ASIA HIGH YIELD OUTLOOK

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Asia's Road to Recovery – Uneven but in the Right Direction

As the world emerges from COVID-19-related lockdown measures and we continue to see strong fiscal and monetary stimulus from the major economies, global growth projections for 2021 have been revised higher. In its April report, the International Monetary Fund (IMF) upgraded its 2021 global GDP forecast to 6.0%, up 0.5% from its January projection. Emerging markets (EM) growth was revised up to 6.7%, an increase of 0.4% driven by stronger growth prospects out of Asia. The region is now estimated to grow by 8.6% in 2021, led by China and India. Importantly, India's growth estimate was revised a full percentage point higher than it was in January.

MANAGER INSIGHT

JUNE 2021

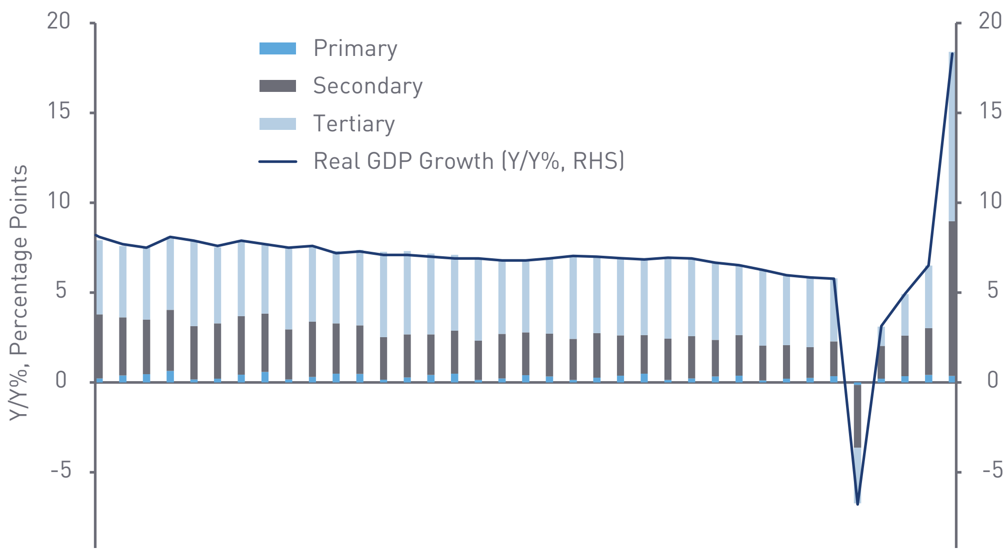
With vaccine programs expanding across much of the developed world, increased activity should support stronger global consumption, benefiting export-oriented economies. We think Asia, given its global trade and supply chain linkages, is well-positioned for a dual tailwind from US fiscal support and the pickup in global economic activity. While Asia's regional rollout of the COVID-19 vaccine has faced setbacks in a few countries, we expect improved access in the upcoming months to provide further support to domestic economies in the second half of 2021. We would also note that the stabilization in US rates has supported the rotation from developed markets (DM) to EM, bolstering risk markets. Considering this constructive macroeconomic backdrop, we maintain a positive outlook on Asia high yield (HY) credit.

China: First In, First Out

Assessing China's first-quarter 2021 GDP print, it appears clear that the Chinese economy has navigated through the pandemic-induced growth slowdown. Decomposing the data, we see a continuation of robust manufacturing, powered by exports, and a solid rebound in service activities. While consumption had remained soft during the recovery, we see evidence of that trend reversing. Double-digit growth in disposable income, an acceleration in retail sales and reduced mobility restrictions are all positive indicators of a revival in consumer demand. Improving domestic demand and a rotation in demand toward consumption should place the economy on a more balanced footing.

CONTRIBUTION TO REAL GDP

Sources: Haver Analytics, chart created by Loomis Sayles as of 31 March 2021. Used with permission from Haver Analytics Inc.



Primary = Raw Material Extraction; Secondary = Manufacturing; Tertiary = Service Industries.

On the employment front, Chinese data has shown gradual improvement versus 2020 data. Employment has faced downward pressure since the pandemic began. To address challenges in the labor market, policymakers have implemented targeted support measures. These measures have yielded early results; we expect government support to remain focused on boosting jobs and household incomes.

In the first quarter, the People's Bank of China (PBOC) introduced gradual measures to normalize monetary policy. The action affirmed the central bank's aim to mitigate financial risks and maintain financial stability. Government action has sought to keep aggregate credit growth in check and ensure macro leverage remains stable. To this end, policymakers have implemented tighter controls on the property market, clamped down on shadow banking activities and allowed for an uptick in defaults within the state-owned enterprise (SOE) and corporate sector. Taken together, we believe these actions should slow credit growth. While no rate hikes are forecasted for the duration of 2021, financial conditions should tighten, albeit at a modest pace, in the wake of tighter credit constraints.

While the recent second wave and associated localized lockdowns could negatively affect near-term economic activity, we believe India has sufficient levers to achieve double-digit full-year GDP growth.

Diverging Recoveries

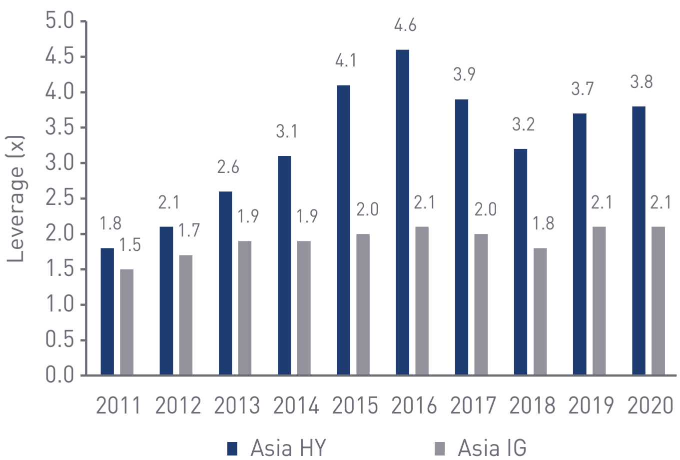
Looking at the Asian region more broadly, COVID-19-related challenges have delayed the broader recovery. Indonesia has yet to fully contain the virus. As a result, first-quarter 2021 GDP came in slightly softer than expected. While economic data has remained lackluster, early signs of job creation, stronger-than-expected government spending and expectations for improved mobility should translate into a stronger second half of 2021 in our view. India's economic recovery was on solid ground until a surge in COVID-19 cases derailed the country's progress. In response, the Reserve Bank of India announced fresh measures to boost credit and facilitate lending to help ensure adequate liquidity within the financial system. While the recent second wave and associated localized lockdowns could negatively affect near-term economic activity, we believe India has sufficient levers to achieve double-digit full-year GDP growth. In frontier Asia, both Pakistan and Sri Lanka are facing COVID-19 outbreaks that have delayed the growth revival.

With the exception of the PBOC, which has shifted toward policy normalization, Asian central banks have remained broadly accommodative, providing support through second and third waves of COVID-19. In our view, central banks across Asia will provide a runway for economies to course correct before removing support.

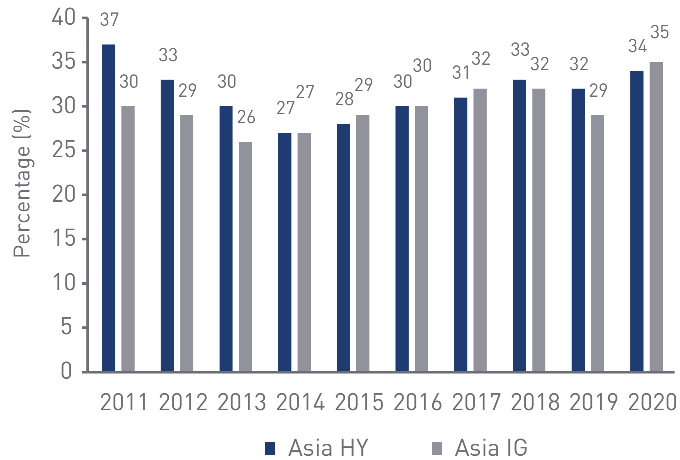
Fundamentals in Asia HY Corporates

Examining full-year 2020 Asia HY corporate fundamentals, we see only a modest weakening of credit metrics. Overall, Asia HY corporates demonstrated resilience in the wake of the global growth shock. Net leverage moved up by 0.1x to 3.8x in 2020 versus 3.7x in 2019. EBITDA (earnings before interest, taxes, depreciation and amortization) margins showed improvement, closing the year at 20% versus 19% in 2019. Liquidity buffers have also remained in place, with cash to total debt closing the year higher.

NET DEBT/EBITDA



CASH TO TOTAL DEBT



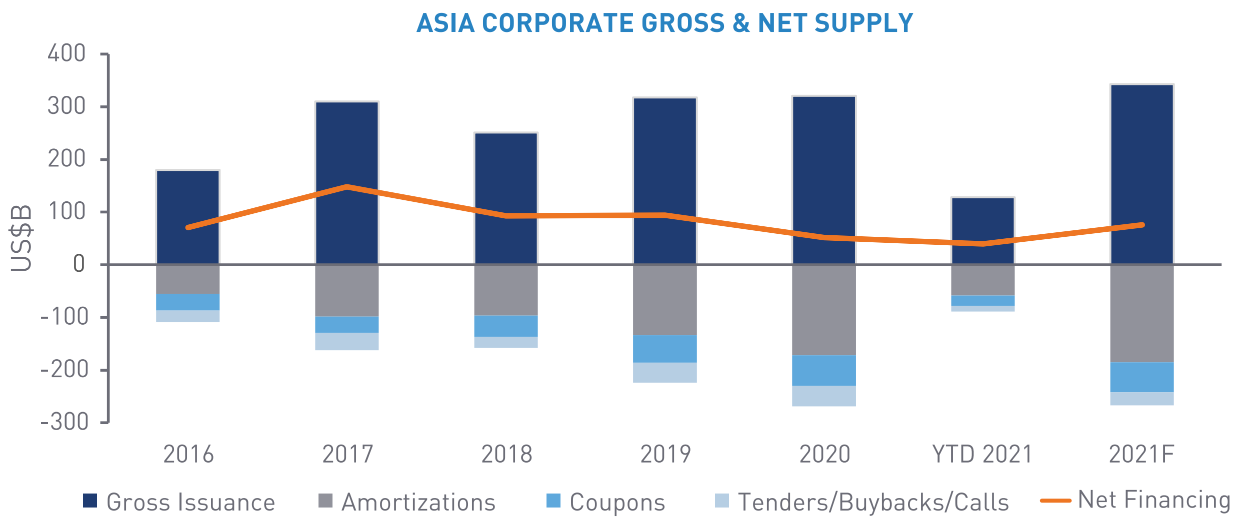
Source: JP Morgan, as of 31 December 2020. IG = Investment Grade.

Despite the recent uptick in idiosyncratic challenges facing the Asia HY market, led by negative headlines on Chinese SOEs and Chinese property names, we believe the fundamental story remains intact. In the first quarter, the pace of downgrades within the Asia HY space significantly slowed, providing evidence of stabilization. Factoring in the strong growth backdrop, we expect positive knock-on effects for corporate balance sheets in 2021 earnings results. Commodity issuers stand out as especially well-positioned. Expectations for full-year 2021 Asia HY corporate defaults remains a benign 2.4%, 100 basis points (bps) lower than 2020 levels.[1]

[1] *Source: JP Morgan, as of 6 January 2021.*

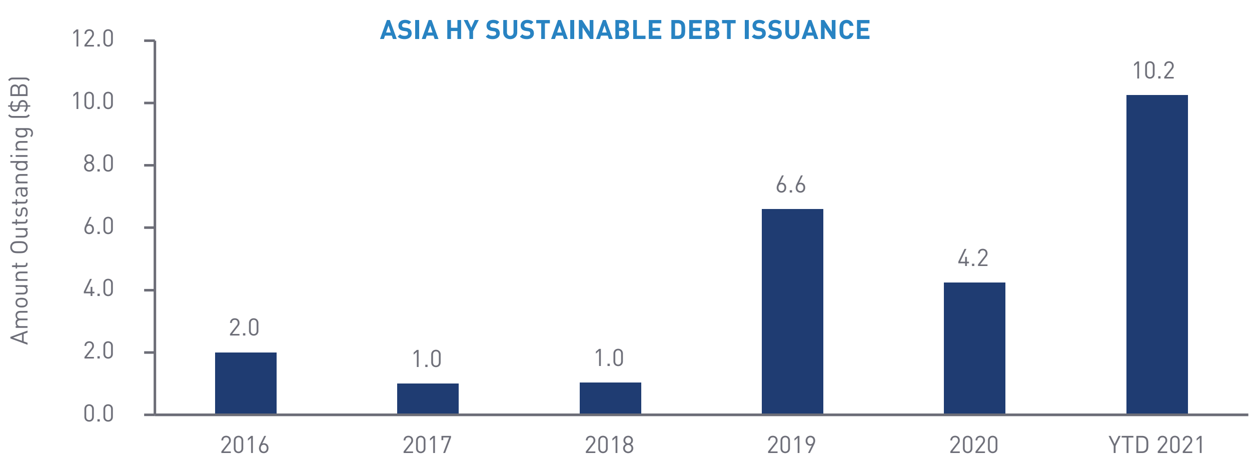
Technical Factors

Year to date, Asia priced $128 billion in gross new corporate supply, a new quarterly record. Issuance was led by the investment grade space, which priced $99 billion. Issuance within the HY segment remained fairly constrained at $30 billion. China has continued to dominate the supply pipeline, accounting for 50% of total supply in the first quarter. Given the volatility in Chinese property, we expect Asia HY supply to be constrained in the coming quarters. Importantly, with the exception of idiosyncratic names, the window for refinancing currently remains open.



Source: JP Morgan, as of 30 April 2021.

A growing source of corporate supply out of Asia has been tied to sustainable debt. Within the rated high yield Asia US dollar space, over $10 billion in green, sustainable, or sustainability-linked debt has priced year to date, the largest amount on record. The surge reflects the strong pipeline of issuance out of the Indian utility (renewable) and Chinese property space.



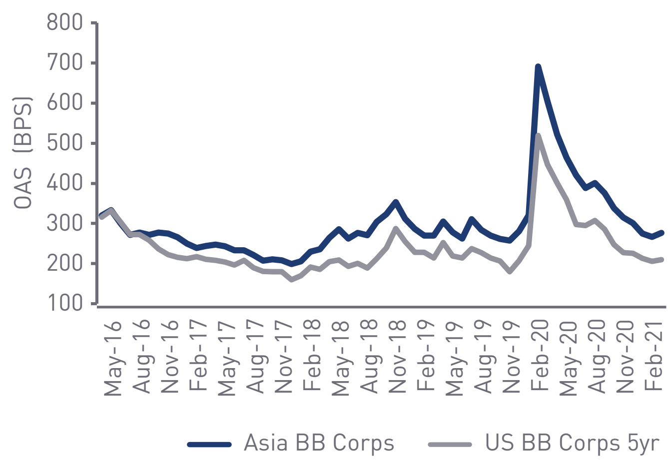
Source: Bloomberg, as of 13 May 2021.

From a demand perspective, Asia investor participation fell over the first quarter, with higher onshore yields attracting attention. However softer local demand has been somewhat offset by rising foreign participation in the Asia primary market, with European and US investors accounting for 29% of Asia new issue allocations in the first quarter.

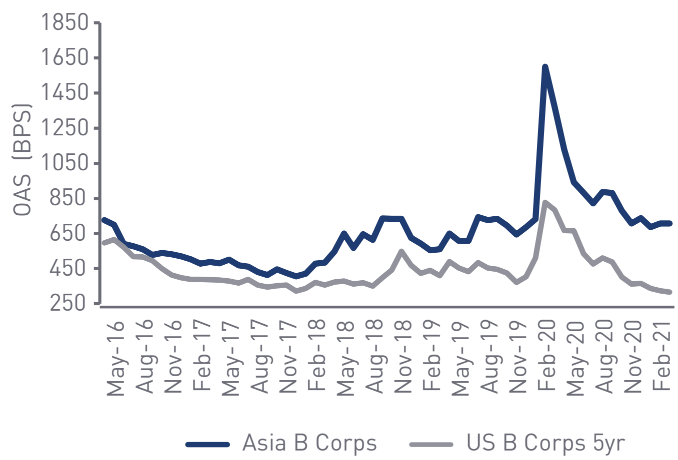
Valuations

From a valuation standpoint, spread levels appear attractive on both a historical and relative basis. Selling pressures on the heels of recent credit events has underpinned the move wider in Asia HY spreads. Asia BB-rated corporates now offer 67 bps of spread premium versus US HY, an 11 bp pickup over the 5-year average. Asia B-rated corporates offer 390 bps of spread premium to US B-rated corporates, a pickup of 180 bps versus the 5-year average.[2]

SPREAD COMPARISON
AVERAGE 5Y SPREAD DIFFERENTIAL 56BPS
CURRENT DIFFERENTIAL 67BPS



SPREAD COMPARISON
AVERAGE 5Y SPREAD DIFFERENTIAL 210BPS
CURRENT DIFFERENTIAL 390BPS



Source: Loomis Sayles, as of 30 April 2021.

While pockets of vulnerability persist in weaker credits, we see the global macro backdrop as constructive for Asia HY spreads, especially for investors willing to look beyond Chinese property. Despite the single-name risk present in the market, robust macro tailwinds coupled with improving fundamentals should help provide solid support for credit spreads in the coming quarters. With spread levels offering elevated premiums, we believe investors have a favorable entry point into the asset class.

[2] *Source: Loomis Sayles, as of 30 April 2021.*

Risks

From a risk perspective, we maintain our view that the global growth recovery hinges on the widespread rollout of COVID-19 vaccines. We acknowledge that uneven distribution and access to vaccines will likely lead to uneven recoveries across Asia. We see COVID-19 flare-ups disrupting but not derailing the global growth recovery. US inflation and an abrupt rise in interest rates are also a concern, but it is too early to call for permanent rather than transitory inflation since the global economy is still only in the early stages of recovery.

We also remain somewhat cautious on the Chinese property sector. While the de-leveraging aims of policymakers will likely strengthen the sector in the long term, negative headlines and pockets of weakness may continue to emerge over the short term. Regarding the rise of onshore defaults, refinancing risks should remain largely manageable for the whole of the market. Risks remain for issuers with weak credit metrics that are heavily reliant on local government support. An overshoot of monetary and fiscal policy tightening by Chinese policymakers could also act as an overhang on the asset class—though that is not our base case view.

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Disclosures

Key Investment Risks: Credit Risk, Issuer Risk, Liquidity Risk, Interest Rate Risk, Non-U.S. Securities Risk, Currency Risk, Derivatives Risk (for portfolios that utilize derivatives), Leverage Risk (for portfolios that utilize leverage), Counterparty Risk, Prepayment Risk, Extension Risk, Equity Risk, Non-Diversified Strategies.

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