

Standing out: Asia high yield bonds in the emerging market context

October 2020

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Key takeaways

As Asia makes up a significant share of emerging markets, the case for investing in either region is often used interchangeably. However, this should not be the case, and there are important differences between Asia bonds and emerging market bonds in the hard currency market.

- ◆ **Asia credit is not necessarily a subset of emerging market debt.** The most commonly used sovereign emerging market bond index – JPMorgan Emerging Markets Bond Index (EMBI) – has only a 23% allocation to Asia. **In fact, 8 of the 17 geographic markets in the Asia credit universe are not even represented in EMBI at all**, and this is a factor of these markets not issuing USD sovereign debt. But even in the corporate bond market, JPMorgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI BD) only gives a 39% allocation to Asia – this is in contrast to Asia making up 63% of emerging market GDP. Further, in comparison to the equity market, Asia makes up 80% of the emerging market equity index (MSCI EM). **Even in the emerging market context, Asia bonds remain underrepresented**
- ◆ **The Asia credit universe has limited exposure to commodities, while the economies of the top non-Asia geographic weights in emerging markets are heavily exposed.** This is one of a number of factors that has helped Asia credit stay relatively resilient in the COVID-19 panic and the recent oil plunge
- ◆ **Asia high yield bonds are supported by Asia's solid macroeconomic backdrop.** Asia ex Japan is one of the only regions in the world that is still expected to see a positive GDP growth in 2020. Recovery is also underway for a number of Asian economies, especially Mainland China
- ◆ **Year-to-date, Asia's high yield default rate of 2.2% is lower than that of the US high yield market at 6.0% and emerging markets at 2.5%.** Historically, Asia high yield bonds have had, on average, lower default rates than emerging market high yield bonds. On a full-year basis, Asia is still forecasted to do better than both the US and the overall emerging market universe in terms of default rates
- ◆ **Asia high yield corporate bonds trade at a 7.5% yield, which is a premium over emerging market corporate bonds' 6.8% yield.** The stability of Asia high yield is also bolstered by lower levels of duration than emerging markets
- ◆ **Versus emerging market high yield bonds, Asia high yield exhibits lower correlation to credit in other regions and may therefore fare better during periods of global risk aversion.** During the height of the COVID-19 market panic, Asia high yield corporate bonds experienced a smaller drawdown than both emerging market corporate and sovereign bonds. Strong local investor demand is one of the reasons why Asia high yield is less susceptible to changes in market sentiment in both emerging markets and global markets in general

Source: JP Morgan, Bloomberg, HSBC Global Asset Management, as of September 2020

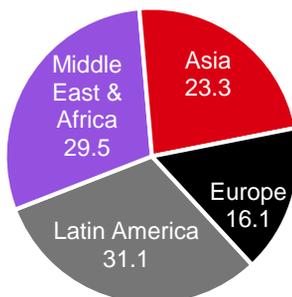
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Asia is not necessarily a subset of emerging market debt

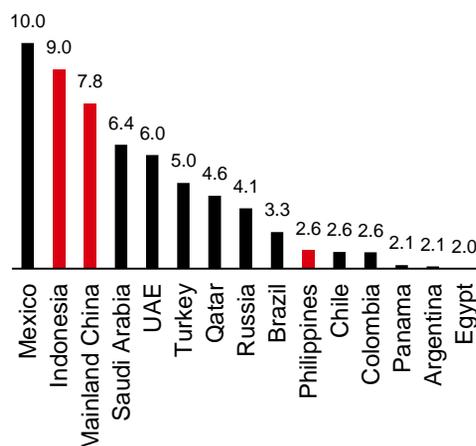
Asia is not sufficiently represented in the sovereign emerging market bond index

- ◆ There perhaps lies a perception that there are little differences between Asia credit and emerging market debt. But this perception is far from reality – starting from the basics of composition. Often, the composition of emerging market bond indices is such that Asia is not fully represented
- ◆ EMBI is the most commonly used emerging market USD debt index. EMBI is a sovereign index, but many Asian countries/territories do not issue USD sovereign debt. Asia thus only makes up 23% of EMBI
- ◆ Because of this, **the EM sovereign bond market omits a chunk of Asian opportunities and is not exposed to South Korea, Hong Kong, and Singapore – quality markets which offer dynamic investment opportunities and which together account for one-fifth of the Asia USD bond market**

EMBI geographic breakdown
(%)



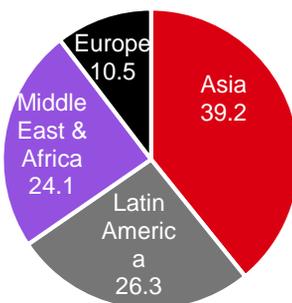
Top 15 countries/territories
(%)



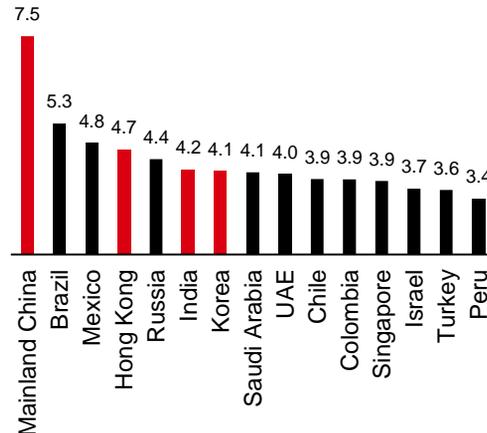
Top 10 non-Asia weights are > 40% of the corporate emerging market bond index

- ◆ Versus EMBI, the corporate emerging market bond index of CEMBI BD is a better comparison to the Asia USD bond market, which is represented by JPMorgan Asia Credit Index (JACI)
- ◆ In CEMBI BD, the top five non-Asia weights of Brazil, Mexico, Russia, Saudi Arabia and UAE – which together account for 23% of the index – have economies which are highly reliant on commodities, including the oil sector
- ◆ In contrast, **there is limited exposure to commodities in the Asia credit universe, a factor which has helped the Asia credit market stay resilient in recent oil plunge in the midst of the COVID-19 pandemic**

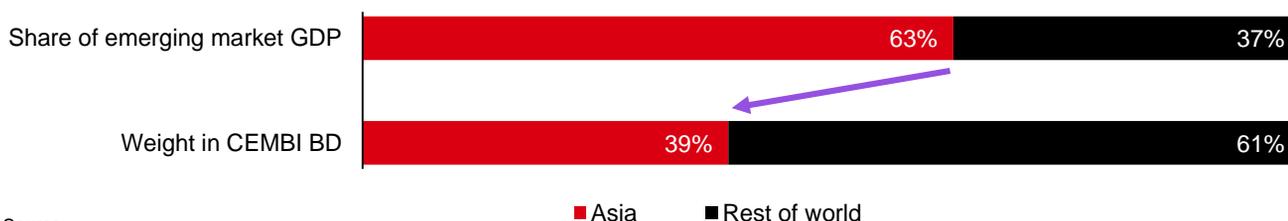
CEMBI geographic breakdown
(%)



Top 15 countries/territories
(%)



Asia remains underrepresented even in the emerging market context



Source:

1. JP Morgan as of September 2020
2. JP Morgan as of September 2020
3. IMF as of latest data available at September 2020, JP Morgan as of September 2020

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The advantage of Asia's solid macroeconomic backdrop

Asia high yield issuers are largely from countries/territories with investment grade sovereign rating

While all bonds in the Asia high yield corporate bond market are rated "non-investment grade", **over 95% of the market is made up of bonds of issuers from investment grade countries / territories.** By comparison, 56% of the EM high yield corporate bond market is made up of bonds from investment grade countries/territories. On average, Asia sovereigns have higher credit ratings when compared to non-Asia emerging markets.

Credit rating	Economies included in Asia high yield market (JACI High Yield)		Non-Asian economies included in EM high yield market (CEMBI BD High Yield) ²	
AAA	Singapore ¹	Aaa(S) / AAA(S)		
AA	Hong Kong	Aa3(S) / AA+(S)		
	Korea	Aa2(S) / AA(S)	UAE	Aa2(S) / NR
	Taiwan ¹	Aa3(S) / AA-(S)	Qatar	Aa3(S) / AA-(S)
	Macau	Aa3(S) / (NR)		
	Mainland China	A1(S) / A+(S)	Israel	A1(S) / AA-(S)
A	Malaysia	A3(S) / A-(N)	Kuwait	A1(S) / AA-(N)
			Chile	A1(N) / A+(N)
	Thailand	Baa1(S) / BBB+(S)	Peru	A3(S) / BBB+(S)
	India	Baa3(N) / BBB-(S)	Panama	Baa1(S) / BBB+(N)
	Philippines	Baa2(S) / BBB+(S)	Mexico	Baa1(N) / BBB(N)
BBB	Indonesia	Baa2(S) / BBB(N)	Colombia	Baa2(S) / BBB-(N)
			Russia	Baa3(S) / BBB-(S)
			South Africa	Ba1(N) / BB-(S)
			Oman	Ba3(N) / BB-(N)
			Brazil	Ba2(S) / BB-(S)
BB			Morocco	Ba1(S) / BBB-(S)
	Sri Lanka	B2 / B-(S)	Turkey	B2(N) / B+(S)
	Cambodia	B2(S) / NR	Jamaica	B2(S) / B+(N)
	Pakistan	B3(S) / B-(S)	Nigeria	B2(N) / B-(S)
	Maldives	B3(N) / NR	Ukraine	B3(S) / B(S)
B			Argentina	Ca(N) / CCC+(S)
CCC				

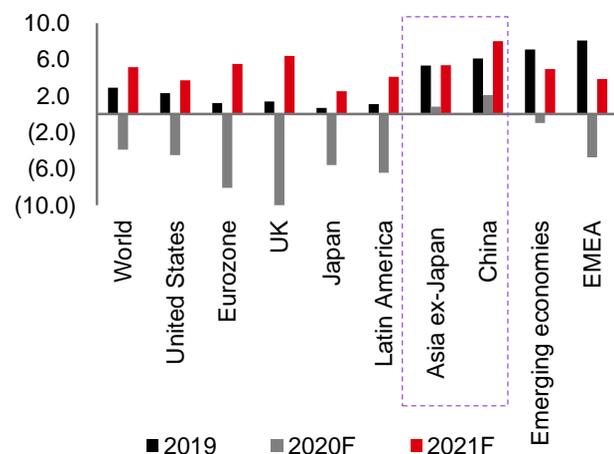
Credit rating is presented as Moody's(outlook)/S&P(outlook). (S) - Stable outlook, (P) - Positive outlook, (N) - Negative outlook

Note 1: Singapore and Taiwan have zero weight in JACI High Yield

Note 2: Using CEMBI BD HY Index. CEMBI BD HY countries / territories shown in the table, including the Asian markets, cover 90% of the index

Asia high yield bonds are supported by Asia's relatively better economic growth

GDP growth year-on-year (%)



Source:

1. S&P, Moody's, Bloomberg, as of 22 September 2020

2. Bloomberg as of September 2020

3. JPMorgan as of August 2020

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Asia high yield market's 2020 default picture expected to be better than other regions

USD bond market: High yield default rates

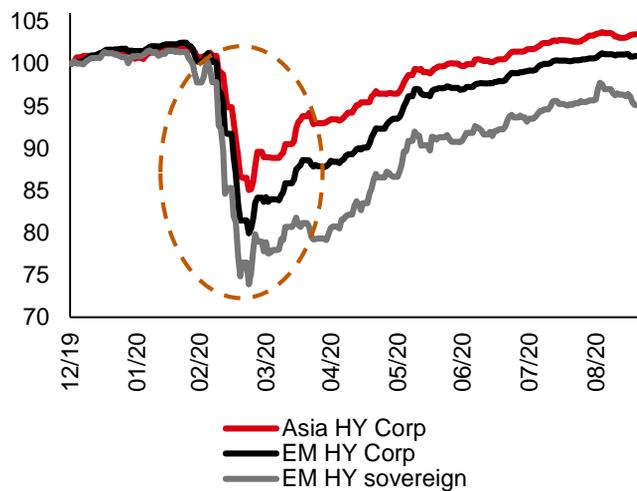
	2019 Actual	2020 YTD	2020 Forecast
Asia	1.6%	2.2%	4.0%
EM Europe	0.0%	2.2%	4.0%
Latin America	2.0%	3.5%	5.7%
MENA	1.6%	1.8%	4.5%
EM (total)	1.2%	2.5%	4.5%
US	2.9%	6.0%	8.0%

Asia high yield bonds offer diversification benefits

Over the years, Asia high yield has shown lower volatility versus EM high yield, and has exhibited lower correlation to US and Euro high yield as well. This could be due to a number of factors, including Asia high yield's strong local investor base and solid macroeconomic backdrop. In terms of value, there is currently a yield premium between Asia high yield corporates and EM high yield corporates. EM high yield sovereigns have a higher yield but this market contains defaulted names.

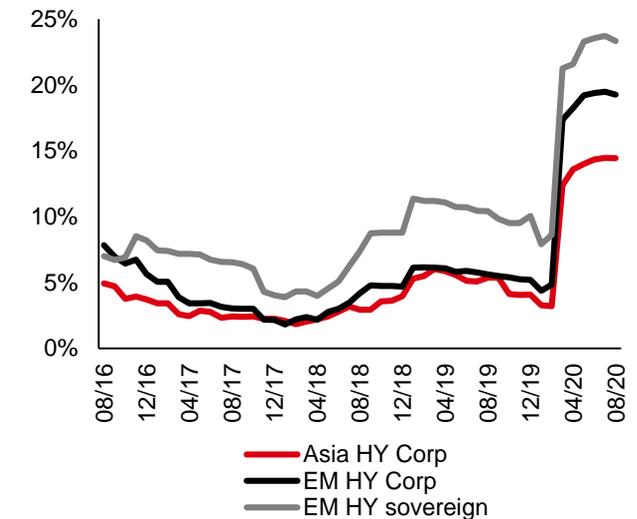
Asia high yield bonds had a smaller drawdown during March 2020 and a faster recovery versus EM

Performance
31/12/2019=100

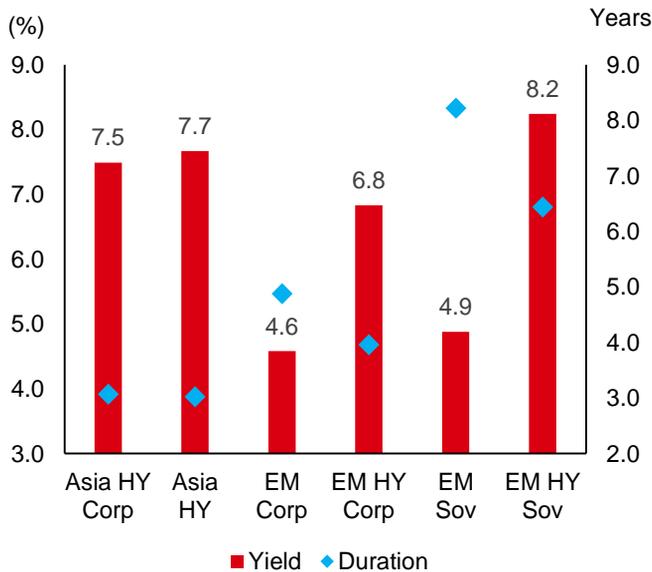


Asia high yield bonds had a slightly lower volatility than EM high yield

Standard deviation (12-month rolling) annualized



Asia high yield offers a yield premium, with a lower duration, versus EM high yield corporates



Versus EM HY, Asia high yield is less correlated to US and Euro HY

Correlation of spreads over 5-year period

	Asia HY	EM IG Corp	EM HY Corp
US IG Corp	0.61	0.60	0.76
US HY Corp	0.51	0.70	0.79
Euro IG Corp	0.55	0.49	0.64
Euro HY Corp	0.59	0.52	0.70

Source: JPMorgan as of September 2020.

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