Active is: Finding new sources of income

Four compelling reasons to consider Asian bonds

by David Tan | 10/06/2019

Summary

Higher yield potential and added diversification aren't the only qualities attracting fixed-income investors to Asia. The region's bond markets are large and growing, and reform-minded governments are providing the necessary policy support to maintain growth.

Key takeaways

- Economic growth in Asia is supported by China's stabilising demand and the efforts of Asian central banks
- Asian bonds offer attractive yield potential, particularly compared with the typically low to negative yields of bonds from more developed nations
- Asian credit fundamentals remain broadly stable: companies generally have lower debt levels and are maintaining adequate cash levels on their balance sheets
- Our medium-term outlook for China's bond market remains positive thanks to policymakers' efforts to balance growth and stability, and the trend towards more open, integrated markets

With many Asian countries focused on reforming their economies and political systems, the region offers strong potential for economic growth and investment – but without the ultra-low or even negative interest rates in effect across much of the developed world. This presents notable opportunities for investors on the hunt for income.

Four key reasons why investors should consider Asian bonds

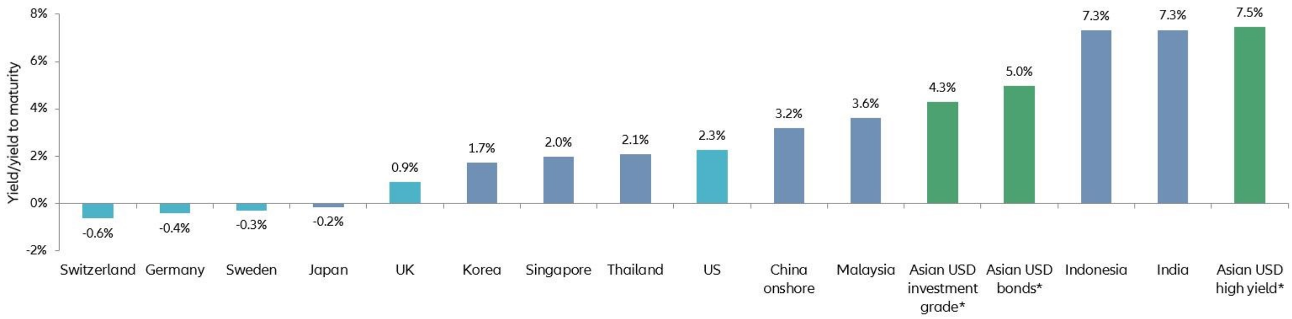
1. Asian bonds offer valuable yield potential

A steady income stream can provide investors with a range of benefits, but sufficient income isn't easy to find in many parts of the developed world. The total amount of bonds with negative yields is close to USD 10 trillion, according to Bloomberg. In contrast, Asian fixed-income securities – particularly US dollar-denominated bonds – can offer attractive yield potential.

- Asian USD-denominated investment-grade bonds remain fairly valued, with a yield-to-maturity of 4.3% as at 30 April. (Yield-to-maturity represents the potential annual return if these bonds were purchased today and held to maturity.)
- Asian USD-denominated high-yield bonds offered a yield-to-maturity of 7.5% as at 30 April – above their historical average over the last 10 years.

High yields for Asian investment-grade and high-yield bonds

5-year yields of government bonds and yield-to-maturity of Asian USD-denominated bonds (in local-currency terms)



Source: Bloomberg, J.P. Morgan, Allianz Global Investors. Data as at 30 April 2019. Based on J.P. Morgan Asia Credit Index. Asterisk denotes yield to maturity; all others are 5-year yields.

2. Asian fixed-income markets are large – and growing

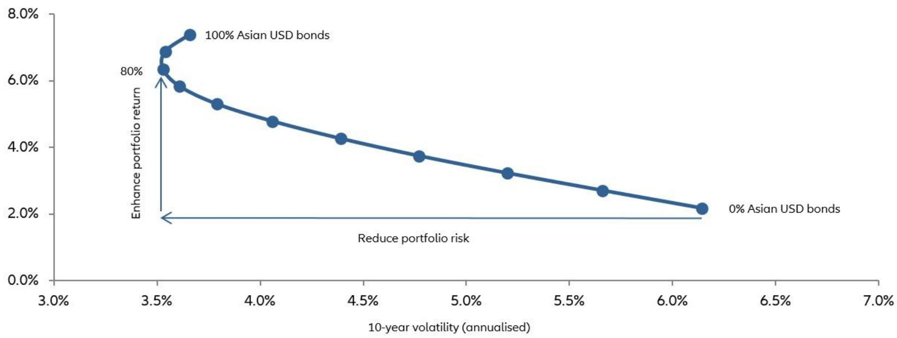
Asian debt markets have grown bigger and deeper in recent years, totalling around USD 1 trillion in US dollar-denominated debt and around USD 13 trillion denominated in local currencies. The development of these markets is fuelled by the rapid growth of Asian economies on the global stage, particularly China, as well as by Asian investors putting their money to work in Asia.

3. Asian bonds can help diversify global bond portfolios

Investors who aren't already invested in Asian bonds should note their ability to help diversify global bond portfolios. As the chart below shows, Asian USD-denominated bonds have the potential not only to help enhance returns, but to reduce portfolio risk.

Adding Asian bonds may boost yields while reducing risk

Effects of adding Asian USD-denominated bonds to a portfolio of global government bonds (10-year average return in USD per year)



Source: Bloomberg, Allianz Global Investors. Data as at 31 March 2019, based on weekly returns in USD terms. Asian USD-denominated bonds based on J.P. Morgan Asia Credit Index. Global government bonds based on FTSE World Government Bond Index (WGBI), in USD. The FTSE WGBI comprises fixed-rate, local-currency, investment-grade sovereign bonds of 20 countries.

4. Asia has a bright economic future

We have a positive overall outlook for Asia, which further supports our constructive view of Asian bonds. Growth in the region will likely remain underpinned by supportive policy measures where they are needed. This is most evident in China, where policymakers have been pumping more liquidity into the economy and making it easier to get loans. We think China's policymakers will continue to fine-tune their policy stance to counteract potential external growth risks.

With the global growth trajectory likely to remain muted as trade tensions linger, we believe central banks globally will likely remain supportive as well, maintaining a neutral or low-interest-rate environment to help ward off a further slowdown in global growth activity. This should continue to be positive for Asian fixed income.

Investment implications

We expect markets to continue being volatile as they react to macroeconomic developments, but these episodes actually present opportunities for investors to find attractive valuations for fixed-income investments in which they have conviction. To help manage risks, investors should continue to pursue active investment approaches, monitoring changes in oil prices and inflation expectations – which could influence central banks' policy trajectories – while keeping an eye on global geopolitical developments.

But as long as central banks globally keep interest rates low, we expect to see investors gravitate towards "riskier", higher-yielding asset classes over "safer", lower-yielding investments. This is likely to contribute to a positive overall environment for fixed-income investments in Asia. Here are our top ideas for investors to consider:

- Amid the larger Asian bond universe, look for attractively priced issues – particularly US dollar-denominated bonds – to enhance yield potential.
- Asian high-yield bonds may offer better value compared with the investment-grade segment; we expect interest accrual to continue to drive the performance of Asian high-yield bonds in 2019. Credit fundamentals remain broadly stable, and we don't expect widespread systemic risk to affect this sector.
- Chinese bonds are an interesting asset class. They are being included in widely used global indices, which is likely to result in large investment inflows that boost China's onshore bond market. In addition, China's bond market is already the third-largest in the world, and policymakers have announced tax exemptions for foreign investors that may make it even more attractive to own onshore renminbi bonds.

Further reading

This is part of an ongoing series on the importance of income, featuring insights from our strategists, economists, CIOs and portfolio managers. Explore the links below for more:

- → TO FIGHT INFLATION, HUNT FOR INCOME
- → AMID LOW RETURNS FROM 'SAFE' BONDS, LOOK TO ASIAN RISK ASSETS
- → LOW RATES ARE BACK, BUT THESE BONDS OFFER OPPORTUNITIES

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Before joining AllianzGI, David was an executive director, fixed income Asia Pacific and Middle East at AXA Investment Managers United Kingdom. Before that, he was CIO at Kyobo AXA Investment Managers in Korea, where he was responsible for fixed income, equities, quantitative investments and asset allocation.

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The opportunities within disruption

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Summary

The world is changing rapidly as disruption impacts every sector. We believe an active management approach is essential to make the most of the opportunities, while managing the threats inherent in this technological and social shift.