November 2018

By Koh Liang Choon,
Head of Fixed Income, Asia

nikko am
Nikko Asset Management

ASIAN FIXED INCOME OUTLOOK

Summary

- US Treasury (UST) yields spiked at the start of October as the market responded to stronger US data and Federal Reserve (Fed) Chairman Jerome Powell's hawkish comments. However, a slew of disappointing results from US companies created a significant correction in US equities thereafter, causing UST yields to slide. As market sentiment turned bearish, outflows from Emerging Market (EM) bond funds accelerated.

- Overall, 2 and 10-year yields ended at 2.87% and 3.14% respectively, about 5 basis points (bps) and 8bps higher compared to end-September.

- Asian credit recorded negative returns in October. Overall, credit spreads widened as the sell-off in global equity markets prompted cautious sentiment to prevail. Investment grade credit returned -0.73%, while high-yield underperformed, losing 2.43% on the month.

- Within the region, inflationary pressures mostly rose in September. The Monetary Authority of Singapore (MAS) further tightened its FX policy while Chinese policymakers announced more measures to support the economy.

- Meanwhile, the primary market activity moderated in October. There were 29 new issues worth around USD 13.9bn in the high-grade space, while the high-yield space saw a total of 21 issues amounting to about USD 5.5bn.

- Local currency bonds are positive due to Indonesian and Chinese bonds. An improvement in technical factors, as well as policy coordination relative to other Asia EM countries, is supporting Indonesian bonds. Chinese policymakers' resolve to inject money into the economy is also supportive of bond prices.

- On currencies, we are positive on the Thai baht and Philippine peso. The baht's services-driven current account surplus, as well as expectations of further rate hikes by the Philippine central bank are some factors that support both currencies.

- Heading into the last two months of 2018, Asian credit spreads are likely to remain volatile. US-China trade tensions and continued monetary policy normalisation in the developed markets remain headwinds for fixed income assets. In terms of technical factors, the primary market for issuances should remain active in November before tapering off in December. Meanwhile, all-in yields look attractive from a historical context.

Asian Rates and FX

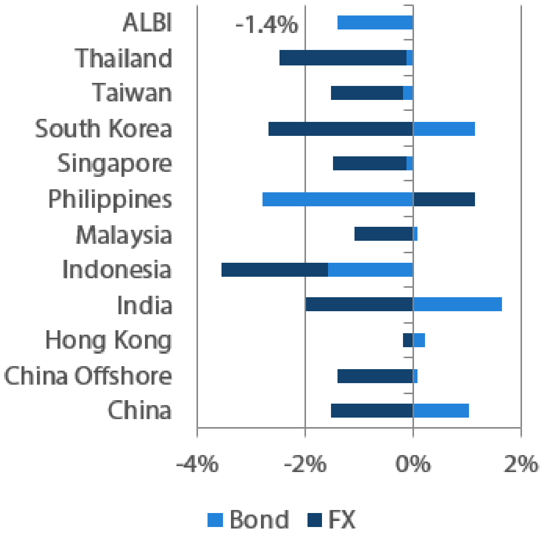
Market Review

UST yields ended higher in October

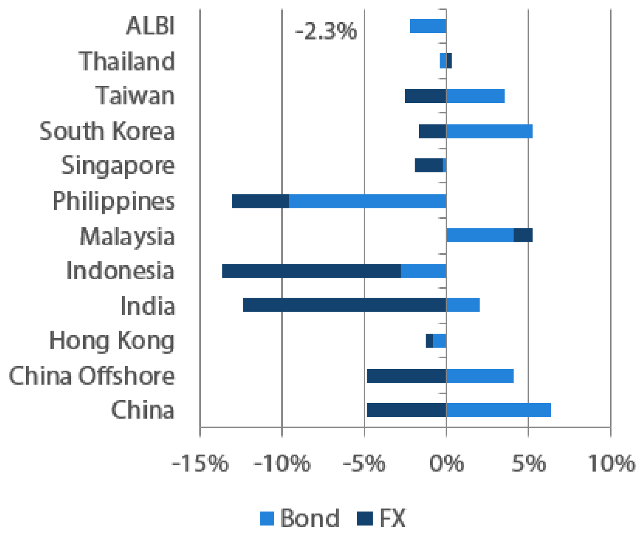
The month started with a spike in UST yields, as market responded to stronger US data and Fed Chairman Jerome Powell's hawkish comments that the Fed was still 'a long way from neutral'. These factors drove the 10-year UST yield to hit a seven-year high of 3.25% on 9 October. However, a slew of disappointing results from US companies created a significant correction in US equities thereafter, causing UST yields to slide, as demand for perceived 'safe-haven' assets rose. Headline news from Italy and Saudi Arabia further contributed to market anxiety. As market sentiment turned bearish, outflows from EM bond funds accelerated. Overall, 2 and 10-year yields ended at 2.87% and 3.14% respectively, about 5bps and 8bps higher compared to end-September.

Markit iBoxx Asian Local Bond Index (ALBI)

For the month ending 31 October 2018



For the year ending 31 October 2018



Source: Markit iBoxx Asian Local Currency Bond Indices, Bloomberg, 31 October 2018

Note: Bond returns refer to ALBI indices quoted in local currencies while FX refers to local currency movement against USD. Returns are based on historical prices. Past performance is not necessarily indicative of future performance.

Inflationary pressures across Asia mostly rose in September

Headline CPI inflation prints across the region mostly saw an acceleration in September. Inflationary pressure in the Philippines rose further, printing 6.7% Year-on-Year (YoY), reflecting the impact of higher oil prices and a typhoon that hit the country in the month. The pick-up was led by higher food inflation, somewhat offset by an easing in utilities inflation. Similarly, gains in Chinese CPI were contributed by a rise in food prices due to adverse weather and a spike in demand due to the Golden Week festival. Retail inflation in India was nudged up by food and fuel prices, while the rise in CPI inflation in South Korea came on the back of a surge in prices of agricultural products. In Singapore, headline CPI registered 0.7% YoY – unchanged from August. Excluding private road transport and accommodation costs, MAS' measure of core inflation moderated slightly to 1.8% in September, from 1.9% in the previous month, as an easing in retail inflation more than offset higher services inflation. Elsewhere, headline CPI inflation in Indonesia rose at the slowest pace in more than two years, driven mainly by lower food inflation, whereas the moderation in inflationary pressures in Thailand was largely due to an unfavourable base effect from a spike in food and energy prices last year.

Chinese policymakers announced more measures to support the economy

China's GDP growth slowed to 6.5% YoY in the third quarter – its weakest pace since the first three months of 2009. Policymakers announced several measures to support growth, partly in response to the deceleration in the economy. The central bank introduced new credit facilities to encourage SME financing, and the State Administration of Taxation unveiled draft measures to reduce tax burden on households. This followed an earlier announcement by the People's Bank of China (PBoC) that reserve requirement ratios (RRR) for most banks will be further reduced (its fourth cut this year) by 100bps. More steps look likely, with PBoC Governor Yi Gang saying that policymakers have plenty of room to adjust interest rates and the RRR, "if needed," after acknowledging that the nation faces "tremendous uncertainties" from the impact of tariffs and trade frictions. Separately, a statement released after a Politburo meeting chaired by President Xi Jinping stated that downward pressure to growth is increasing, and that the government needs to introduce timely steps to counter this.

The MAS further tightened its FX policy

The MAS increased the slope of the Singapore Dollar nominal effective exchange rate (SGD NEER) policy band 'slightly', and left the width and mid-point of the band unchanged. The monetary authority added that 2018 GDP growth should come within the upper half of the 2.5-3.5% forecast range, and moderate slightly in 2019. On inflation, MAS said it expects headline CPI to average 0.5% this year, picking up to between 1-2% in 2019, and for core inflation to average between 1.5-2% this year and between 1.5-2.5% in 2019.

Market Outlook

Positive on Indonesian and Chinese bonds

We have turned positive on Indonesian bonds. Bond supply technicals have improved, due in part to significant pick-up in private placements and retail issuances of late. This should provide support to demand. Indonesian authorities continue to signal that stability in the face of elevated external risks is a priority. Policy coordination is improving relative to other Asia EM countries. Despite 2019 being an election year, the government has budgeted a lower fiscal deficit. These factors combined, provide reassurance to investors. In November, the central bank will launch the domestic non-deliverable forward (DNDF) market, which it hopes will take external pressure off the rupiah. Meanwhile, we maintain our positive view on Chinese bonds, as policy makers' increasing resolve to inject money into the economy to support growth should be favourable for bond prices. Moreover, we see a prolonged slowdown in growth.

Positive on the baht and peso

The baht's services-driven current account surplus, together with an improving Thai economy are factors supporting demand for the currency. We also see the peso outperforming regional peers for the rest of the year, on the back of a seasonal surge in remittances from overseas Filipinos, and support from expectations of further rate hikes by the Philippine central bank.

Asian Credit

Market Review

A month of negative returns

Asian credit recorded negative returns in October. Overall credit spreads ended wider by about 21bps, as the sell-off in global equity markets prompted cautious sentiment to prevail. The sharp drop in Chinese equity markets – stirred by fears of a worse-than-expected economic slowdown – added to pressure on Asian credit. Investment grade credit returned -0.73%, while high-yield underperformed, losing 2.43% on the month.

Primary market activity moderated in October

The slowdown in primary market activity was prompted by Golden Week holidays in China, as well as subdued market sentiment. Total issuance amounted to about USD 19.5bn in October, compared to about USD 21.64bn in the previous month. There were 29 new issues worth around USD 13.9bn in the high-grade space, including USD 3bn sovereign issuances from China. Within high-yield, there was a total of 21 issues, including re-taps, amounting to about USD 5.5bn.

JP Morgan Asia Credit Index (JACI)

Index rebased to 100 at 31 October 2017

Note: Returns in USD. Past performance is not necessarily indicative of future performance. Source: JP Morgan, 31 October 2018

Market Outlook

Volatility Likely to Persist

Asian credit spreads are likely to remain volatile heading into the last two months of 2018. Ongoing trade tensions between the US and China as well as continued monetary policy normalisation in the developed markets, particularly the US, are likely to remain headwinds for fixed income assets. Gyrations in global equity markets are also likely to influence sentiment towards Asia credit markets, as evident from developments in October. Additionally, there are potential market-moving political events in the developed markets scattered throughout November, including the US mid-term elections, progress of Brexit negotiations and the ongoing fiscal budget tussle between Italy and the European Commission. Positively, the Chinese authorities have begun to recognise the degree of pessimism onshore and are responding more forcefully with fiscal and liquidity support. Further and more impactful easing measures may provide support to risk sentiment toward Asia credit, and risk assets globally. The high-profile meeting between President Donald Trump and President Xi JinPing at the G20 summit later this month will be closely watched for any positive breakthrough on the trade deadlock. Lastly, credit spreads have widened somewhat in October, so some of the negatives may be already priced in.

Primary market to remain active in November; all-in yields look attractive from historical context

In terms of supply technicals, the primary market should remain active in November before tapering off in December. All-in yields for high-grade and high-yield corporates (at 5.02% and 9.06%, respectively) have risen sharply with UST yields and the widening of credit spreads in October, and are now above the historical averages seen over the last five years.

Important Information

This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute investment advice or a personal recommendation and it does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this material will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual stocks, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

United Kingdom and rest of Europe: This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules).

This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the FCA (122084). It is directed only at (a) investment professionals falling within article 19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005, (as amended) (the Order) (b) certain high net worth entities within the meaning of article 49 of the Order and (c) persons to whom this document may otherwise lawfully be communicated (all such persons being referred to as relevant persons) and is only available to such persons and any investment activity to which it relates will only be engaged in with such persons.

United States: This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments. This document should not be regarded as investment advice. This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. Nikko Asset Management Asia Limited is a regulated entity in Singapore.

Hong Kong: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed institution in Hong Kong.

Australia: Nikko AM Limited ABN 99 003 376 252 (**Nikko AM Australia**) is responsible for the distribution of this information in Australia. **Nikko AM Australia** holds Australian Financial Services Licence No. 237563 and is part of the Nikko AM Group. This material and any offer to provide financial services are for information purposes only. This material does not take into account the objectives, financial situation or needs of any individual and is not intended to constitute personal advice, nor can it be relied upon as such. This material is intended for, and can only be provided and made available to, persons who are regarded as Wholesale Clients for the purposes of section 761G of the Corporations Act 2001 (Cth) and must not be made available or passed on to persons who are regarded as Retail Clients for the purposes of this Act. If you are in any doubt about any of the contents, you should obtain independent professional advice.

New Zealand: Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562) is the licensed Investment Manager of Nikko AM NZ Investment Scheme, the Nikko AM NZ Wholesale Investment Scheme and the Nikko AM KiwiSaver Scheme.

This material is for the use of researchers, financial advisers and wholesale investors (in accordance with Schedule 1, Clause 3 of the Financial Markets Conduct Act 2013 in New Zealand). This material has been prepared without taking into account a potential investor's objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this material, who are not wholesale investors, or the named client, or their duly appointed agent, should consult an Authorised Financial Adviser and the relevant Product Disclosure Statement or Fund Fact Sheet (available on our website: www.nikkoam.co.nz).

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Bank group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.
The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).
No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.