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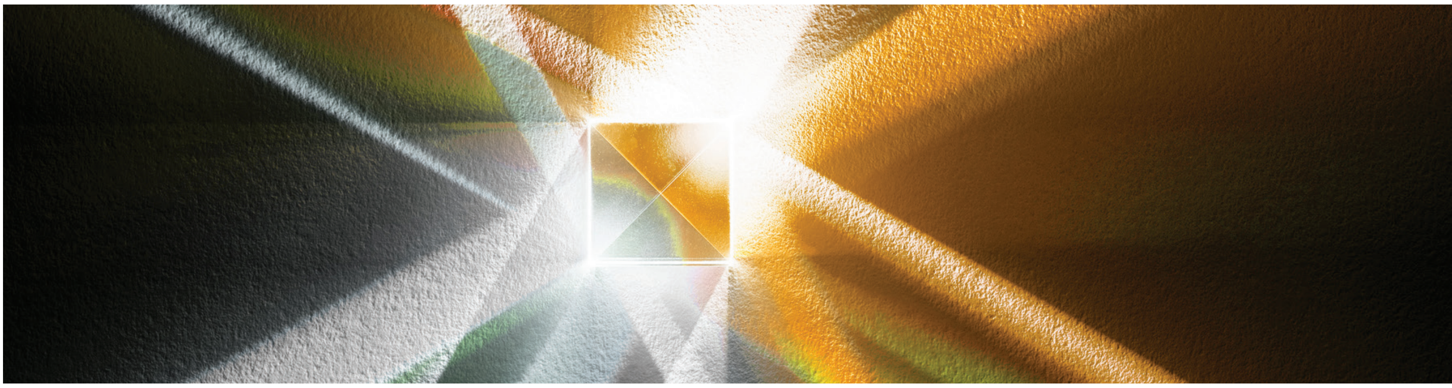

2021 MARKET OUTLOOK

Fixed Income

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Eastspring's Singapore-based Fixed Income team believes that the 10-year US Treasury bond yield will be capped in 2021, thereby supporting the outlook for Asian bonds. In addition, new financing rules may moderate the amount of risk taking within the Chinese real estate sector, a positive for the Asian High Yield bond market. Meanwhile broad USD weakness should lead to opportunities within Asian local currency bonds.

Q. DO YOU THINK LONG-TERM TREASURY YIELDS WILL HEAD HIGHER IN 2021? HOW WOULD THIS IMPACT ASIAN BONDS?

Guan Yi: We see the 10-year US Treasury bond yield capped at 1% given the downside risks to global growth going into 2021 and the US Federal Reserve's (Fed) clear policy stance.

Following the initial rebound in global economic activity from highly depressed levels in the second quarter of 2020, we expect the pace of improvement to moderate from the fourth quarter of 2020 and going into 2021. At the end of 2021, the output from the OECD economies will likely still be 2-4% lower than pre-COVID-19 levels. The spending on goods will slow after the initial burst of pent-up demand has been met. Spending on services, which requires face to face interaction, will continue to struggle. The more immediate risks to growth come from new waves of COVID-19 infections, as well as the fall in household income if the support from earlier fiscal programmes in the developed economies is not extended.

Meanwhile, the Fed is committed to keep policy rates on hold until the US labour market has achieved maximum employment and inflation averages 2% over time. This implies that the US policy rate will stay at 0-0.25% till 2023.

This backdrop raises the appeal of Asian government bonds given subdued inflation in Asia and the attractive yield differential between Asian sovereigns and US Treasuries. Following the outcome of the US elections, a more predictable geopolitical environment also encourages capital inflows to Asia where the growth outlook is being supported by a better management of the COVID-19 outbreak. We have a positive outlook on the bond markets in Asia.

Q. HOW WOULD YOUR HIGH YIELD INVESTING STRATEGY DIFFER IN 2021?

Wai Mei: Investors' 2021 playbook will potentially contain some features from 2020, yet there will also be some key differences. In 2020, Asian High Yields' (HYs) relative performance was largely influenced by the Fed's unprecedented policy response to the COVID-19 induced economic slowdown. The Fed's announcement to purchase unlimited amounts of Treasuries and mortgage-backed securities, together with its corporate bond purchase programmes brought about a rally in rates and bolstered demand for US corporate bonds. As a result, Asian HYs gained 0.55% in 2020[1], underperforming US HYs which rose 1.1% despite the former's relative resilience during the sell-off in March and April. The Fed's policy response will continue to be a key driver of relative performance going into 2021.

Meanwhile, although government support in Asia had provided temporary relief to many companies in 2020, further aid may not be forthcoming given already stretched government balance sheets. While we expect defaults to remain manageable, investors would need to navigate the landscape carefully. On the other hand, the default risk of the Chinese real estate sector, which makes up the bulk of the Asian HY market, may fall. China's new financing rules require developers wanting to refinance to be assessed against three red lines, or thresholds. These thresholds include a 70% ceiling on developers' debt-to-asset ratio after excluding advance receipts, a 100% cap on the net debt-to-equity ratio and a requirement that short-term borrowings do not exceed cash reserves. These limits on bank borrowings should help moderate the amount of risk taking within the sector.

"The default risk of the Chinese real estate sector, which makes up the bulk of the Asian High Yield market, may fall."

On balance, several factors favour Asian HYs going into 2021. Low rates will continue to encourage investors to search for yield. Asia is well positioned to benefit from this ongoing theme, given its attractive yields and against expectations that the region is likely to be the first to recover from the pandemic. As such, default rates are forecasted to be lower for Asian HYs compared to Emerging Market and US HYs. Meanwhile, valuations remain attractive relative to history. See Fig.1.

Q. WITH BOND YIELDS HAVING FALLEN SIGNIFICANTLY IN 2020, CURRENCIES MAY PLAY A MORE IMPORTANT ROLE IN BOND RETURNS IN 2021. WHICH ARE YOUR FAVOURED ASIAN CURRENCIES GOING INTO THE NEW YEAR?

Rong Ren: Asian currencies present interesting opportunities in 2021, particularly against a backdrop where the USD is expected to weaken.

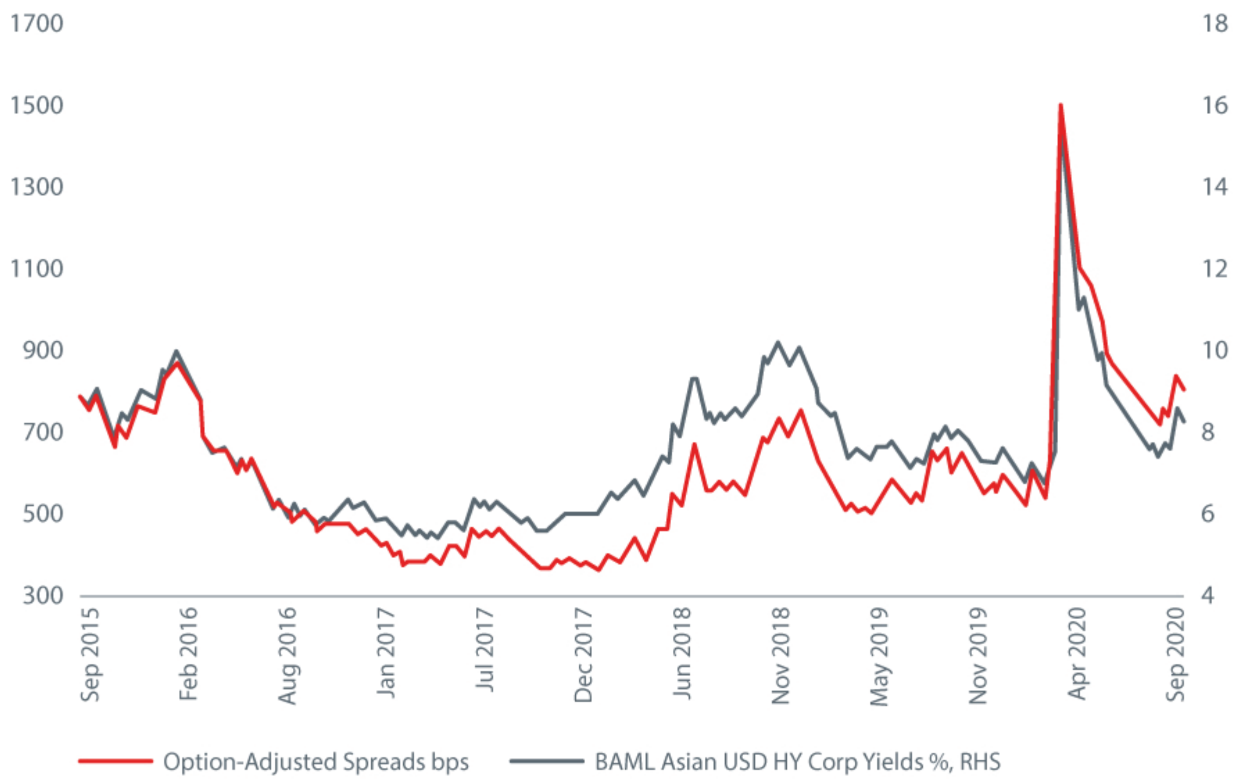
In the past six months, many Asian economies have demonstrated resilience in part due to the effective management of the COVID-19 pandemic. Taiwan and China, for example, are expected to register positive GDP growth for 2020. Meanwhile, some Asian economies still have fiscal room to provide additional support to counter the demand shock resulting from the outbreak.

With Asia being a relative bright spot amid a pandemic-induced recession, local equity markets (and therefore local currencies) are poised to enjoy liquidity driven inflows. The Chinese Yuan should continue to perform strongly, benefitting from a strong current account and capital inflows to its domestic bond market.

The Taiwanese Dollar and Korean Won may be beneficiaries of US-China technology decoupling. The SGD should also perform well as a proxy to broad USD weakness. Meanwhile, high yielding currencies like the Indian Rupee and Indonesian Rupiah can benefit from the global search for yield and carry despite their weaker fundamentals.

Source: [1]As of end October 2020. Asian high yield bonds are represented by the JACI Non-investment grade index. Asian Investment Grade bonds are represented by the JACI Investment-grade index. US High Yields are represented by the Bloomberg Barclays US HY index.

Fig 1: Asian High Yield corporate bond yields and spreads



Source: ICE BofAML Asian Dollar High Yield Corporate index as of 10 October 2020 (weekly data).

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