversification benefits for equity and bond portfolios

Asset correlations using monthly returns since 2014

	Asia USD	Asia IG	Asia HY	US HY	US IG Corp	Euro HY	Euro IG Corp	Global Equities	Global Bonds
Asia USD	1.00								
Asia IG	0.96	1.00							
Asia HY	0.85	0.68	1.00						
US HY	0.67	0.62	0.56	1.00					
US IG Corp	0.87	0.91	0.59	0.72	1.00				
Euro HY	0.67	0.58	0.64	0.90	0.68	1.00			
Euro IG Corp	0.74	0.75	0.51	0.76	0.85	0.81	1.00		
Global Equities	0.55	0.48	0.53	0.84	0.59	0.78	0.62	1.00	
Global Bonds	0.76	0.82	0.49	0.60	0.87	0.48	0.69	0.53	1.00

Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.

To determine the impact of including Asian, US and Euro bonds into a portfolio, we allocate 60% into Global Equity, 30% into Global Bonds, and allocating the final 10% into either Asia, US or Euro IG bonds. As illustrated in the table, the allocation to Asia IG bonds has improved the return/risk ratio to 0.69, a step-up from 0.67. Even when we compare against the portfolios with US and Euro IG Corporate bonds, it has demonstrated better risk adjusted returns against both portfolios.

This suggests Asian bonds have the potential to benefit portfolios either through higher returns or reduced risk via lower volatility as compared to other alternatives or even compared to a 60/40 Equity/Bond portfolio.

Fig. 18

A 10% allocation to Asia IG bonds to a traditional 60/40 Equity/Bond portfolio has improved risk adjusted returns

Performance of traditional equity/ bond portfolios with 10% allocation to Asia, US or Euro IG bonds using monthly returns since 2014

Portfolio	Return	Volatility	Return/Risk
60/40 Equity/Bond	6.1%	9.1%	0.67
With Asia IG	6.4%	9.2%	0.69
With US IG	6.3%	9.4%	0.66
With Euro IG	6.3%	9.3%	0.68

Source: Bloomberg, Standard Chartered. Data as of 31 August 2024.
* Equities uses MSCI ACWI Index and Bonds uses Bloomberg US Treasury Index.

Why Asia bonds offer compelling risk-reward

In our view, there are several compelling reasons to include Asia USD bonds within any diversified portfolio:

- High yield per unit of duration risk
- Attractive spreads over Treasuries
- Historically strong risk-adjusted returns and absolute returns
- Enhances the risk-adjusted profile of a typical 60/40 equity/bond portfolio

While the asset class may face some concentration risks, particularly with Chinese issuers, its solid performance historically, diversification benefits and attractive yields make Asian USD bond an attractive addition to global portfolios.

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