Market Commentary

The upside surprise on inflation and job market prints anchored the trend of higher US treasury (UST) yields, with the 10-year UST climbing to this year's high at 4.7% in late April before settling at about 4.3% currently.

Market expectations for a Fed pivot to materialise this year remain unchanged, though the timeline is being pushed back to September onwards. The last mile of disinflation could be bumpy, given the ongoing resilience in both US growth and its labor market. Markets now price in for a 50bp rate cut in 2024 versus 28bps in late April. Ultimately, we think the Fed's view is predicated on inflation being durable enough to reach the 2% target, and obstacles are unfolding that may imply a more gradual rate cut path – not an aggressive one. For instance, the US fiscal position and the geopolitical tension-led energy inflation are developing events.

The resilient macro backdrop and an overall constructive tone on Asian credits support the spread tightening trend this year. Credit spreads for Asia high yield (Asia HY) bonds compressed by an average of 140bps (source: JACI) in 2Q24, with a continued risk-on sentiment (versus -122bps in 1Q24). Asia investment grade (Asia IG) bonds showed a similar trend, with spreads tightening by 18bps in the same period (versus -22bps in 1Q24).

For the month of June, spreads widened out (Asia HY +22bps, Asia IG +14bps) modestly on higher bond supply, predominantly in Asia IG. We expect Asian credit spreads to remain well-anchored, given supportive technicals in terms of net negative issuance, stabilised default trend, and improved sector diversification outside of China. Returns will be driven by decent carry in the Asia HY space, while a Fed pivot poses a modest upside for Asia IG bonds.

Asian credit performance compared favourably with its US peers. Total return for US IG (source: JPM) slightly recovered to +0.06% in 2Q24 (+0.12% in 1H24) after the pullback on UST yields, while US HY noted +1.25% (+3.33% in 1H24). Asia IG and HY generated +1.02% and +3.46% in 2Q24, respectively.

Portfolio Commentary

In the second quarter, the Fund performed well thanks to its relatively higher allocations to China and Indonesia HY credits, which rallied more. Some alpha opportunities also played out in China, Indonesia, and India HY credits, on top of the overall yield compression in the Asia HY space. China's more supportive policy measures, Asia's resilient growth and benign inflation outlook, and risk-on sentiment are key drivers behind the fall in yield for the Asia credit market YTD.

Quarterly performance drivers

Key credit contributors to performance over the Quarter included:

- **China Vanke** bonds rebounded significantly. The risk-reward is attractive, given our entry at a distressed price level (mid $40s) and Vanke's credit profile benefitting from both a macro perspective (supportive policy plus negative social impact if Vanke fails) as well as potential asset disposal and ongoing bank financing.
- **GLP** a data centre operator in China, benefits from the deleveraging story and ongoing fundraising exercises. There were news articles on the potential sale of GLP SP shares (held by China Vanke) to certain SOEs and GLP SP to sell assets to a global asset manager.
- **New World Development** a Hong Kong-based property developer, bonds rebounded, thanks to the general risk-on environment. The company has also maintained its strategy of asset disposal to deleverage.
- **Alam Sutera** an Indonesian property developer has been one of the top five holdings. The company successfully obtained an onshore bank loan to fully repay its USD bond in full at $100.781. Our average cost is high $80's.

- **Vedanta** an India-based commodity player, bonds responded positively after the company successfully completed a liability management exercise. The company has benefitted from the commodity boom, particularly in oil (+17% YTD), zinc (+12% YTD), and aluminium (+6% YTD), which accounted for c70% of its revenue. It is also seeking to reduce debt via a potential demerger to unlock value at operating companies and asset disposal, including a copper asset in Africa. Our average cost is in the high $50s.

Key credit detractors to performance over the Quarter included:

- **Road King**, a Chinese real estate developer, launched a debt exchange in June to extend the maturity of its five USD bonds for 3.5 years, with upfront cash and tender offer. The event is well expected by the market and has been reflected in the bond price, with investors unsurprisingly responding negatively upon the announcement of the exchange. After the company obtained the necessary approval from bondholders to pass the debt exchange on 3 July, bonds were up about 2pts and largely resumed back to the pre-announcement level.
- **West China Cement** bonds softened after reaching a yearly high at the mid-$80s, given the large capex spending overseas and an overall challenging operating environment in China. However, these are offset by its strong market position in the Shaanxi province in NW China, long operating track record, and stable banking relationship. We believe the company's EBITDA will expand when significant non-China cement capacity kicks in during 2024-25, which helps offset the business slowdown onshore. This should facilitate an improvement in leverage ratios.
- **Ehi Car** posted weak 1Q24 results due to a lower fleet utilisation rate after its aggressive fleet expansion. Notably, its fleet size expanded 65% in the past 12 months ending March 2024. Its debt level in the form of lease liabilities also increased notably. We believe the fleet utilisation will gradually improve and take comfort that the company's debt maturity profile is more manageable after the debt exchange in March.

Portfolio changes

Macau Gaming	Switched trades from Wynn Macau to SJM Holdings, which has a similar yield, and took profit on the higher cash price for the former. Macau has enjoyed strong gross gaming revenue (GGR) recovery YTD in 2024. GGR in 1H24 increased 42% YoY to MOP114bn, or 76% of the 1H19 level. We continue to expect mass-driven EBITDA growth at 20-25% YoY in 2024, which should underpin operators' deleveraging efforts. Though bond valuations for Macau gaming bonds are increasingly demanding, improving fundamental trends and limited bond supply shall keep the sector a good carry and diversification play within Asia HY.
Beijing Capital City Development Group Co	Added Beijing Capital City Development Group Co., Ltd (bond ticker: CPDEV) for carry and indirect parent support from Beijing State-owned Assets Supervision and Administration Commission (SASAC). The company primarily operates in urban development and renewal projects. As the core business platform responsible for urban development within BCG, CPDEV receives strong support in terms of asset injection, resource allocation, and financing arrangements. Despite the collapse of the property sector, CPDEV has maintained good access to onshore financing channels at a low interest rate due to its SOE status, which helps mitigate refinancing risks. CPDEV's bond prices have also remained relatively resilient.
New World Development	Added New World Development (NWD) bonds. NWD is on the right path to deleverage, given the challenging operating environment for property developers in Hong Kong. Overall sentiment turned better, given a) the company's intention to pay down the perpetual bond (callable in March 2025 with a high coupon step-up if not called), b) continued disposal of non-core assets, and c) the general risk-on environment. Despite the company has sizable maturing debts, we believe parental support from Chow Tai Fook or the Chen Family, and some of its unpledged assets available for bank financing will help mitigate refinancing risks.
Indonesia HY credits	Took profit from some Indonesia HY credits, given the strong rally YTD. These include tyre maker Gajah Tunggal and thermal coal producer Indika. We also trimmed positions on Indika due to ESG angle, though the company's underlying credit profile is solid.
Ehi Car	We trimmed some positions on Ehi car, as stated above, following its weaker-than-expected results in 1Q24 and slower-than-expected earnings recovery.

Further information

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