Market Watch

Bonds: Opportunities and Challenges

Summary

- **We continue to see value in Asian USD and EM USD government bonds, especially as they have lagged the recent rally in US corporate bonds.**
- **Within Asia USD bonds, real estate and utilities sectors appear inexpensive relative to fundamentals, in our view.**
- **However, exploiting opportunities efficiently will mean navigating market liquidity challenges.**

Which bond markets are attractive at present?

- Asian USD bonds continue to be attractive, in our assessment. While yield premiums over Treasuries are lower than those on DM HY bonds, Asian USD bonds have the advantage of investment grade (BBB+) credit quality, in aggregate. They also offer a nearly 200bp yield premium over US IG corporate bonds, which have similar credit quality.
- Among the higher yielding bonds, we continue to prefer EM USD government bonds over DM HY bonds. The sharp decline in DM HY yield premiums following the Fed's policy announcements is likely overdone as defaults may still rise, especially given the fall in oil prices. EM countries may be slightly better positioned to navigate the fall in oil prices – while they are net oil exporters, sovereigns likely have more tools at their disposal to manage their finances than corporates. Yield premiums are also closer to their historical recessionary peaks than DM HY. Hence, we believe EM USD government bonds offer better risk reward, even if defaults rise in this asset class.

Are there any sectors or market sub-segments that we like?

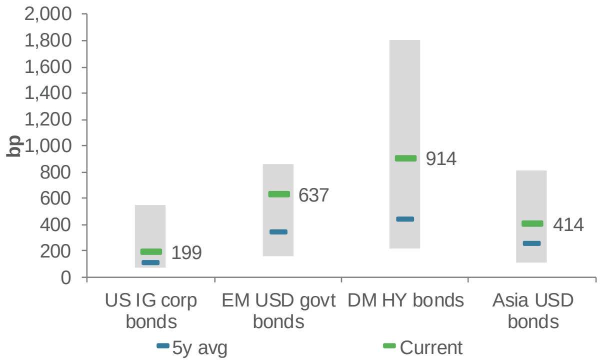
- Within Asian USD bonds, we believe the real estate sector and, to a lesser extent, utilities look attractive at present. Transport, consumer and metals & mining sectors are trading quite cheap to historical averages. However, the first two are highly exposed to the virus-related slowdown and metals & mining has seen its aggregate credit quality decline steadily over the past few years. On the other hand, the real estate sector is primarily comprised of Chinese developers, which may benefit from China being one of the first to emerge from the virus-related slowdown and encouraging property sales resumption data.

What are the challenges to be mindful of?

- Higher market volatility, a fall in new bond issuance and strong recent demand has led to a moderate shortage of bonds. These factors have likely resulted in wider bid-ask spreads across major bond markets. As an example, on a 12-month horizon, the elevated bid-ask spread on the Asia USD bond index would chip away nearly a quarter of the yield on offer. This argues for examining implementation options carefully when considering adding exposure to bond markets today.

EM USD and Asian USD bonds are still trading at cheap valuations relative to their history

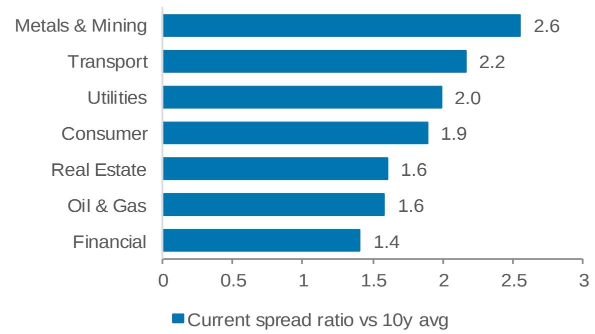
Yield premiums; Grey bars denote the highest and lowest yield premium since 2000



Source: Bloomberg, Standard Chartered

Real Estate and Utilities sectors within Asian USD offer cheap valuations and relatively resilient fundamentals

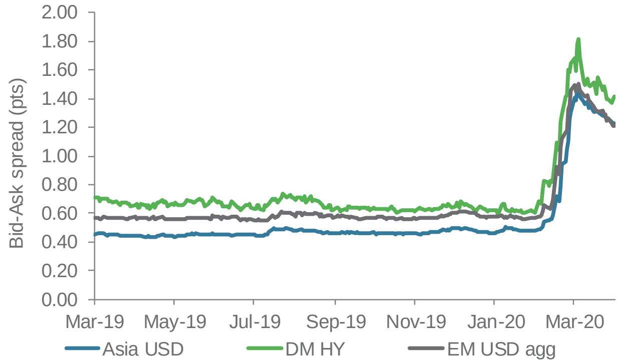
Ratio of current yield premiums versus their 10-year average



Source: Bloomberg, Standard Chartered

Lower liquidity and higher volatility have resulted in wider Bid-Ask spreads across most bond asset classes

Weighted-average Bid-Ask spreads for Bloomberg Barclays Asian USD, EM USD aggregate and Global HY bond indices



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