2024 Mid-Year Investment Outlook – Asia Fixed Income: High Yield

May 2024

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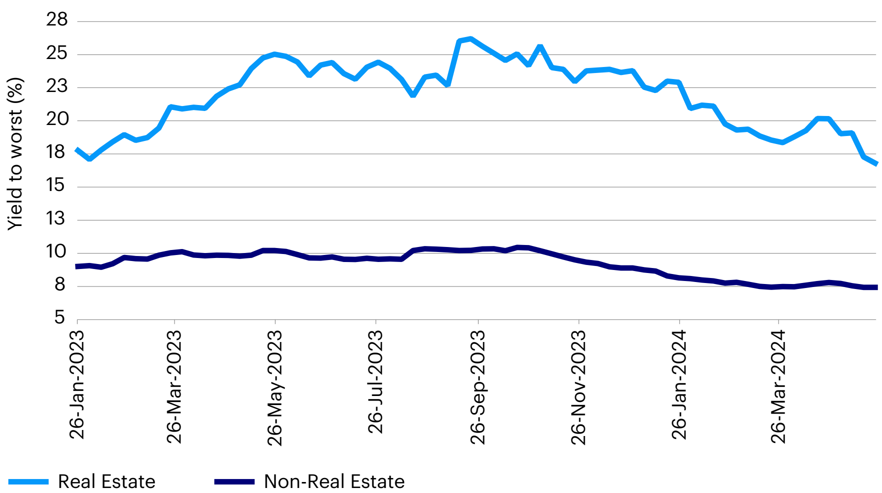
Asia high yield (HY) bonds started the year off strong and JPMorgan Asia Credit Index (JACI) HY total return reached 9.2% as of May 2024 (Figure 1). Asia HY has significantly outperformed both Europe and US HY bonds year-to-date, the latter two asset classes delivering negative total returns.

Asia HY total return has predominantly been driven by excess returns in the real estate sector, contributing to around one-third of overall return at the index level. However, the yield to worst of real estate names has come down significantly from the high of over 25% in September 2023 to below 17% as of May 2024. For non-real estate sectors within the HY index, year-to-date spread tightening has led to a decline in yield to around 7.5%, which is lower than that of the US HY index.

Figure 1 – Yield to worst change of non-real estate HY vs real estate HY



Source: Bloomberg, data as of 24th May 2024.

We home in on three key themes that we believe are worth keeping an eye on for investors looking at Asia HY bonds in H2.

- Focus on income and preference for short-dated high yield paper;
- Resurgence in HY supply, but credit selection is key;
- Relative value between Asia HY and Asia IG.

Focus on income and preference for short dated high yield paper
As highlighted in our 2024 Investment Outlook, security selection is critical so investors can identify resilient business models with strong fundamentals that can operate in a higher interest rate environment. Considering this, we are optimistic on HY-rated companies which generate free cash flow over and above their short-term debt maturities, and we believe that short-dated HY paper from these issuers can provide attractive risk-adjusted returns for income-focused investors.

Within the short-dated HY bond space, we see opportunities to invest in Asian national champion banks across the capital structure that are well capitalized and provisioned, as well as in the Macau gaming sector where issuers remain in deleveraging mode as earnings recovery continues apace. We also see good opportunities in Indian renewables after the recent spread correction.

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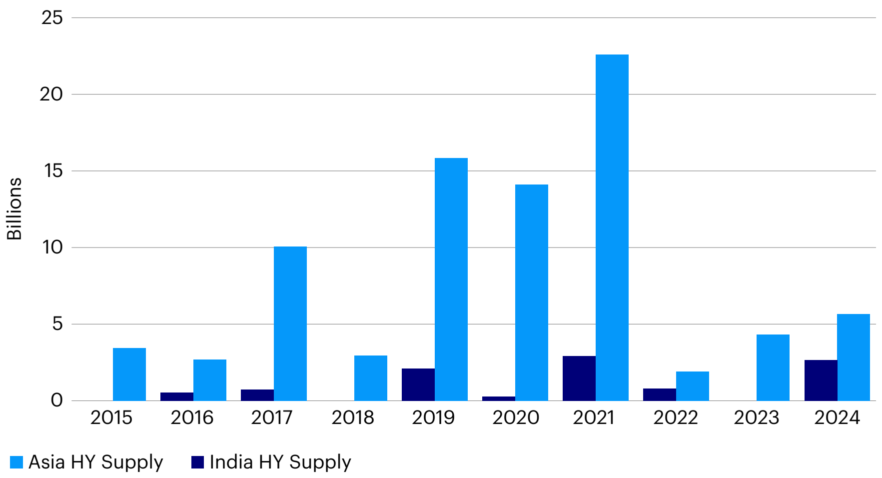
Resurgence in HY supply, but credit selection is key
As discussed in our Q2 outlook, the tightening of spreads has lowered all-in financing costs for Asia HY corporates. This is likely to spur more Asia HY issuance and offer new investing opportunities. Total Asia HY supply amounted to US $5.6 billion in 2024, nearly equivalent to the supply of 2022 and 2023 issuances combined (Figure 2). The mix of issuers has changed with Indian issuers accounting for nearly half of total supply in 2024.

While Asia HY spread levels have compressed on a relative basis, this has still been offset by high US treasury yields. This year's vintage of HY supply has amongst the highest coupons, averaging 8%. This plays to the theme of name selection to capture income with a robust credit underwriting process.

Figure 2- While Asia HY supply is on the rebound, it is still not near 2021 levels

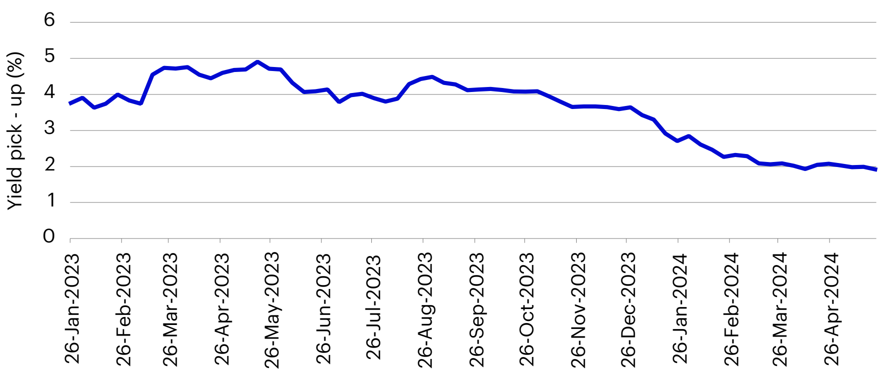


Source: Bloomberg, Invesco, data as of 24th May 2024.
Note: Only includes non-defaulted names and based on country of domicile.

Relative value between Asia HY and Asia IG
When looking at the relative value between Asia HY and Asia IG (ex-real estate issuers), we note that yield pick-up in HY has continued to drop from 3.5% at the end of 2023 to just 1.9% as of May 2024. As such, the additional yield pick-up to be had in the HY asset class has become relatively less attractive. That said, Asia HY bonds still offer differentiated sector and country exposures that are not available within Asia IG bonds, and the higher yields and lower duration are supportive in periods of interest rate volatility. The new vintage of HY bonds with higher coupons could offer attractive opportunities in terms of income and risk adjusted carry in the current period of interest rate volatility.

From our perspective, having the ability to have a flexible allocation between IG and HY will be a key source of alpha, allowing the manager to select the best risk-adjusted credit ideas across all ratings categories and sectors.

Figure 3 - Asia HY (ex-real estate) yield pick-up versus Asia IG (ex-real estate)



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Investment risks
The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

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