2025 Investment Outlook – Asia Fixed Income: High Yield

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In 2024, the JP Morgan Asia Credit Non-Investment Grade Index continued to build on its positive total return with the index up by 16.1% year-to-date (as of November 8), outperforming both US and European high yield (HY) indexes. [1] The high total return has been driven by spread tightening across various sectors aside from just the real estate sector, as evidenced in Table 1.

Table 1 – JP Morgan Asia Credit Non-Investment Grade Index return attribution by sector

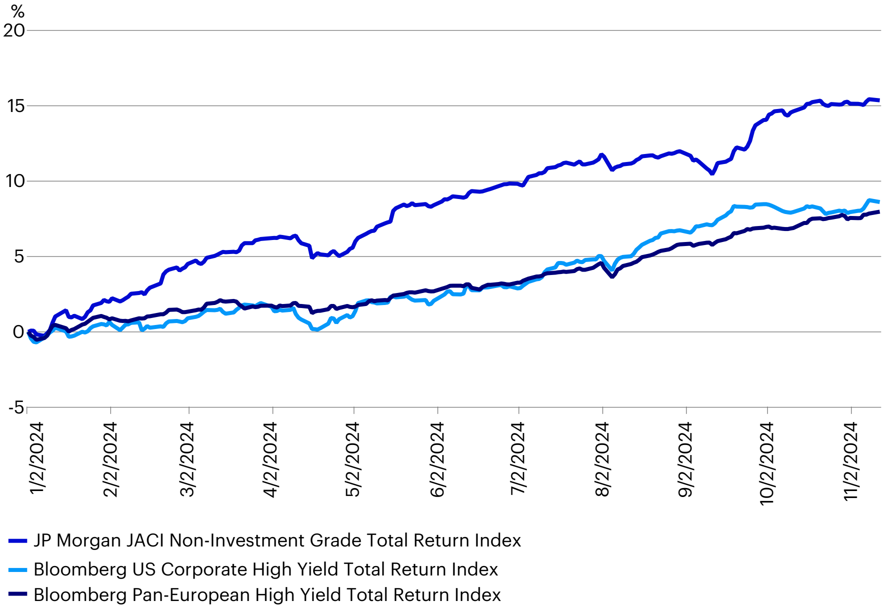
	Market Value Weight	**Contribution**	
Description	Portfolio	Total Return (bp)	Excess (bp)
JPM Sector Breakdown	100.00%	1,615.43	1,271.95
Real Estate	15.38%	483.65	427.71
Financial	27.32%	257.85	161.83
Government Related	9.45%	239.80	205.65
Utility	11.03%	152.10	118.64
Consumer Products	12.28%	129.23	87.27
Metals and Mining	4.66%	119.91	104.37
Other Securities	4.73%	87.67	73.45
Infrastructure	4.03%	32.63	19.66
Telecommunications	3.35%	31.92	21.65
Energy	2.22%	28.09	20.10
Transportation	2.68%	27.59	19.28
Industrials	2.87%	24.72	12.34

Source: JP Morgan, Aladdin, data as of 8 November 2024.
Past performance is no guarantee of future results. An investment cannot be made directly in an index.

1. Source: Bloomberg, data as of 8 November 2024.

The relatively benign Asia HY default rate of 4.2% year-to-date (as of 23 October), the lowest since 2020, has also proved to be supportive of total returns in the asset class. [2] Within the 4.2% default rate, we have observed that most defaults occurred in the real estate sector. Outside of this there has been only one issuer that has defaulted thus far this year. This occurrence was classified as a default due to a distressed exchange rather than because of a missing coupon payment, principal repayment, or restructuring.

Figure 1 – Asia HY performance versus US and European HY in 2024



Source: Bloomberg, data as of 8 November 2024.
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Heading into 2025, we highlight the following topics that may be of interest to investors looking at the asset class.

Dissecting the Asia HY asset class
Asia high yield is a short duration asset class at just 2.4 years (as of 8 November) with lower rate sensitivity as compared to Asia investment grade (IG). Given the backdrop of limited high yield issuance and the real estate sector shrinking in weight, the market value of the JP Morgan Asia Credit Non-Investment Grade Index declined from US $235 billion at the end of 2021 to $138 billion at the end of October 2024. [3]

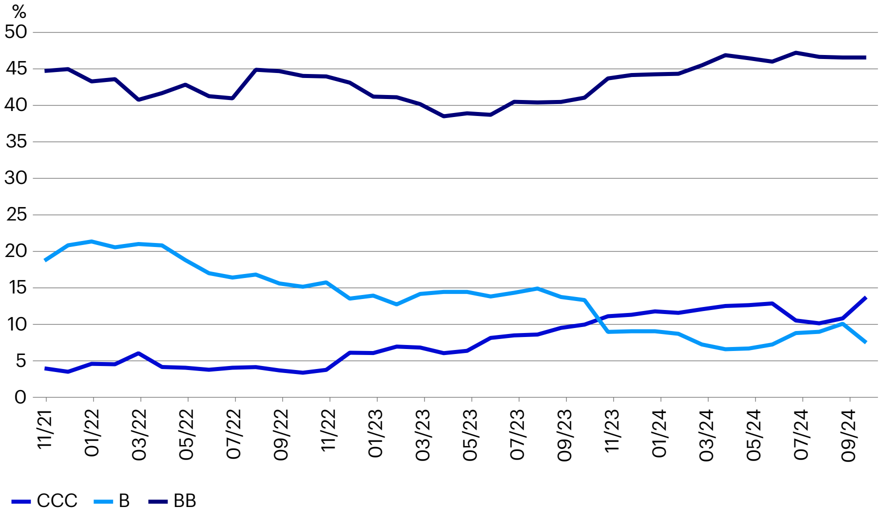
BB-rated bonds have consistently remained the largest component of the index over the last few years at around 45% weighting (Figure 2). On the other hand, we have seen a ratings migration from single B into the CCC category since late 2021. In our Asia Q4 HY outlook, we also noted the increasing weight of India within the Asia HY asset class as a positive dynamic.

We continue to favor BB-rated issuers which have robust credit fundamentals and consistent cash generation through the credit cycle to pay down their debt. There are also potential rising angels that could get upgraded to IG in the next 12 to 18 months. We remain selective within the single B space and are paying particular attention to their refinancing plans while also leveraging our credit research expertise to engage continuously with the companies on their short-term operating trends.

2. Ibid
3. Source: JPMorgan, Aladdin, data as of 8 November 2024.

From a sector perspective, we continue to favor Macau gaming, renewables, subordinated financials, infrastructure and consumer companies. This shows the value of diversification within this asset class to obtain multi-sector exposure to fast-growing economies in Asia. We think that it is important to have the flexibility to invest across BB and BBB-rated names as we can harvest credit premium and a broader spectrum of opportunities by investing in names in these rating categories.

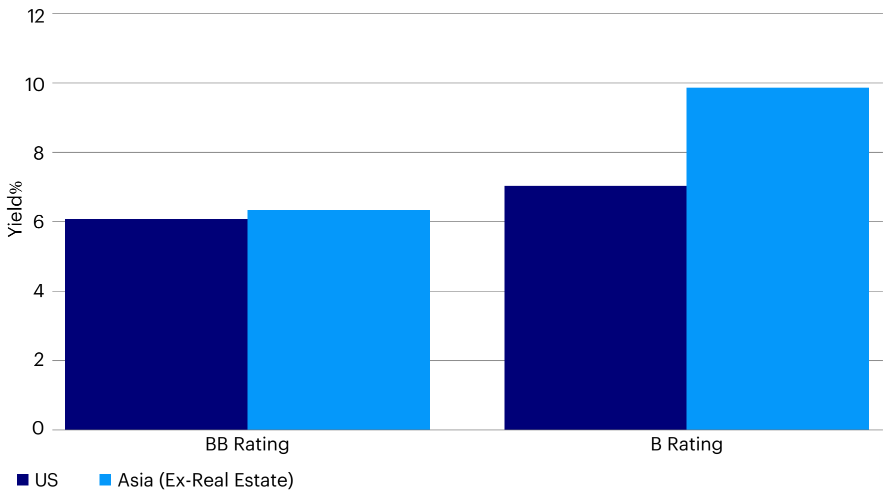
Figure 2 - Ratings evolution within Asian high yield



Source: JP Morgan, Aladdin, data as of 8 November 2024.

How do Asia HY market valuations compare to global HY markets?
In our Asia HY Q4 outlook, we argued that Asia HY markets offer attractive valuations versus US HY with a yield pick-up opportunity. With the recent rally in Asia credit spreads, we have seen that Asia (ex-real estate) BB names have compressed to almost flat to US BBs (Figure 3). The valuation opportunity where Asia HY remains cheap relative to global HY is largely within the single B space. We would highlight Mongolia, commodity names, and double-digit coupon bonds in performing credits as investment opportunities that could provide both income and capital appreciation potential.

Figure 3 – Asia HY versus US HY



Source: Bloomberg, Aladdin, data as of 8 November 2024.
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Reviewing capital structure for investment opportunities within Asia HY
There has been an increase in asset-backed securities issuance and convertible bond issuance by Asia HY bond issuers in recent years. We see this as a positive development as it provides investors with the opportunity to generate more alpha by selecting the part of the capital structure that has the highest risk-reward profile. This is where we think active investing will be a key differentiator, as both asset-backed securities (ABS) and convertible bonds are not part of the JP Morgan Asia Credit Non-Investment Grade Index, but they leverage on the same fundamental credit view of the issuer.

For instance, we see opportunities for portfolio upgrading by switching from a vanilla HY-rated corporate bond into an IG-rated ABS bond of the same issuer, which has the benefit of a social use of proceeds. Similarly, given the strong spread rally within the asset class, we also favour opportunities to switch into convertible bonds where the downside is limited to the bond floor. In these examples, we look for bond issuers with a high free cash flow to equity, where deleveraging is accretive to equity value and will increase the value of the embedded equity call. This also serves as a good hedge versus more equity friendly behaviour by issuers, with the alignment of interest of a convertible bond holder more akin to equity but with a bond floor.

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