CIMB PREFERRED INSIGHTS

MAR 2021

Key Highlights

- **Asian HY** offers a yield pick up against Asia IG and US IG as well as US HY credits.
- **Defaults** are expected to be lower for the APAC region. Moody's 2021 forecast for APAC default rate is at 3.6% (2020: 7.3%).
- **Healthcare and Technology** continue to have support from shifting secular trends. Modernizing of healthcare infrastructure, increased demand for healthcare products and services are some examples. Working from home as the norm favour the industries that support these mobile work arrangements.
- **Opportunities**. **Blackrock World HealthScience or UOB Global Healthcare** offers exposure to the healthcare sector. For Fixed Income, investors can consider **Elect Global (Hysan Development Co. Ltd.) USD 4.85% FFL Perp, Peak Reinsurance USD 5.35% Sub Perp, ING Groep USD 6.75% AT1 Perp, ChemChina HAOHUA 3% senior unsecured 2030.** Investors keen on equity investments can look at possibly **Microsoft (MSFT US)**, **Facebook (FB US)**, **Abbott Laboratories (ABT US), Procter & Gamble (PG US)**, **Starbucks (SBUX US)** and **McDonald's (MCD US)**

Asian High Yield Update

US Treasury continued its selloff in Feb as yields climbed on concerns of higher inflation, optimism on US$1.9 trillion stimulus bill and an encouraging vaccine rollout. The benchmark 10-year Treasury yield climbed to the highest in about a year at ≈ 1.38%.

Markets have been guided by the Fed's stance to remain accommodative as they pursue an inflation target (i.e. inflation of 2% over time before considering to hike rates), as well as watching out for the Fed's intention to signal prior to the tapering of their monetary policies.

This ultra-loose monetary policy is expected to keep short-end rates anchored. Coupled with optimism from potential US stimulus and an expected reflation trade, these expectations have indirectly led to a spike in the long-end of Treasury yields.

Consequently, we have observed the yield curve steepening over a short period (US 5s30s spread:

155 bps @ 19th Feb 21 vs 130 bps @ 4th Jan 21). Bonds (in particular long dated papers) are expected to come under pressure in the immediate term amidst this development.

Notwithstanding the above, we remain constructive on the Asian HY dollar space (i.e. hard currency).

To offset the impact of interest rate movements to total bond returns, we should be selective in positioning in the Asia HY space, premised on the following factors.

(a) Additional yield pick up over Asia IG credits and US IG/HY credits

Yield premiums on Asian HY dollar bonds still offer investors higher yield over investment grade credits, and even HY from other regions. For instance, Asian HY continues to offer among the highest yields at circa 6.53%, which contrasts fellow Asia IG credits (2.17%) as well as US HY credits (3.99%).

Additional yield pick up against their HY peers implies investors may achieve positive carry after applying leverage. The Asia HY space is also expected to benefit from China's stronger growth as well as healthy macro recovery.

Asia IG Yield*	Asia High Yield^	US IG Yield`	US High Yield#
2.17%%	**6.53%**	1.97%	3.99%

Source: Bloomberg, as of 19th Feb 21;
Note: *H29382US; ^BAHYYW; `LUACTRUU; #LF98TRUU

(b) Potential spread compression play

We observe that Asia HY spread is still trading at 622 bps, which is still higher than pre-Covid levels of < 500 bps. This may suggest room for tightening in view of Asia's positive macro outlook, improved earnings outlook, and the expectation of continued accommodative policies.

On a relative basis, the current Asia HY spread levels are considered the widest versus their HY peers (US HY corp overnight adjusted spread: 3.21%).

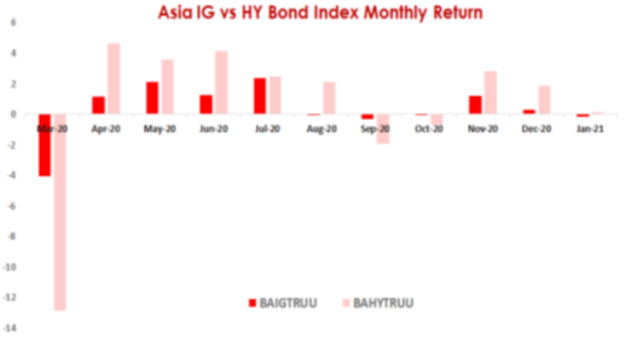
Note: Credit spread reflects the difference in yield between a Treasury and corporate bond of similar maturity.

Source: Bloomberg

(c) HY debt (with higher coupons and lower duration) are less vulnerable to climbing rates

IG debt typically have lower coupons than their HY cousins, and therefore are likely to be more vulnerable in an increasing interest rate environment. Typically, bonds with higher fixed rate coupons will tend to have lower interest rate risk compared to their IG counterparts. Therefore, HY bonds provide some buffer to rising rates. However, there are still idiosyncratic risks that might weigh down the HY space and cause a sudden widening of spreads.

To further illustrate this point, we have extracted the monthly return for Bloomberg Barclays Asia IG USD index (BAIGTRUU) vs Bloomberg Barclays HY USD index (BAHYTRUU) as shown below. We note that the IG index has shown a return of -0.50% YTD as compared to HY index, which has yielded a positive return of +0.67% over the same timeframe.



Source: Bloomberg

(d) Manageable default risk

The Chinese HY onshore segment has seen some high profile defaults in FY20 (i.e. Tsinghua Group, Tahoe Group, Brilliance Auto), amounting to RMB 136.2 bn (~USD20.9 bn). Onshore defaults may have a spillover affect to the Chinese offshore bond market through cross defaults and dampened investor sentiment hampering refinancing efforts. According to Bloomberg data, 13 Chinese companies defaulted on bonds in the offshore market amounting to approx. $8.2 billion in FY20.

Nevertheless, we continue to be constructive on HY positioning underpinned by manageable rollover risk as selective HY issuers continue to be able to tap the market for refinancing in view of (i) ample liquidity; (ii) yield chasing behaviour from investors amidst low rate environment; and (iii) accommodative stance of major central banks. Furthermore, positive front from vaccine rollout and improving macro outlook would aid overall economic recovery.

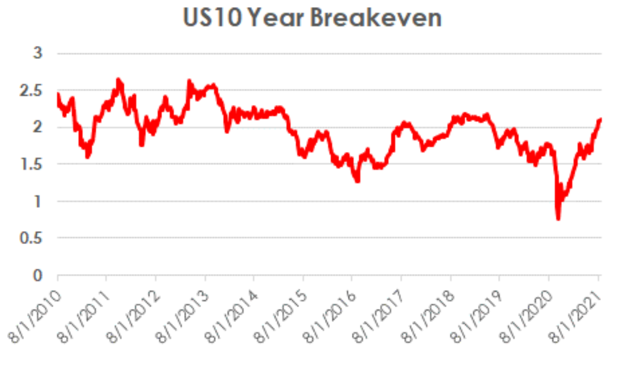
Moody's 2021 forecast for APAC default rate is at 3.6% (2020: 7.3%).

Note: Based on historical figures, APAC default rate stood at 14.1% during 2009 (peak of GFC).

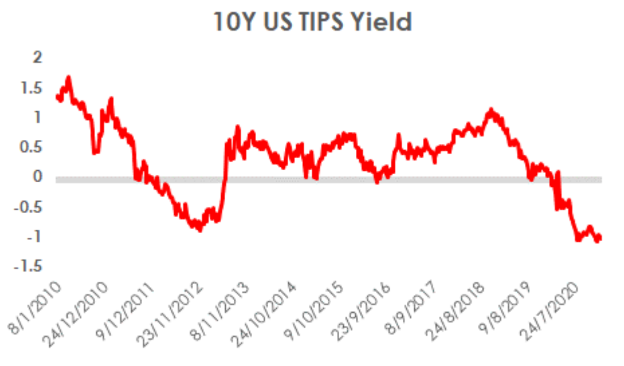
(e) Lower duration risk

The rise in US Treasury yield curve poses interest rate risk to fixed income investments. One of the ways in managing interest rate risk is via duration exposure. Bonds with shorter maturities tend to have less severe impacts towards interest rates movements. Asia HY, which has lower a duration (i.e. Bloomberg Barclays Asia USD HY Bond Index has a duration of 2.64 years) could be considered.

Current equity environment. The current market environment, especially the US is characterized by low real yields, rising inflationary expectations and higher government bond yields. So far, this has not derailed the equity market. The main reason has been an extremely high equity risk premium.



Source: Bloomberg



Source: Bloomberg

Since the March 2020 lows, the US equity market has rallied, and while it has fallen some, the US equity risk premium remains above its long-term average. The US Equity risk premium is currently ~110bps above the long term average of about 4%, according to SocGen Research.

An environment where there are higher bond yields but less economic uncertainty is unlikely to trigger a higher risk premium.

From an equity risk premium perspective and relative to treasuries, the US equity market may not be as expensive as feared. It should be noted that economic, as well as earnings outlook would be key in driving equity prices.

We take a look at some companies that announced their financial results.

Among the companies covered, the results from tech companies like **Microsoft (MSFT US)**, **Facebook (FB US)**, and **healthcare companies** like **Abbott Laboratories (ABT US)** - both segments of which benefitted from pandemic but set stronger foundations for positive outlook as well.

- **Microsoft's** 2Q results and forward guidance beat expectations. For a company its size, its revenue and profit growth remain impressive. Microsoft's portfolio had leveraged on its strength in large enterprise deals, Teams, Windows OEM and Gaming. Over the longer term, it can continue to drive secular adoption of public cloud through Azure while exploring growth opportunities.
- **Facebook**'s 4QFY20 results beat expectations and showcased its ability to continue to scale profitability and monetize its large user base. FB's continued monetization efforts and ongoing network effect should enable it to generate attractive growth rates in the near term.
- **Abbott's** 4QFY20 results was very strong and beat consensus, largely on the back of strong demand for its diagnostic solutions (related to Covid-19 testing) and strong momentum for its other products. Its strong Forward FY21 guidance boosted confidence that growth momentum can be sustained even if Covid-19 pandemic normalizes.

Selected consumption stocks such as **Procter & Gamble (PG US)**, **Starbucks (SBUX US)** and **McDonald's (MCD US)** also showed positive results and encouraging outlook.

- **Procter & Gamble** delivered 8% organic sales and 15% EPS growth in 2QFY21 which beat consensus. It continues to benefit from increased cleaning, health, and hygiene due to COVID, on top of improved strategy, brand portfolio, and execution.
- **Starbucks**' 1QFY21 results were in line but market was disappointed at the same-store-sales (SSS) trend in US for 1Q as well as the news on the departure of its COO. We believe the SSS weakness in US is transitory while Starbucks has a deep bench. We fall back on its strategy and execution, noting that Investor Day in Dec 2020 offered a clear and positive longer term trajectory and provides higher confidence to it achieving those aggressive targets.
- **McDonald** continue to see improvements in its results, especially in US where its formats (such as digital and drive-thrus) helped. International markets were more volatile due to lesser proportion of drive-thrus and changing government regulations (various lockdowns and restrictions).

From a more macro and longer term perspective:

Healthcare Sector. According to Blackrock, beyond the innovation taking place, the healthcare sector is underpinned by strong secular growth trends; in particular demographic change in both developed and developing countries.

In the developed world, populations are aging and living longer which will lead to increased demand for healthcare products and services. In emerging markets, modernization of healthcare infrastructure and increased spending on healthcare from emerging market economies will lead to increased healthcare consumption over the coming decades.

Technology Sector. The high COVID-19 case load globally will continue to favor work-from-home related technologies, and consumer facing tech that benefits from social distancing and lockdown measures. While the pandemic has benefited select software companies that are considered priority technology spend, such as cloud security or remote work, many other software names are likely to experience pressure as cases continue to rise.

While many of these companies may experience some normalization of growth in 2021 as the world returns to some level of normalcy in 2nd half of the year, the trends that underpin the future growth of these companies, namely the digital transformation of enterprises and increased adoption of consumer tech, have been accelerated and will persist far into the future.

For diversified exposure, funds such as the **Blackrock World HealthScience Fund or UOB Global Healthcare Fund** have exposure in some of the themes mentioned above.

Fixed Income. We continue to have a NEUTRAL position on fixed income despite rising rates expectation.

Meanwhile the bond markets were trading fairly firm over last week. For instance, EM Asia USD credit average spread trading at 277 bps (27th Jan 21) vs 276 bps (22nd Jan 21).

We opine that clients should continue to stay invested in the fixed income space and here are some ideas for consideration:

i. **Fixed for Life ("FFL") perpetual securities with high coupon (>4.50%).** An example is **Elect Global (Hysan Development Co. Ltd.) USD 4.85% FFL Perp (callable Aug 23)**. Issue Rating: A3 (Moody's)

ii. **IG-rated corporate perpetual bonds with high coupon reset on call date**; An example is **Peak Reinsurance USD 5.35% Sub Perp (callable Oct 25).** Issue Rating: Baa2 (Moody's) and issue has Coupon reset: 5Y US Swap rate + 5.011%.

iii. **AT1s/ CoCo bonds with coming call dates in 2022– 2024 that have high reset spread**. An example is **ING Groep USD 6.75% AT1 Perp (callable Apr 24).** Issue Rating: Ba1/BBB (Moody's/Fitch) with coupon reset: 5Y US Swap rate + 4.204%

iv. **We favour Asia IG over DM IG**, in particular China SOEs & Chinese tech space that continue to trade wider than US/European counterparts. An example is **ChemChina HAOHUA 3% senior unsecured 2030 (100% govt. owned).** Issue Rating: Baa2/A- (Moody's/Fitch)

v. **Select positioning in Asia High Yield space** for spread compression play and additional yield pick up over IG credits; See next section on High Yield

vi. **To trim duration risk**. Prefer to position in the belly section of the curve (i.e. 5 – 10 years) in anticipation of reflation trade/steeper yield curve.

vii. **Utilize leverage moderately**. Clients stand to benefit from positive carry amidst low funding cost.

viii. We continue to advocate a Hold to Maturity or to First Call Date stance to benefit from carry.

Please speak to your relationship manager for more details.

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