Manulife Investment Management

Asian high-yield bonds: Compelling opportunities in a yield-starved environment

Jan 2022

With interest rates expected to rise under the path of policy normalisation, conventional wisdom tells us that 2022 may be a challenging year for fixed-income investors as bond prices face increased volatility. However, the Asian bond market is diverse and broad, offering pockets of opportunity tied to fundamental dynamics, including Asian high-yield credits which present compelling opportunities for income-seeking investors in this investment environment.

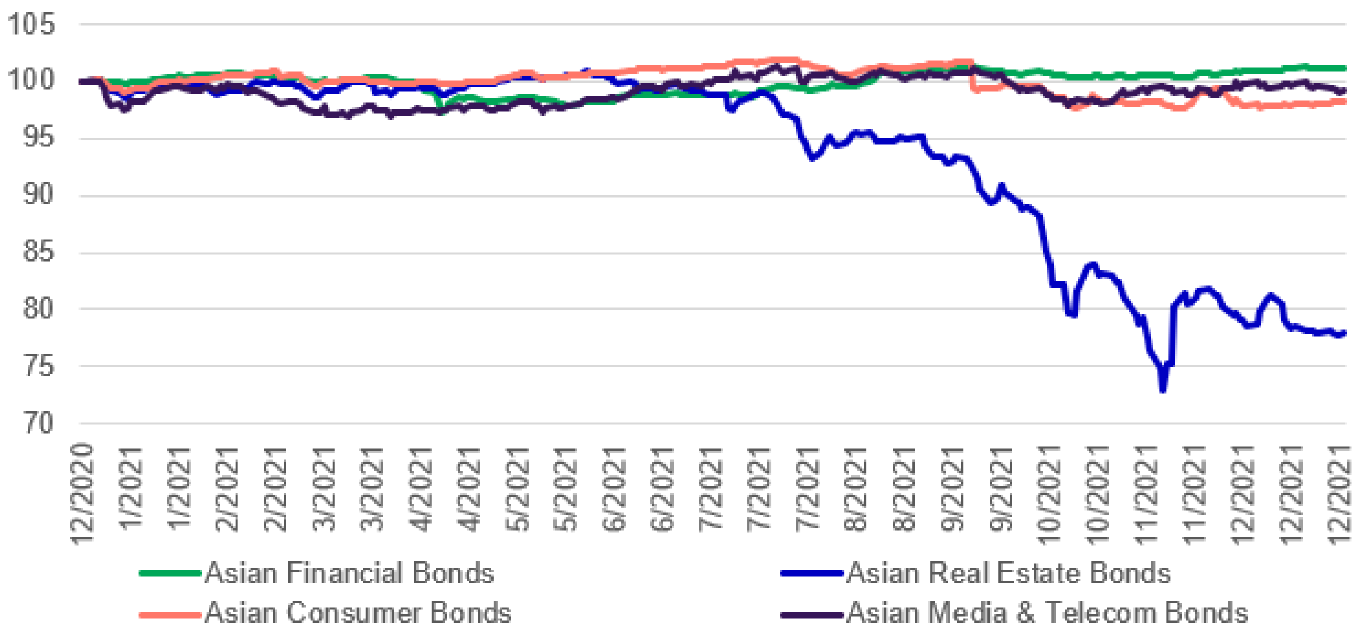
In retrospect, Asian high yield instability may be limited to China's property sector

Within the Asian fixed-income space, China's high-yield property sector dominated the headlines in 2021 with concerns about being over-leveraged and possible defaults[1]. As seen in Chart 1, the broad Asian high-yield market had stabilised since being initially impacted by headlines stemming from the Chinese real estate sector. The data points toward the recent correction being limited to the property sector, while the rest of the Asian high-yield market had diverged with resilient performance.

Despite these attention-grabbing headlines, active managers with robust credit capabilities have been taking advantage of sectors and credit names whose performances were indiscriminately dragged by market events, as our Asian Fixed Income team writes in the [2022 outlook].

Indeed, the longer-term outlook for Asian fixed income is generally positive. While North Asian economies have enjoyed a better recovery trajectory than their Southeast Asian counterparts in 2021, the latter are catching up and are expected to outpace North Asia in 2022. Vaccination

Chart 1: Market correction was mainly contained in property sector



Source: Bloomberg, as of 31 December 2021. Asian Financial Bonds are measured by JPMorgan JACI Financial Total Return Index; Asian Real Estate Bonds are measured by JPMorgan JACI Real Estate Total Return Index; Asian Consumer Bonds are measured by JPMorgan JACI Consumer Total Return Index; Asian Media & Telecom Bonds are measured by JPMorgan JACI Media & Telecommunications Total Return Index. Investment involves risk. Past performance is not indicative of future performance.

rates are accelerating[2], and although there is some way to go for many markets, we already see economic activity returning. An immunised population that is well-adapted to social-distancing measures should reduce the need for costly lockdowns. This will be positive for business activity and corporate credit profiles across the board in Asia, providing cushion for default risks. The region's growth is also sustained by healthy long-term macroeconomic fundamentals, spurred by structural trends in consumption, technology, and healthcare. The International Monetary Fund expects Asian economies to grow 5.4% in 2022, faster than the global average (4.9%) as well as advanced economies (4.5%)[3].

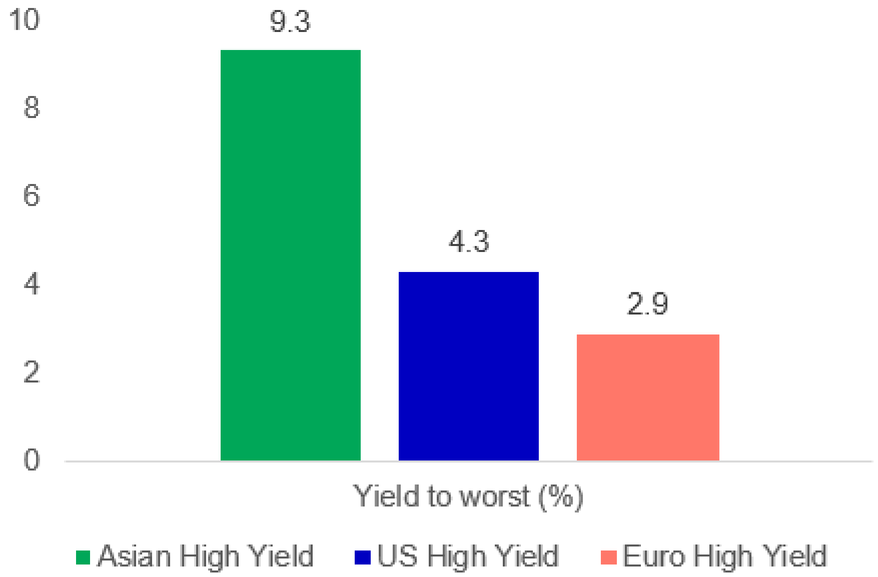
Compelling rates: A beacon for yield-starved investors in this environment

Fundamentals aside, market expectations are for the US Federal Reserve to begin tightening sometime in 2022[4]. Several other central banks are expected to follow suit. That said, monetary policy is still accommodative and the expected rate increases are still limited compared to historical standards. Consider that the highest 10-year US Treasury yields seen in 2021 – about 1.77% – have yet to reach pre-pandemic levels[5].

That means the search for yield – an enduring theme of the past decade – will likely continue. And as US Treasury yields creep up, the yield spread offered by US high-yield debt will narrow. As of 10 December 2021, the yield spread stood at about 3.13% over US Treasuries[6].

By contrast, Asian high yield could offer a higher yield spread over US Treasuries (Chart 2). And while this implies some sort of credit trade-off (which can be managed via robust credit selection by experienced active managers), these higher yields in combination with its short duration characteristics can often, from a total-return perspective, act as a buffer to compensate for lower bond prices in a rising interest rate environment.

Chart 2: Compelling yield compared to global peers



Source: Bloomberg, Manulife Investment Management, as of 31 December 2021. You cannot invest directly into an index. Asian high yield is measured by JACI Asia Non-Investment Grade Corporate Index; US high yield is measured by ICE BofA US High Yield Index; Euro high yield is measured by ICE BofA Euro High Yield Index.

Asian high-yield credits look to have decent support in a global environment that is still flushed with liquidity. For investors who are drawn to the region's long-term growth story, Asian high yield could provide superior risk-adjusted returns.

Short duration and less rate sensitivity make for a resilient play

Another attractive characteristic of the Asian high-yield market is its lower duration compared to peers. Duration is typically used as a measure of a bond's interest rate sensitivity – the lower the duration, in theory, the lesser its price would fall as interest rates increase (and vice versa). Asian high yield has an average duration of 3.1 years, which is over a year lower than its US high-yield counterparts and almost 2.5 years less than Asian dollar bonds (Chart 3).

Attractive valuations are emerging – but robust credit selection is a must

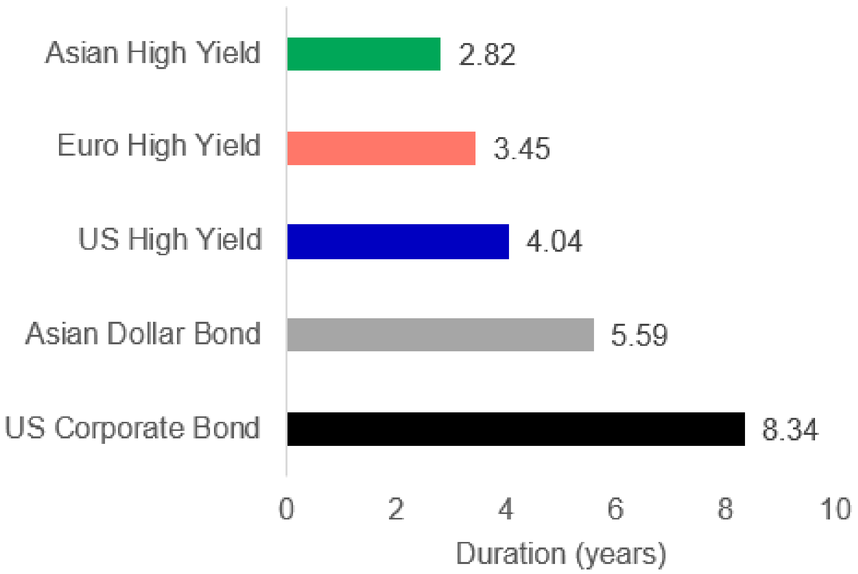
Finally, as the market turbulence surrounding the Chinese high-yield property space continues, attractive entry points are emerging. However, to fully realise the value of these opportunities, robust credit selection is a necessity. The implication here is that not all Asian high-yield credits are created equal, but with differences in credit quality, fundamentals, and default risks.

Investors without access to research capabilities or expertise may invest in bonds based on their higher yields without fully evaluating the potential trade-offs between risks and total returns. A failure to screen out poor quality credits or diversify adequately could result in a credit event that wipes out the entire portfolio's gains. On the other hand, we believe investors who can identify "winners" from the China property sector and navigate this market cycle could be handsomely rewarded for alpha returns.

Manulife Global Fund – Asian High Yield Fund (the "Fund")

We believe bottom-up credit selection is key to finding attractive opportunities in the Asian high-yield market. We have a team of almost 20 credit analysts[7] across Asia ex-Japan uncovering credit opportunities. In 2021 alone, our investment team screened out at

Chart 3: Less sensitive to rising interest rates



Source: Bloomberg, Manulife Investment Management, as of 31 December 2021. You cannot invest directly into an index. Asian high yield is measured by JACI Asia Non-Investment Grade Corporate Index; Euro high yield is measured by ICE BofA Euro High Yield Index; US high yield is measured by ICE BofA US High Yield Index; Asian dollar bonds are represented by ICE BofA Asian USD Bond Index; US corporate bonds are represented by ICE BofA US Corporate Bond Index.

least four recently defaulted Chinese property developers – protecting the portfolio from potentially substantial idiosyncratic downside.

In a high yield market dominated by Chinese issuers, our investment team saw opportunities in Indonesian and Indian high-yield credit. The Fund diversified and was overweight in both of these sectors, which ultimately resulted in a positive contribution, as the high-yield credits issued in these markets outperformed their Chinese counterparts. The Fund has also consistently outpaced its reference benchmark – both on a year-to-date and since inception basis – displaying resilience amid market volatility[8].

Investors should not solely chase after headline yield (the stated income or dividend in the "headlines"), especially in the high-yield segment, because the highest headline yield may not ultimately offer the most optimal or largest total return if a high-yield name defaults. Investors should consider the track record of investment managers who can screen out poor quality credits, and consistently provide outperformance and total returns.

To find out more about the Manulife Global Fund – Asian High Yield Fund, contact us.

[1] Bloomberg, 1 December 2021.
[2] Reporting ASEAN, 29 December 2021.
[3] Reuters, 20 October 2021. International Monetary Fund, October 2021.
[4] Reuters, 3 December 2021. International Monetary Fund, October 2021.
[5] CNBC, as of 10 December 2021.
[6] Federal Reserve Bank of St. Louis. ICE BofA US High Yield Index Effective Yield as of 10 December 2021.
[7] Comprising of investment professionals of Manulife Investment Management, Manulife-TEDA Fund Management Co. Ltd., a 49% joint venture is a joint venture between Manulife Financial and Northern International Trust, part of the Tianjin TEDA Investment Holding Co. Ltd. (TEDA), and Mahindra Manulife Investment Management Private Limited, a 49% joint venture of Manulife and Mahindra AMC.
[8] Class AA (USD) MDIS (G), as of 31 December 2021. Benchmark is JP Morgan Asia Credit Non-Investment Grade Index. The class returned -10.31% and -14.80% year-to-date, on NAV-to-NAV and offer-to-bid basis respectively; the benchmark returned -11.05%. Since inception (21 December 2020), the class returned -9.88% (annualised) on NAV-to-NAV basis and -14.28% on offer-to-bid basis, annualised with net income & dividends reinvested; the benchmark returned -10.55% (annualised).

Information as at 31 December 2021.

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