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Investment viewpoint

Asia Fixed Income Outlook 2023

For professional investor use only

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Asian fixed income: a bright spot in 2023

We believe Asian credit reached a bottom in early November 2022 and is now on the ascendent due to China pivoting away from its zero-Covid policy and back towards a pro-growth stance, as well as the emergence of clear US disinflationary trends. Spreads have recovered considerably from dislocated levels over the last two months, but remain wide versus historic Asian levels, the current US markets and the implied probability of default. We remain highly optimistic for return trajectories in both the short term and the long term.

Asia is expected to be the world's bright spot in 2023. While Western economies slow considerably this year as extraordinarily tight monetary policy weighs, China is finally re-opening and stimulating its economy. We expect a strong rebound in private consumption, which will mitigate the weakness of the country's exports arising from a challenging global environment, and enable China to achieve a cyclical recovery with more than 5% GDP growth. Various sectors in Asia are expected to benefit that are linked to consumers and services, including hospitality, gaming, technology, malls and even real estate.

Meanwhile, Asian inflation peaked in 2022 and terminal-rate expectations in domestic economies have fallen by as much as 100 bps so far as a result of rapid disinflation. Asian central banks will likely have more room to cut their domestic rates before the Federal Reserve (Fed) in 2023 and 2024, thus better shielding their economies from the global growth slowdown.

Against this backdrop, funding markets across Asia are reasonably robust, especially for well-capitalised firms. Unsurprisingly, the USD-denominated debt market has become expensive for Asian firms to raise new capital, but firms are able to borrow via bank loans or domestic bond issuance thanks to ample liquidity in domestic markets. As a result, issuance of new, USD-denominated debt is softer than expected and we expect 2023 to mark the second year of net negative supply, whereby smaller new bond amounts are issued than the capital being returned to investors from existing debt stock. Net negative supply will provide strong, positive, technical support for the market, especially as domestic Asian savings are put back to work and investors search for higher yields.

We also expect significantly reduced volatility for the asset class compared to that of the past five quarters. This may sound like a brave call, in our view, and stems from multiple factors: the Fed's historic rate hiking cycle is largely complete; US inflation should, at least, approach around 4% this year; China's policy trajectory is clear and decisively pro-growth; the Asian credit universe is much 'cleaner' following historical default rates in high yield (HY); and the negative net supply outlook should lead to more demand than supply of paper. All of these factors could dampen volatility, lowering liquidity risk premia and in turn further tightening spreads, in our view.

We outline the following five key themes in this report:

1. The global macroeconomic backdrop affecting Asian credit
2. The outlook for China
3. Expectations of USD-denominated Asian bond supply
4. The outlook for Asian HY
5. Our top picks

We thank you for taking the time to read this report and look forward to presenting our views. Lastly, I would like to thank the team which has painstakingly put this report together.

Dhiraj Bajaj,
Head of Asia Fixed Income
On behalf of the LOIM Asia Fixed Income team

1. Global macroeconomic backdrop

Need to know

- We expect the US economy to slow down faster than markets anticipate as the historical hiking cycle begins to feed through. We believe that the peak in US rates is firmly behind us
- Strong fundamentals in Asia stand out and we see the region leading global growth in 2023
- Supportive factors include: China's re-opening, growth and investment in India and Indonesia, and room for some Asian central banks to cut rates before the US.

2022 was one of the worst years for fixed income. So what is the likely setup for 2023?

US growth slowdown

A global recession is set to dominate the global macro environment in 2023. The depth of the recession will be key, and depends on how high and for how long the Fed and other global central banks are willing to go to return inflation to the 2% target.

Broadly, sell-side forecasts expect a mild recession in the US between Q1 2023 and Q32023. A few banks (such as Goldman Sachs) are boldly calling for a mere slowdown rather than a recession given the strength of the labour market.

Our base case is that the growth slowdown will come faster than markets expect as the historical hiking cycle begins to feed through into the real economy. There are clear signs of housing market weakness (typically the first indicator to weaken given the rates pass-through) and this will soon spread to the broader economy, in our view. Elsewhere, while the labour market has been resilient, we note that the turn in unemployment figures can occur rather quickly and will likely transpire in Q1 to Q2.

TABLE 1: BANK FORECASTS FOR KEY US INDICATORS IN 2023 AND 2024

	US headline CPI		US core PCE		US real GDP	
	2023E	**2024E**	**2023E**	**2024E**	**2023E**	**2024E**
HSBC (15 Nov)	4.7%	3.5%	–	–	0.4%	0.9%
Standard Chartered Bank (SCB) (8 Dec)	–	–	3.2%	2.1%	-0.2%	1.8%
Morgan Stanley (MS) (5 Dec)	3.3%	2.1%	-	–	0.5%	0.9%
JP Morgan Chase (JPM) (16 Nov)	–	-	2.8%	2.1%	0.4%	1.0%
Barclays (5 Dec)	3.6%	2.1%	3.1%	–	0.3%	0.4%
Bank of America (BOA)(2 Dec)	4.4%	2.5%	–	–	-0.4%	0.9%
Goldman Sachs (GS) (7 Dec)	2.9%	2.4%	–	–	1.3%	1.6%
Citigroup (Citi) (30 Nov)	3.9%	2.4%	–	–	0.7%	1.5%

Sources: Bank forecasts as of specified dates, LOIM. For illustrative purposes only.

Clear US disinflation, but to what level?

The disinflationary trend has been clear with headline and core CPI surprising to the downside for two consecutive months in October and November 2022.

While the Street broadly agrees on a mild recessionary scenario, inflation forecasts for 2023 are more widely dispersed between 3-5%.

- **Arguments for faster disinflation.** Historical tightening by the Fed will have a disproportionate and lagged impact on growth through slowdowns in consumption and housing
- **Arguments for sticky (but lower) inflation.** Supply shocks could continuously deliver shocks to inflation – through a) energy shocks through worsening geopolitics; b) labor shortages – exceptionally tight labor markets will keep wage growth high; c) persistent de-globalization pressures and 'friend-shoring' amidst rising geopolitical tensions

Our expectation is skewed to the dovish side but not overtly so, as we expect CPI to touch ~3.75% by the end of 2023.

Fed terminal rate and US rates outlook

Broadly, it is clear to us that the Fed is beginning to slow down the pace of its rate hikes. However, we still believe that it will move towards a 5-5.25% terminal rate as the Fed is likely to remain resolved to seeing significant disinflation on CPI inflation.

Taken together with our growth and inflation views, we expect US 10-year rates to settle at 3.25%-3.5% by the end of 2023 and expect that the peak in US rates is firmly behind us.

Given the hawkish Fed rhetoric so far, the US Treasury curve has bear flattened significantly with the 2y versus 5y section nearing is post-Volcker maximums. The US 10y versus 30y has traded in a 0-30bps range through most of last year while the 5y versus 10y was in a -20 to 10bps range over the past 6 months.

We expect that the peak of curve inversion should now be pretty much behind us, and curves should now trade in a range-bound manner. A steepening bias could arise in the long end if the Fed pivots sooner than expected. However, the direction of travel for rates is expected to grind tighter over the course of 2023, which makes duration very attractive to buy on the dips.

TABLE 2: BANK FORECASTS (FROM DOVISH TO HAWKISH)

	US headline CPI	US core PCE
HSBC (7 Dec)	4.75%-5.00%	Feb 2023
SCB (8 Dec)	4.50%-4.75%	Q1 2023
MS (7 Dec)	4.50%-4.75%	Feb 2023
JPM (2 Dec)	4.75%-5.00%	Q1 2023
Barclays (5 Dec)	5.00%-5.25%	Q1 2023
BOA (2 Dec)	5.00%-5.25%	Q1 2023
GS (7 Dec)	5.00%-5.25%	May 2023
Citi (7 Dec)	5.25%-5.50%	May 2023

Sources: Bank forecasts as of specified dates, LOIM. For illustrative purposes only.

	US Treasury 10Y		US Treasury 30Y	
	2023E	**2024E**	**2023E**	**2024E**
HSBC	2.5% (7 Dec)	2.0% (7 Dec)	2.3% (7 Nov)	–
SCB (8 Dec)	3.30%	–	–	–
MS (13 Nov)	3.50%	–	3.55%	–
JPM (2 Dec)	3.40%	–	3.75%	–
Barclays (15 Nov)	3.75%	–	3.90%	–
BOA (2 Dec)	3.25%	3.25%	3.40%	3.50%
GS (7 Dec)	4.30%	4.05%	4.40%	4.15%
Citi (7 Dec)	4.35%	4.35%	–	–

Sources: Bank forecasts as of specified dates, LOIM. For illustrative purposes only.

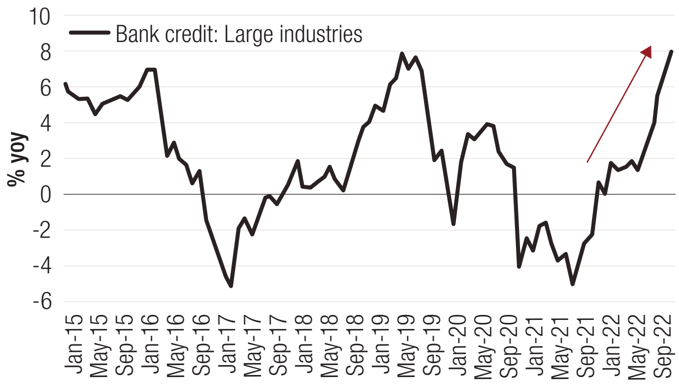
Asia to lead global growth in 2023

Amid a global growth slowdown and equilibrium inflation uncertainties, fundamentals in Asia stand out significantly, driven by:

- **China's re-opening.** There is now greater certainty around the re-opening path for China following the signals in the immediate aftermath of the December Politburo meetings and Central Economic Work Conference (CEWC). Authorities have abandoned key parts of their zero-Covid strategy – they are significantly reducing testing and quarantine requirements and introducing more accountability to local officials for deviations from guidelines. We expect China to be fully re-opened by the end of Q1, setting the country up for a strong cyclical recovery of over ~5% in 2023
- **Asia's inflation having peaked.** Inflation peaked in most countries in Asia in 2022; consequently, terminal rates in domestic economies have re-priced lower by nearly 100bps so far. The recent turn in the US dollar (weaker) and more rapid disinflation have opened roomed for a few Asian central banks such as India, Korea, the Philippines and Indonesia to cut rates ahead of the Fed in 2023 and 2024. Effectively, central banks with more room for easing can better shield their economies from the global growth slowdown (especially for relatively closed economies such as India)
- **Secular growth and investment stories emerging in India and Indonesia.** This should support a strong growth trajectory in both those economies. For India, infrastructure investing has been at decade highs over the past two years. Bank balance sheets are much stronger with higher profitability and better asset quality. Bank credit growth is now at an 8-year high, supporting growth in the system. In 2023, private capex should also start to support growth, and we expect growth to be around 6.5-7% next year as well. Indonesia is also seeing continued foreign direct investment (FDI) inflows as it expands its EV supply chain capabilities, which should continue to support the country's growth resilience in 2023

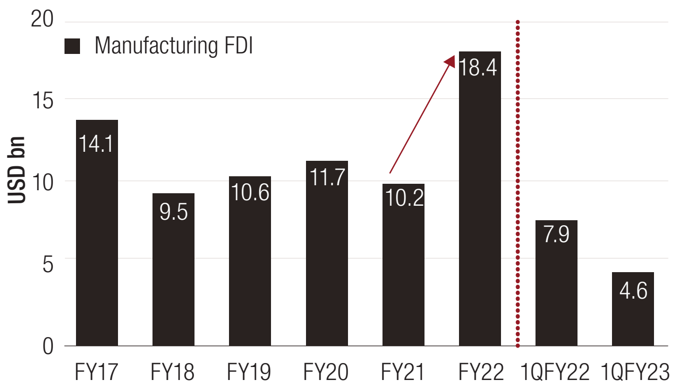
From a fundamental standpoint, all of these factors will make Asia stand out from a global capital allocation perspective. The next sections highlight limited USD debt issuance, ample local liquidity, and attractive valuations from a spread perspective, despite the recent rally. These factors should ensure an extremely constructive 2023 for Asian fixed income.

FIG 1. INDIA: GROWTH IN BANK CREDIT TO LARGE INDUSTRIES AT EIGHT-YEAR HIGH



Source: Reserve Bank of India, CEIC, Citi Research.

FIG 2. INDIA: SHARP RISE IN MANUFACTURING FDI IN FY2022



Source: Reserve Bank of India, CEIC, Citi Research.

2. The outlook for China

Need to know:

- China has significantly pivoted towards a pro-growth stance and is set for a full re-opening that will pave the way for a strong cyclical growth phase
- Although we see a further decrease in national residential property sales in 2023, we see this marking the end of the downturn for the property sector due to supportive natural demand and government policies
- The high-quality companies remaining solvent in the sector should continue to perform well

After two difficult years due to its strict zero-Covid policy as well as significant regulatory crackdowns in the technology and property sectors, China has significantly pivoted towards a pro-growth stance. The 20th National Party Congress (NPC) at the end of October 2022 saw President Xi gain leadership for a third term and further consolidate power and a renewed Politburo line-up. Since then, the authorities have moved swiftly to abolish the zero-Covid strategy, decisively support the property sector and soften the country's stance geopolitically.

China re-opens and re-enters a cyclical growth phase

China is now set for a full re-opening much earlier than the market's original projection of Q2 2023. Key supportive policy measures in place since December 2022 are:

- China's National Health Commission (NHC) has announced that it is officially downgrading the effective risk level for Covid-19 from Level 1 to Level 2 from 8 January and renaming the Covid-19 pneumonia as an infection
- Level 2 for infectious diseases only requires necessary treatment and measures to curb the spread. The focus will shift to the control of severe cases
- Centralised quarantine, close contact tracing and the categorisation of risk areas are being removed. The new rules will also apply to inbound travelers to mainland China

These policy shifts pave the way for a strong cyclical recovery for the Chinese economy once the first major wave of infections passes and herd immunity is built by Q2 2023. We believe the initial surge in infections will likely result in underwhelming Q1 2023 growth data, with recovery starting to gain momentum from the first Golden Week of 1 May 2023.

Our interpretation of the December 2022 CEWC highlights the Chinese government's decisive turn towards a pro-growth stance, particularly given the country missed its 2022 growth target of 5.5% by a large margin. In light of various coordinated positive policy measures, we outline our views in table 3.

TABLE 3: KEY TRENDS IN 2023

Key trends in 2023	Our view
Monetary policy	· Expect accommodative monetary policy with at least two 25 bps RRR cuts
Fiscal policy	· Remain expansionary with fiscal deficit widening modestly · Expect deficit at around 5.5% of GDP (versus 5.2% in 2022 and 3.8% in 2021)
Investment spending and labour	· Investment spending to remain largely state-driven · State-owned enterprises (SOEs) to take greater market share from privately owned enterprises (POEs) across various sectors · Private sector will be slow to increase spending · Fixed asset investment may contribute ~1-1.5bps to growth in 2023 as housing investment is likely to stabilise following the policy shift · Industry employment to be constrained given weak external (global) demand · Services employment will see a more prominent recovery

TABLE 3: KEY TRENDS IN 2023 (Contd.)

Key trends in 2023	Our view
Private consumption	· Re-opening should engineer a solid recovery in consumption supported by excess household savings over the past three years and fueled by pent-up demand. Over the past two years, household new deposits have soared whilst household new homes have reduced (see figure 3) · Expect the consumption boost to be pronounced in H2 2023, with household consumption recovering beyond pre-pandemic level in H1 2024 · Retail sales likely grows by high-single digits y-o-y
Exports	· To be challenged due to expected recessions in UK, EU and US · Expect negative growth in exports during 2023 by at least 5% y-o-y · Recovery expected in 2024
Inflation	· PPI to be negative between 0 to -3% yoy · CPI to be contained within 2 to 2.5% · Do not expect China's re-opening to impact global inflation
GDP	· Overall, expect 2023 GDP growth to be over 5% with the key driver coming from domestic demand as consumption normalises from a very low base · We also believe that the Street is likely to revise upwards its China 2023 GDP growth expectations in coming months
Key national long-term themes	Based on the 20th National Party Congress, China will start pursuing an aggressive agenda across three long-term national economic development themes: i) Industrial modernisation ii) Supply chain resilience iii) National security modernisation As such, we expect manufacturing investment in strategic sectors such as agriculture and food processing, technology equipment including semiconductors, and communications to be significant

Source: LOIM. For illustrative purposes only.

Overall, China's re-opening coupled with its positive policy stance should lead to a meaningful recovery in private consumption, which will aid the economy as it balances the difficult external demand environment. We believe this cyclical recovery will last well into 2024, and by then the advanced global economies will likely exit their technical or shallow recessions. This will allow China's export segment to pick up again, albeit with some permanent demand destruction from geopolitical tensions.

Chinese property

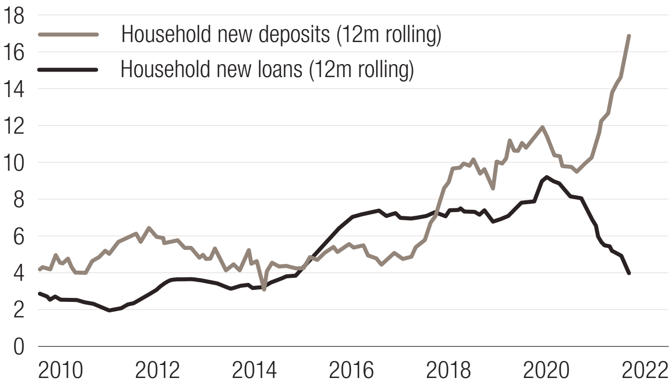
China's national residential sales by value doubled from 2010 to 2016, from RMB 5 trillion to RMB 10 trn.[1] Since 2016, sales have continued to climb to a record RMB 16.3 trn in 2021, spurred by long-term urbanisation trends, the re-development of old housing stock and demand from consumers. Chinese savers typically rely on equity and real estate assets for their savings and capital growth; as such, other domestic markets such as fixed income remain underdeveloped for retail investors.

However, with the significant regulatory crackdown on real estate since 2021, residential sales have collapsed to an estimated RMB 11.8 trn in 2022. We expect residential sales to further consolidate to around RMB 9-10 trn in 2023, reaching levels not seen since 2015-2016. This would mark the first consecutive annual decline in residential sales: previously, sales fell by 19% in 2008 and dropped by 8% in 2014, but all other years had positive sales growth.

We believe the expected further decrease in 2023 sales will stem from:

- Diminished consumer sentiment from national campaigns restricting housing price growth since 2021
- Job and house-price expectations needing time to recover following the positive change in the zero-Covid and macro policy stances

FIG 3. CHINESE EXCESS SAVINGS HAVE INCREASED SIGNIFICANTLY IN TWO YEARS



Source: BofA Global Research, CEIC, NBS, PBOC, WIND.

- A significant reduction in supply by developers following widespread defaults by private-sector developers. Many survivingdevelopers are unable to buy land for development purposes due to the tight credit environment. Therefore, land acquisition and new starts have only been 30% and 50%, respectively, of 2020 levels[2]

Nevertheless, we believe this will mark the end of the downturn for the property sector for two reasons. Firstly, the annual household formation rate for China stands at ~7million, which is the core natural demand for new housing. In addition, there is a need to redevelop ageing properties as well. Taken together, this should imply a run rate of RMB 8 to 10 trn in development per year. Secondly, the government has made a clear policy turn to support the real-estate sector since November 2022. Various key measures are summarised in table 4.

[1] Source: National Bureau of Statistics of China.
[2] Source: Citigroup research, 22 December 2022.

TABLE 4: KEY SUPPORTIVE POLICES TO PROPERTY SECTOR SINCE NOVEMBER 2022

Policy	Authority	Details
Offshore debt repayment support	SOE banks	· Four SOE banks issue new offshore loan to high-quality private developers to enable offshore debt repayment
Real-estate equity financing support	CSRC	· Five supportive measures on real-estate equity financing including the ability to raise funds from the Chinese A-shares market
Strategic cooperation	SOE banks	· A few property developers entered a strategic cooperation agreement with SOE banks to secure credit facilities for their operations
Financing support #2	PBOC	· The PBOC issues RMB 300 billion in a new re-lending facility to assist property names on project delivery
Financing support #1	CBRC, PBOC	· 16 point policy plan to support the stable and heathy development of the real estate market, including funding support, relaxation of bank prudential measures towards the property sector etc
Escrow account support	PBOC, CBRC, MOHURD	· Banks granted letters of guarantee that allowed developers to withdraw a portion of the pre-sale funds held in escrow
Bond financing support	NAFMII, PBOC	· Further bond financing support for the non-SOEs via “The Second Arrow” initiative
Expand RIET program	CSRC	· CSRC will consider expanding the REIT pilot program to include market-orientated, long-term rental and commercial real estate sectors
TBTF support	PBOC	· Development of the TBTF (too big to fail) support scheme for private property developers

Source: Bloomberg, LOIM. CSRC refers to China Securities Regulatory Commission. PBOC refers to the People’s Bank of China. CBRC refers to China Banking Regulatory Commission. MOHURD refers to Ministry of Housing and Urban-Rural Development. NAFMI refers to National Association of financial Market Institutional Investors.

We believe that the 16-point policy directive from the PBOC and China Banking and Insurance Regulatory Commission (CBIRC) was a game changer from a policy perspective, and that the worst is over for the sector. Additionally, the continued supportive tone from a CEWC meeting that ended on 16 December 2022 reinforced the view that more demand measures will be unveiled to support the sector going forward.

As such, we now expect average selling prices (ASP) to remain fairlystable as they are also cushioned by moderate inventory levels (not high) and tighter supply of new homes. However, contracted sales will take a few months to start their recovery process because of the lag effect and the severity of this cycle. We expect a sales recovery in H2 2023 or after the first Golden week of 1 May 2023 at the earliest.

Once the falling sales trend bottoms, it usually takes at least two to three quarters for developer balance sheets and investments to stabilise. Only following this stabilisation can property new starts and acquisitions increase, implying that the growth impulse from the property sector will be muted in 2023. Therefore, we expect a modest positive growth contribution from the real-estate sector to the broader economy only in 2024.

Amongst the property developers, we expect the SOEs and the high-quality POEs (Longfor and Seazen[3]) to continue to thrive and gain market share. Furthermore, we expect Country Garden to fall under the TBTF scheme of the government which could potentially help it gain a path towards long-term sustainability. POEs such as Longfor and Seazen could potentially improve their balance sheets from listing their recurring income property portfolios in a REIT format in the IPO pilot programme.

With improving economic growth in 2023 and a supportive policy backdrop, the high-quality survivors in the sector should continue to perform well, and we remain positioned only in selected high-quality curves across our portfolio.

[3] Any reference to a specific company or security does not constitute a recommendation to buy, sell, hold or directly invest in the company or securities. It should not be assumed that the recommendations made in the future will be profitable or will equal the performance of the securities discussed in this document.

3. Expectations of USD-denominated Asian bond supply

Need to know:

- Overall, gross supply in 2023 should improve relative to 2022. Still, various estimates point towards a negative net supply as maturities and coupon payments more than offset any new issuance
- New issuance is forecast to be more skewed to IG than HY
- Key segments of expected IG issuance include: Korea, Asian and Australian financials, quasi-sovereigns, IG-rated sovereigns and the technology sector.

Asian credit markets have undergone significant change over the last two years, the bulk of which was within the HY segment which we discuss in section four. However, we believe certain factors such as China's slowing long-term growth, the increased reliance on Asian domestic capital markets, and the higher level of US Treasury yields (versus 2021), will continue to play an important role in how the market evolves in 2023 and 2024.

In 2023, we expect following factors to determine the supply outlook:

1. **Less issuance from China in the investment-grade (IG) segment.** With much lower Chinese government bond yields in CNY than US Treasury yields in USD, SOE corporates pay a much lower all-in-yield in CNY than in USD to issue bonds (not adjusted for FX). Furthermore, issuance from SOEs in the USD-bond market is likely to continue to diminish as outbound M&A from China has been highly restricted since the Covid pandemic. Within the IG private sector, technology companies are unlikely to be large issuers either, given ample liquidity in most cases (including net cash positions). Overall, we expect issuance in Chinese IG to be mainly for refinancing purposes.
2. **Minimal issuance expected from Chinese HY.** The large-scale default and stresses in the Chinese real-estate segment (by private-sector credits) illustrate that debt resolution challenges remain elevated when a credit event occurs. Simply put, creditors have little recourse for unsecured, private-sector HY debt. Based on this, we believe the market will be closed for Chinese HY unsecured debt until new, and stronger structures, are available.
3. **Issuers to focus on liability management.** Rising interest rates (and therefore falling bond prices) have provided avenues for good-quality issuers from India, Indonesia, Hong Kong and others to undertake liability management exercises via bond buybacks or tender offers. About 20 corporates in Asia engaged in such exercises in H2 2022. We believe decent cash-flow generation and access to cheaper, domestic-market funding will continue to provide opportunities for good-quality issuers, mainly in the BB ratings segment, to undertake such liability management exercises in 2023, as well. We expect ~USD20-30bn of such action from issuers in 2023.
4. **Price-sensitive issuers from India.** Given significant macroeconomic and idiosyncratic risks faced by investors in Chinese credits, Indian credits are likely to see continued increased allocation from investors. However, at the same time, Indian issuers in offshore bond markets are generally market leaders of their industries and have strong access to domestic markets. This makes USD-denominated bond funding highly expensive for them; hence we believe issuance from India will continue to be muted in both IG and HY segments.
5. **Alternate avenues for refinancing have opened.** New funding avenues have opened in the non-Chinese, Asian space via local bank credit as well as private credit avenues. For example, Vedanta[4] (a B rated Indian commodity producer) tapped nearly USD1-1.5bn in new bank lines in 2022. This was driven and supported by a significant improvement in the financial sector's balance sheets in India. Similarly, Indonesian banks have supported their property developers with bank loans which have been used to support tender offers in the offshore market.

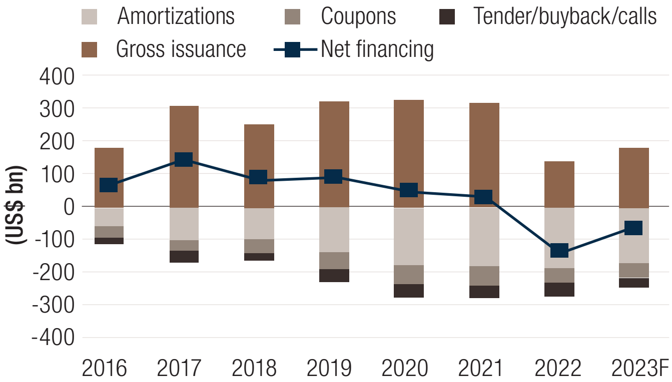
[4] Any reference to a specific company or security does not constitute a recommendation to buy, sell, hold or directly invest in the company or securities. It should not be assumed that the recommendations made in the future will be profitable or will equal the performance of the securities discussed in this document.

Overall, we expect new issuance to be more skewed to IG than HY. Within IG, key segments where issuance is expected include Korea, Asian and Australian financials, quasi-sovereigns, IG-rated sovereigns and the technology sector. Issuance is also likely from Indonesian sovereign and quasi-sovereign entities ahead of the Presidential elections in early 2024.

For HY, the new issuance outlook is extremely limited at current, higher-yield valuations as issuers will remain price (yield) sensitive. Issuance for refinancing will be partially diverted to the local market given the attractive levels in the domestic market and the expectation of earlier easing as disinflation takes hold faster in Asia than the West.

Overall, we believe gross supply in 2023 will improve relative to 2022 as interest-rate volatility tapers, while issuers with tighter onshore liquidity are likely to step up their external, USD-bond issuance. Having said that, various estimates point towards a negative net supply in 2023 (for the second successive year after 2022) as maturities and coupon payments more than offset any new issuance. Liability management exercises will further depress the net supply outlook. This introduces scarcity value in the quality names and we expect the Asian asset class to outperform US credit as a result of attractive fundamentals, higher relative value spread and scarcity.

FIG 4. NEGATIVE NET ISSUANCE EXPECTED IN 2023, BUT HIGHER THAN 2022



Source: JPMorgan as of 9 November 2022.

4. The outlook for Asian HY

Need to know:

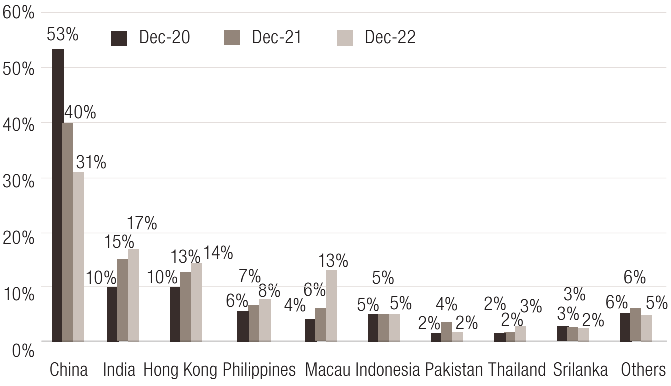
- The Asian HY market has been significantly disrupted, mainly due to defaults in the Chinese property developer sector
- These defaults have led to a migration in Asian HY issuers from China to other regions, and is likely to bring certain beneficial outcomes
- We believe the next phase of growth will be driven by Indian renewables, Indian infrastructure and Macau gaming

The shifting mix of Asian HY

The Asian HY market has been significantly disrupted over the last 2 years, as the universe contracted from ~USD280bn as of end-2020 to only about ~USD150bn as of end-2022. Such a marked reduction was driven predominantly by widespread defaults within the Chinese property developer sector, which in 2020 accounted for ~40% of the entire Asian HY universe. This sector has seen defaults to the tune of USD100bn over the last two years. Additionally, Sri Lanka defaulted on its sovereign bonds in 2022 while Pakistani sovereign bonds have become stressed.

The massive defaults in the Chinese property sector in turn led to a large shift in the regional mix of the Asian HY universe, with China now accounting for only ~30% of the HY universe (versus 53% in 2020), India for 17% (versus 10%) and Macau for 13% (versus 4%). These changes are illustrated in figure 5.

FIG 5. REGIONAL EXPOSURE IN ASIAN HY



Source: JP Morgan, LOIM.

We believe this migration in Asian HY from China to other regions is likely to be long term with certain beneficial outcomes for investors:

1. **More transparency and disclosures.** A move away from Chinese credits is likely to improve the transparency and disclosures within the Asian HY market. This will be driven mainly by increased scrutiny from investors on the underlying credits as well as generally better disclosure practices from companies in India, Indonesia, Hong Kong and Macau with access to English-speaking management and financials.
2. **Emphasis on security, better structure.** Going forward, we believe Chinese HY credits will be unable to tap the primary markets with unsecured bond structures as they have in the past. Investors will no longer trust the Chinese corporates' willingness to service their debt without receiving adequate collateral and covenant protection in bond documentation. This,in turn, will enhance the overall credit quality of the instruments over time.

   Additionally, we believe this trend will likely be adopted within the non-Chinese HY universe as well. A case in point is the recent refinancing deal completed by PT Jababeka,[5] an Indonesian industrial land developer. Jababeka recently completed refinancing of its USD300m 2023 bonds by issuing USD185m of secured bonds and the rest by secured bank loans. In this instance, the security under the bond documentation is comprised of certain land parcels owned by the company, and bondholders will have the right to acquire these properties should the company default on its debt obligations in future.
3. **A more diversified mix.** The substantially reduced weight of Chinese credits in Asian HY has materially improved the diversity of Asia HY markets. This, in turn, will reduce single sector or country risks going forward. Higher allocations to countries such as India will also improve underlying credit strength as most of the corporates in Indian HY are industry leaders with strong equity and debt market access in domestic capital markets.

[5] Any reference to a specific company or security does not constitute a recommendation to buy, sell, hold or directly invest in the company or securities. It should not be assumed that the recommendations made in the future will be profitable or will equal the performance of the securities discussed in this document.

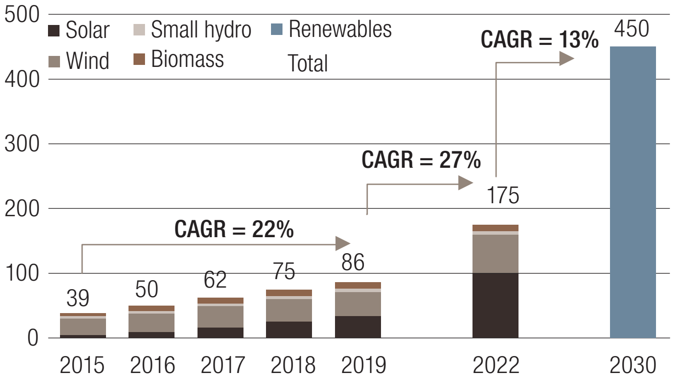
New avenues of growth in the Asian HY market

We believe the next phase of growth for Asian HY markets will bedriven by Indian renewables, Indian infrastructure and Macau gaming.

Indian renewables

- The renewable energy market in India is one of the fastest growing global markets with a CAGR of ~25% over the past 6-7 years[6] because of large-capacity additions, strong government support and a favorable policy regime. In time, we anticipate this will be one of the largest solar and wind markets globally
- Solar power capacity has increased by more than nine times in the last seven years from 6.7 GW to 62 GW as of December 2022.[7] The government of India further targets increasing the total Renewable Energy Capacity to 450GW by 2030 from the current 175 GW
- India is committed to the global climate change initiative and has ratified the Paris Agreement on Climate Change in October 2016. As part of the Nationally Determined Contributions (NDC), India has committed to reducing the emissions intensity of its GDP by 45% by 2030 compared to 2005 levels
- One of the main pillars to meet these targets is to achieve a 50%share of renewable energy-based power capacity by 2030 (from ~40% currently)

FIG 6. INDIAN RENEWABLE ENERGY PRODUCTION (IN GIGAWATTS)



Source: BloombergNEF as of 31 December 2022.

- India's renewable energy sector has seen investments of close to USD70bn over the last seven years and is expected to need another USD500bn over the next decade
- We believe the majority of this investment will require debt capital, and a significant portion will be financed by the USD-bond markets

Indian infrastructure

- Besides renewables, the Indian infrastructure sector - including airports, toll roads and power transmission – has grown significantly over last few years as shown in table 5
- The Indian government has outlined plans for a ~ USD1.3 trn push towards infrastructure sector capex over the next 4-5 years with a focus on sectors such as transport (including railways and roads), water treatment and supply, housing, and airports
- We believe government spending, together with the need for private-sector financing will lead to the Indian infrastructure sector becoming a significant issuer in Asian USD-bond markets over time

Several such issuers have already emerged in the USD-bond market over the last few years as shown in table 5.

Macau hospitality and gaming

Macau gaming companies currently have a large array of bonds outstanding across six issuers. We believe this sector will be another important issuer in the market over the next few years driven by following factors:

- **To improve liquidity profile:** While China's re-opening measures will help improve the cash flows of gaming companies in Macau, we believe some issuers would tap the USD-bond markets to improve their liquidity profile
- **To refinance bank debt:** Most of the gaming companies have utilised their bank facilities like Revolving Credit Facilities (RCFs) to help raise liquidity during the last few years amid low visitations. We believe some of these RCFs could be refinanced in the bond market
- **To fund any capex:** While most operators do not have major expansion plans, they could invest more into non-gaming businesses going forward, which could be funded by issuance from the USD-bond market

[6] Source: Bloomberg, December 2022.
[7] Source: Bloomberg.

TABLE 5: ASIAN ISSUERS RECENTLY ACTIVE IN USD-DENOMINATED BOND MARKETS

Issuer	Credit ratings	Key shareholders (%)	Bonds outstanding (USD m)	Comments
IRB Infrastructure[1]	Ba2 /BB	Promoter Family (34%), Ferrovial (BBB, 25%), GIC (20%)	300	· India's leading toll-road operator benefits from improving traffic growth and collections · The company has recently received ~USD710m of investment from GIC (the sovereign wealth fund of Singapore) and Ferrovial (a leading Spanish global infrastructure investor), which we believe will provide a significant catalyst to deleverage the credit profile in the short to medium term
JSW Infrastructure	Ba2/BB+	Sajjan Jindal & Family (100%)	400	· JSW Infrastructure is the second largest private port operator in India with an annual capacity of about 180 million tonnes
GMR Hyderabad International Airport Ltd (GHIAL)	Ba2/BB- /BB+	GMR Airport (63%), Airports Authority of India (13%), Govt. of Telangana (13%), Malaysia Airports (13%)	810	· GHIAL operates the 12m passenger capacity Hyderabad International Airport in India · The bonds are secured by a direct charge on the airport assets
Delhi International Airport Ltd (DIAL)	B1/B- /BB-	GMR Airport (54%), Airports Authority of India (26%), Fraport AG (10%), Eraman Malaysia (10%)	1,650	· DIAL operates the Delhi International Airport with a capacity of about 66 million passengers annually · DIAL bonds are secured by a direct charge on the airport assets
Adani Transmission (ATL) & Adani Electricity Mumbai (AEML)	Baa3/BBB- /BBB- AEML:	ATL: Adani Group (75%) AEML: ATL (75%), QIA (25%)	ATL: 1,000; AEML: 1,300	· ATL is India's largest private sector operator of transmissions lines with a capacity of 18,000 ckm · AEML distributes power to more than 3 million consumers in Mumbai with regulated returns on its capex · Bonds issued by ATL and AEML are secured by a direct charge on its assets

Source: LOIM as of 31 Dec 2022. For illustrative purposes. Any reference to a specific company or security does not constitute a recommendation to buy, sell, hold or directly invest in the company or securities. It should not be assumed that the recommendations made in the future will be profitable or will equal the performance of the securities discussed in this document.

5. Our top picks

Need to know:

- We share our top picks, split into alpha and beta names
- Alpha top picks refer to names that are wide and expected to see spread compression, and have clear credit improvement drivers
- Beta top picks are expected to witness spread compression as well, but do not have specific or outsized idiosyncratic drivers for fundamental credit improvement.

The Asian credit markets bottomed out in early November 2022, due to clearer US disinflationary trends and China ending its zero-Covid stance and returning to a pro-growth trajectory. Since then, spreads across both IG and HY have made significant headway from very wide and even dislocated levels, but still remain wide in comparison to (a) historic mean levels (b) US markets and (c) default probability. We continue to be in a spread compression environment backed by both improving credit fundamentals for many sectors in Asia amid improving growth with China's economic re-opening, as well as supportive asset class technicals (inflows, lack of primary supply, etc).

Below we share some of our top picks by segment. We have split them into alpha top picks and beta top picks. Alpha top picks essentially represent names which are wide and expected to see spread compression but have clear credit improvement drivers. Beta top picks essentially are expected to witness spread compression as well, but do not have specific or outsized idiosyncratic drivers for fundamental credit improvement.

TABLE 6: OUR ALPHA TOP PICKS

Segment	Details
Asian hospitality and gaming	· Macau to fully allow all visitors from January 2023 after 3 years of significant restrictions. Expect utilisation to go from current 15-20% to over 60% this year (breakeven ~40%) and to return to 2019 levels in 2024 · Positive on all Macau names but prefer names with greater mass market exposure than VIP exposure · Expect Sands China to return to full IG credit metrics in 2024 · Genting Complex to continue strong revenue recovery in Malaysia, Singapore and US
HK real-estate and consumer plays	· Full HK re-opening will stabilise consumer, business and real-estate sentiment · Positive on residential property cycle, followed by pick up in retail and logistics property. Office segment to witness slowest recovery · New World Development and Lifestyle represent strong recovery potential as HK re-opens with their strong mall and consumer-focused portfolio
Chinese BBB tech	· Chinese BBB large cap tech companies continue to trade at 300-350 bps despite being net cash or lowly levered · Expect strong improvement in consumer sentiment and digital advert spending by businesses in 2023 · Meituan, Xiaomi and Weibo likely to be beneficiaries
Logistics and mall owners	· Expect strong recovery in Chinese shopping malls and logistic property assets · Dalian Wanda (China) likely to benefit from a strong rebound in domestic malls · Longfor (China) also to benefit partially from its investment property assets · GLP (China focused) likely to benefit from strong demand of logistic assets as ecommerce and manufacturing supply chains resume growth · Scentre (Australia) to continue to see improvement in mall portfolio and upward rental reversion

TABLE 6: OUR ALPHA TOP PICKS (contd.)

Segment	Details
Indonesian HY	· Clear refinancing pathway of USD bonds by domestic bank debt, at least partially. Lowering of maturity wall in 2023 and more distributed maturity profile · Improving revenue generation and cash flow · Lippo Group a likely key beneficiary due to its largely unsecured debt capital structure and ability to introduce secured debt
Legacy Chinese real estate	· Strong and clear policy turn by the Chinese authorities supports credit availability to key surviving real-estate developers · Country Garden shaping up to be key beneficiary of policy support · Sino-Ocean benefiting from asset disposals and China Life support

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TABLE 7: OUR BETA TOP PICKS

Segment	Details
Indonesian long-dated quasi-sovereigns	· Attractive spread versus Indonesian sovereign · Compression ability as global emerging market (EM) flows turn positive in Q1 2023 · Top picks are Freeport Indonesia, Inalum and Pertamina
Thai long-dated quasi-sovereigns	· Supportive fundamentals with continued recovery across Thai refining and chemical complexes · Spreads attractive for strong quasi-sovereign PTT Global Chemical and Thai Oil refinery
Australian bank Tier II	· Significant issuance of Tier II bank debt resulting from regulator APRA's revised capital requirement · Issuance expected to slow down going forward · Spreads of both callable and non-callable 10-year paper look attractive at 250-350 bps for strong AA-rated mega banks[8]
Asian bank capital	· TII and AT1 bonds of strong HK, Korean, Thai and Indian banks provide stable yield and beta compression opportunities · Strong and stable balance sheets, credit metrics · High probability of call being exercised for bank AT1, especially Thai banks
Indian infrastructure and renewables (BB)	· Stable credit metrics but trade with spread pick-up to US BBs · Defensive and moderate duration, and with attractive total return upside with low volatility

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Given the strong environment for spread compression and for credit improvement in Asia, we see little value in tight spread IG which outperformed in 2022 such as Chinese SOE corporates and financials, or IG sovereigns such as Korea, Indonesia and the Philippines.

We continue to favour the strong fundamentals of GCC (Co-operation Council for the Arab States of the Gulf), Japan and the Philippines IG credit, and continue to hold them as 'beta fillers' and diversifiers in our portfolios as we focus more on our top alpha and beta picks.

[8] For illustrative purposes. Yields are subject to change and can vary over time.

IMPORTANT INFORMATION

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