IP VIEWPOINT

DECEMBER 2019

Macro and Investment Outlook 2020 Outlook

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EXECUTIVE SUMMARY

Asian credit markets performed well in 2019, in line with our bullish view at the end of 2018. The strong performance was driven by attractive valuations, peaking US rates and China's de-leveraging policies being put on hold.

Going into 2020, the yield pick-up offered by Asian credit has become more pronounced. Valuation remains attractive both relative to other regions and to its own historical range, while fundamentals and technicals are very supportive. Medium-term positive outlook for Asian credit markets stay intact.

That said, the easy beta ride is largely behind us. 2020 should provide interesting opportunities for active managers with strong and deep research capability to take advantage of performance divergence. Careful credit selection and active portfolio management will be crucial to managing risks and seeking returns.

Our base case scenario on the macro backdrop remains intact: US will avert a recession in 2020, global monetary and financial conditions stay supportive, and China continues to fine tune policies to uphold steady growth.

Key risks we monitor are US-China trade tensions, global economic slowdown and US elections. We would be constantly reviewing our macro assumptions and stress-testing our credit selections in order to mitigate changing risks.

KEY VIEWPOINTS

A. **STAY CONSTRUCTIVE ON ASIAN CREDIT GOING INTO 2020**

B. **ALPHA OPPORTUNITIES EMERGING AMID PERFORMANCE DIVERGENCE**

C. **BASE CASE: NO RECESSION IN US, FED REMAINS ON HOLD, AND CHINA SOFT LANDING**

D. **LOCAL RATES: MEDIUM TO LONG-TERM CONSTRUCTIVE ON CGBS; RANGE TRADE FOR 10Y CGB: 2.50% -3.50% IN 2020**

E. **INDONESIAN LOCAL GOVERNMENT BONDS STILL ATTRACTIVE**

F. **KEY RISKS: GLOBAL ECONOMIC SLOWDOWN, US-CHINA TRADE TENSIONS & US ELECTIONS**

A. STAY CONSTRUCTIVE ON ASIAN CREDIT GOING INTO 2020

ASIAN CREDIT PERFORMED STRONGLY IN 2019 AS WE PREDICTED

Asian credit markets have performed well in 2019, in line with our bullish recommendation at the end of 2018. In our report at the time, we mentioned that Asian credit offered an attractive opportunity following the significant widening in spreads in 2018.

In particular, we favoured Asian high yield bonds with yields surpassing 9% for first time since 2009. Against consensus, we also suggested that US rates were peaking and China's de-leveraging policies were on hold – both of which turned out as important drivers in 2019.

MARKETS CONTINUE TO LOOK ATTRACTIVE IN 2020

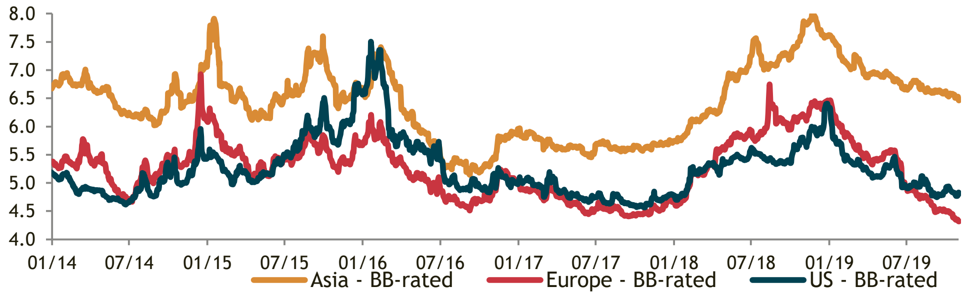
Valuation, credit fundamentals and monetary conditions are all supportive.

VALUATION

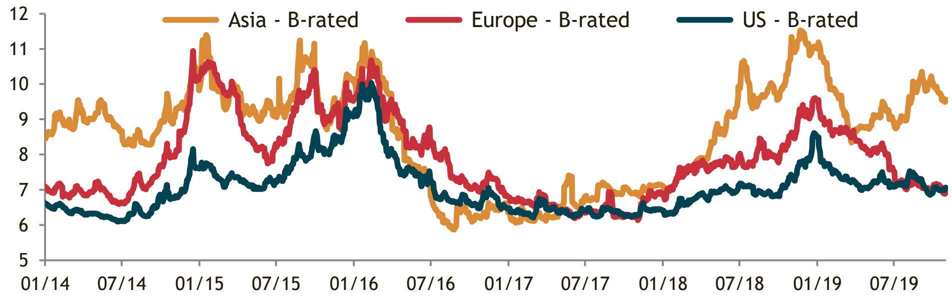
Asian credit markets offer attractive valuations compared to other regions – this is most apparent in the high yield segment (see Figure 1). We believe this will likely increase the appeal of the asset class to non-regional investors, who have been underweight Asian credit in recent years.

Figure 1: Asian High Yield look attractive compared to DM markets

Double B credit spreads



Single B credit spreads



Source: JP Morgan

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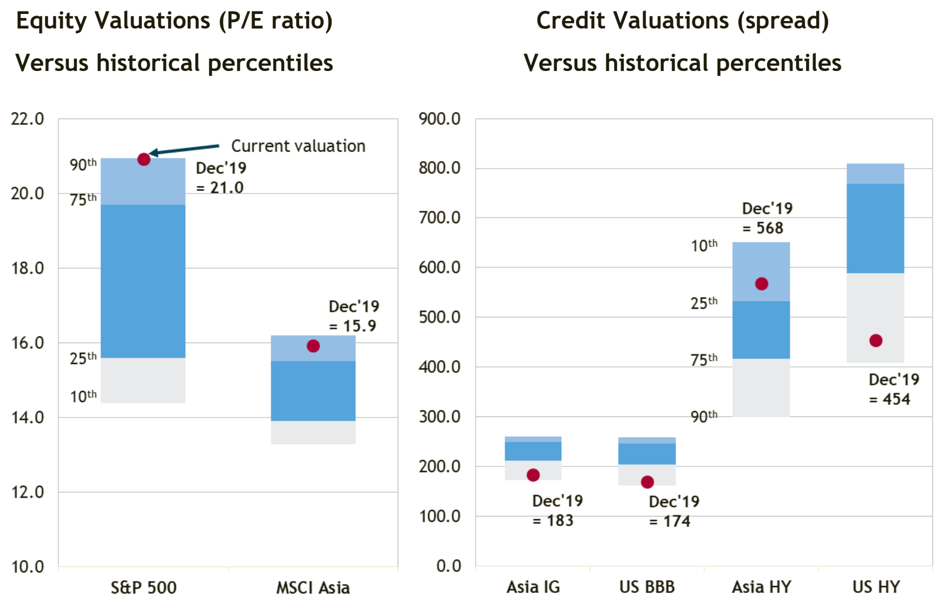
Furthermore, Asian high yield markets stand out as still offering value, as seen in Figure 2, while other asset classes globally appear to trade at the high end of valuation ranges.

Figure 2: Asian HY looks attractive relative to historical 10 year ranges



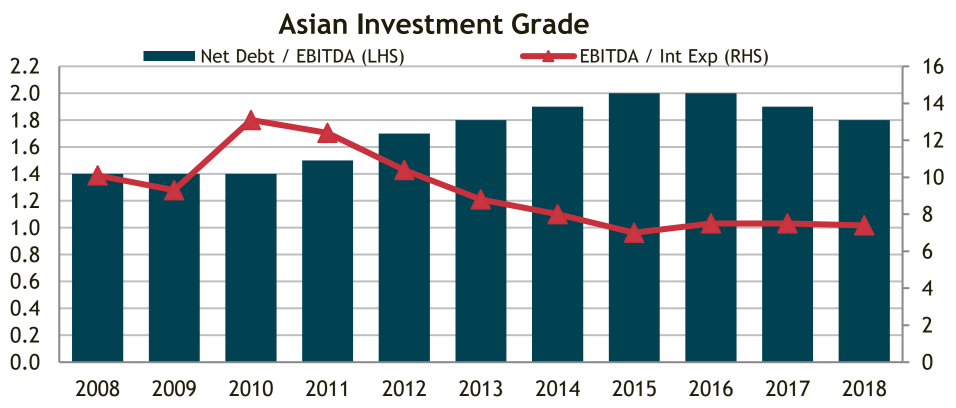
Source: JP Morgan, Bloomberg, Income Partners

CREDIT FUNDAMENTALS

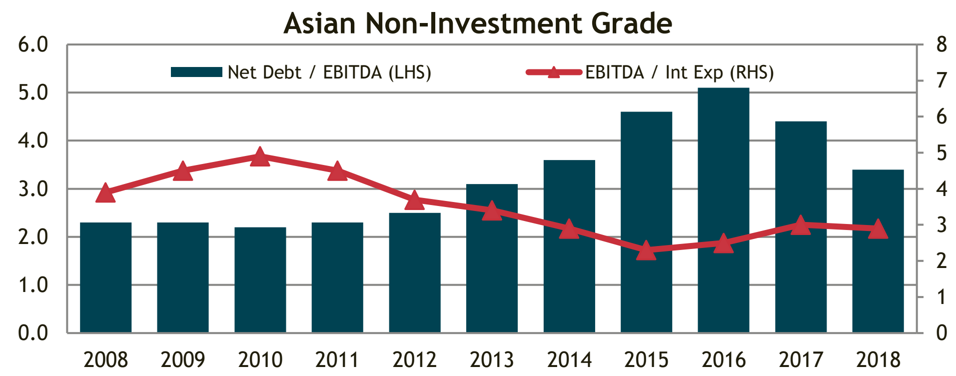
Another key supporting factor for Asian credit going into 2020 is that, in general, Asian issuers of USD bonds have actually been de-leveraging since 2016, both among IG and HY credits (see figure 3).

Figure 3: Asian offshore bond issuers seeing healthier credit profiles

Asian Investment Grade



Asian Non-Investment Grade / Asian High Yield



Source: JP Morgan

FAVORABLE MONETARY CONDITIONS

Synchronised policy easing globally is expected to continue in 2020 as central banks deploy whatever tools they can to stimulate growth and avoid a full-blown recession. In this climate of low and negative rates, hunt-for-yield environment will persist, favouring Asian fixed income assets.

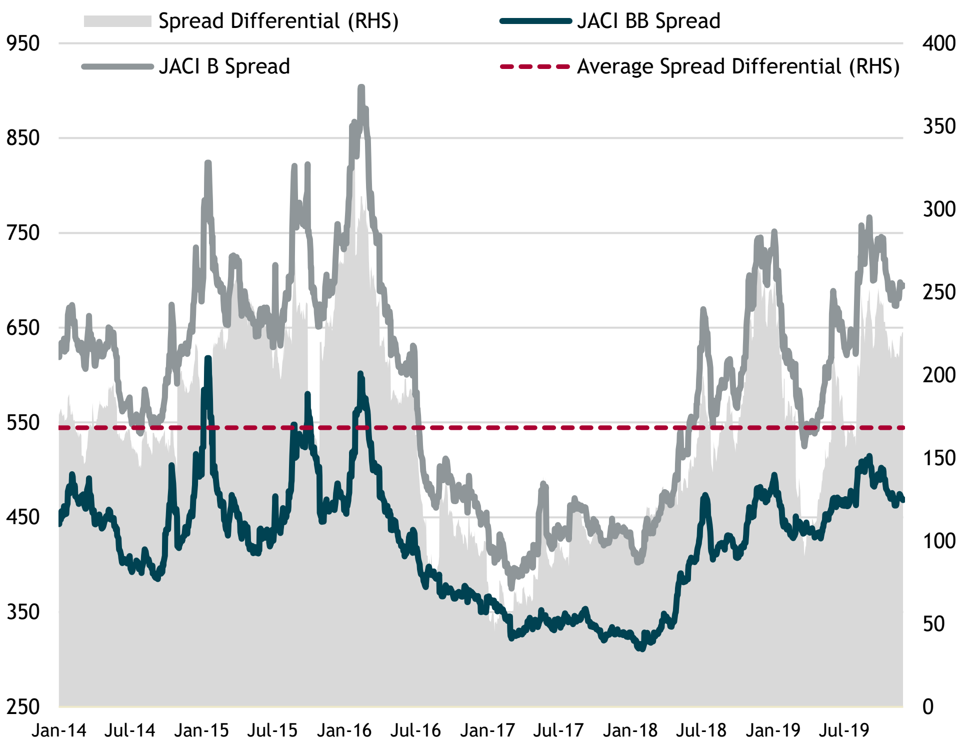
B. ALPHA OPPORTUNITIES EMERGING AMID PERFORMANCE DIVERGENCE

2020 ASIAN CREDIT STRATEGY - SEEKING ALPHA

Despite the overall strong performance in 2019, there has been a divergence in performance within Asian HY space. Investors, wary of slowing economies, focused on short-duration and quality credits.

This has created opportunities further out the duration curve and selective in lower rated credits. Figure 4 shows the widening between Asian BB and B credits currently at relatively wide levels.

Figure 4: Asian BB versus B divergent performance in 2H 2019



Source: JP Morgan

Against such market backdrop, the need to stay focused on bottom-up credit selection will become even more important in 2020. This will be key in seeking alpha opportunities and avoiding pitfalls.

CHINA PROPERTY - STILL AMONG THE HIGHEST YIELDING SEGMENTS

Tightening of China HY property credits were one of the main return drivers for the region in 2019. Over the course of the year, we witnessed a mini-policy cycle unfolding in front of us. On the balance, we think the collection of policies on developers has evolved from outright tightening to a combination of "tight on funding, but supportive on sell-through".

This policy trend arguably favours the bigger developers who would have more internally generated cash flow to spend on land banking, and it is further exacerbating the sector consolidation. We expect that by end of next year, top 50 players could contribute to 2/3 of national sales (from around 50% now). M&A helps larger players maintain their margins while the whole sector margin is compressing. In the meantime, more large players emphasized faster asset churn and cost control as the sector growth inevitably slows down. We remain comfortable that our choice of credits, mostly top 50 national players, will continue to benefit from such trends within the next 2-3 years.

Looking into 2020, the main challenge is that the room for strong BB credits to rally further becomes more limited while weaker B names continued to face the curse of onshore credit contraction. Without significant onshore funding relaxation (which we think is unlikely) to developers, we remain rather selective in the lower credit quality developers. We find value in names which are in the high single digit yield space while having balanced land bank and credit metrics. Overall, we think next year China property is largely a carry play with selective alpha opportunities.

CHINA INDUSTRIALS – AVOIDING LANDMINES

Chinese non-investment grade industrial credits underperformed in 2019 as the refinancing environment for smaller and weaker Chinese industrial credits remained challenging. We have seen credits continued to diverge and we believe this will continue to be the case in 2020.

In 2019, with the default of Tewoo Group, Hohhot LGFV and Peking University Founder, investors started to realize that the potential government support on local SOE, LGFV and University corporates with weaker fundamental is not as strong as believed. We believe such situation will continue into 2020 and beyond.

Our bottom-up, fundamental-driven investment approach has served our investors well by steering our portfolios away from the landmines. Going forward, avoiding default candidates and identifying oversold credits with solid fundamentals will become increasingly important.

We note some potential situational credit opportunities in 2020, as several weaker credits printed during 2017 coming due in 2020 (see Figure 5). As they approach maturity next year, heightened price volatility is expected with a number of stressed credits potentially requiring restructuring. We will watch how the situations unfold with keen interests in potential alpha opportunities.

Figure 5: Stressed situational credits

Company	Ticker	Average rating	Debut year	Maturing 2020 (USD mln)	Trading price
Tunghsu	DONGXU	CCC+	2017	342	68.5
Huachen Energy	HCELEC	C+	2017	500	54.3
Jiangsu Nantong Sanjin	JINANC	CCC+	2017	298	72.5
Qinghai Provincial Invt Group	QHINVG	CCC-	2017	300	59.9

Zhongrong Xinda	SDCOKI	CCC+	2017	500	51.3
Tianjin Real Estate	TJREOM	NR	2017	100	55.0
Yida China	YIDCHL	CCC	2017	300	74.0
Yihus	YIHUGR	CCC-	2017	250	57.5
Shangdong Yuhuang Chemical	YUHUNG	CCC+	2017	300	75.5
TOTAL				**2,890**	

Source: Income Partners

INDIAN CREDIT – NAVIGATING INDIAN CREDIT MARKETS AMID A WEAK ECONOMIC CONDITIONS

With growth only expected to recover gradually, we think 2020 will be more of the same – with large dispersion in performance. Credits with more near-term refinancing needs and those more geared to the economy could continue to see pressure. Even within the renewable sector which did well in 2019, we think performance will start to diverge. News that certain states are trying to re-negotiate off-take contracts and further delays in payments could weigh on the bonds of the companies exposed.

All-in-all we continue to be selective in the Indian HY space. There are still certain credits which are priced too tight given the current economic conditions – and we would avoid those. However, a handful of names which underperformed in 2019 could be due for some recovery.

INDONESIAN CREDIT – OPPORTUNITIES DOWN THE CREDIT CURVE

With the presidential election completed and Bank Indonesia's easing stance, we see a supportive framework for economic growth. The property sector is expected to see improving marketing sales in 2020 as the residential market recovers. Continuous infrastructure spending will further support demand for industrial estates. Within the coal sector, some coal miners with USD bonds outstanding should have adequate liquidity runway to weather the down cycle amid weakening coal prices.

One key supporting factor we see for this space is the limited maturing debt over the next 12 months. This reduces near term refinancing risk for the sector and provides a time buffer for companies to improve operations. We continue to focus on cash flows and maturity profile in finding alpha opportunities.

C. BASE CASE: NO US RECESSION, FED REMAINS ON HOLD AND CHINA SOFT LANDING

OUR MACRO BASE CASE SCENARIO

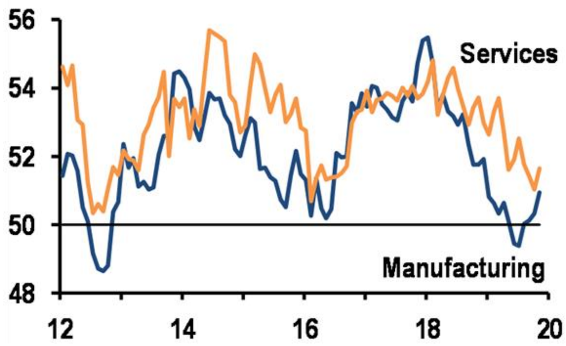
US ECONOMIC VIEW – RECESSION AVERTED IN 2020

We expect that the United States will continue to grow slowly (sub 2%), with minimal inflationary pressures. The economy should escape a recession in 2020 largely thanks to monetary easing in the 2019, and the subsequent improvement in financial conditions (lower mortgage rates, higher equity prices, tighter credit spreads).

Having switched from a hawkish stance to three pre-emptive cuts in 2019, we expect the Fed to be on hold for 2020 and allow the easing to feed through the economy. Inflation expectation is expected to remain benign with wage inflation easing through 2019.

Also supporting our view for a stable Fed policy is stabilization in global PMI's indicating that the initial reaction of trade tension maybe fading, and global monetary stimulus maybe filtering through to the economy (See Figure 6).

Figure 6: Global PMIs starting to show some life



Source: JP Morgan

With the Fed expected to remain on hold and some stabilization in global economies, we look for the 10 year treasury yield to trade between 1.5-2.5% during 2020 as the market navigates around trade negotiations and US presidential elections.

Despite the benign outlook for the US economy in 2020, we continue to remain concerned about the late stage of the economic cycle we are in. The economic expansion is already the longest on record, leverage levels are high and unemployment levels are at cycle lows — thus a turn in the economic cycle is still a medium term risk in our opinion.

CHINA SOFT LANDING

SOFT ECONOMIC LANDING CONTINUES TO MANIFEST

In the third quarter of 2019, China's real YoY GDP growth slowed further to 6.0%, from 6.6% for the whole year of 2018. The slowdown concentrated in manufacturing investment and consumption, mainly due to the lagging effect from last year's deleveraging policy, while net export has showed strong resilience under the trade war uncertainty, and contributed positively to GDP growth. In 2019, the PBOC has injected more liquidity into the banking system, by cutting the Bank Reserve Ratio (RRR) three times to 13.0% form 14.5%.

In the near term, we expect a temporary stabilization of China's economy, coinciding with the recent rebound of manufacturing PMI data globally. However, looking forward, our base case calls for China's economy to slow down further to 5.8-6.0% area in 2020, due to the fading effect of deleveraging policy and potential phase one trade deal with US. For China's economy, we focus keenly on these two moving factors in 2020:

- The speed of credit growth: Our base case calls for China's overall YoY credit growth (Total Social Financing) to stay flat at around 10% in 2020. Any acceleration or deceleration from our base case could bring upside or downside risk to the economy.
- Further development in trade talks: Any volatility from future trade negotiations may bring upside or downside risk to the economy.

D. LOCAL RATES: MEDIUM TO LONG TERM CONSTRUCTIVE ON CGBS; RANGE TRADE IN 2020

CHINA RATES – BULLISH MEDIUM TO LONG TERM; RANGE TRADE IN 2020

We are bullish on onshore Chinese Government Bond (CGB) yield in the medium to long term, for the following reasons:

- The onshore 10-year CGB yield is trading 30-50bps higher than as implied by fundamentals at November end level of 3.17%. Over the past 15 years, China's onshore 10-year government bond yield has been in a range of 2.6-5.4% with China's quarterly real GDP growth ranging between 6.0-15.0% (the lower end occurred in Q3 2019). In 2018, due to deleveraging, the 10-year CGB yield rallied 65bps from 3.88% to 3.23%. In 2019, instead of decreasing along with further economic slowdown, the 10-year CGB yield traded in a tight range of 3.00-3.43%- even higher than the low of 2.6% in 2016 when China's GDP was growing at 6.7%.
- We believe that China's growth will continue to slow down gradually in the medium- to long-term, due to more emphasis on quality of growth and higher base.
- CGB offers more attractive real yield than most DM countries (See Figure 7).

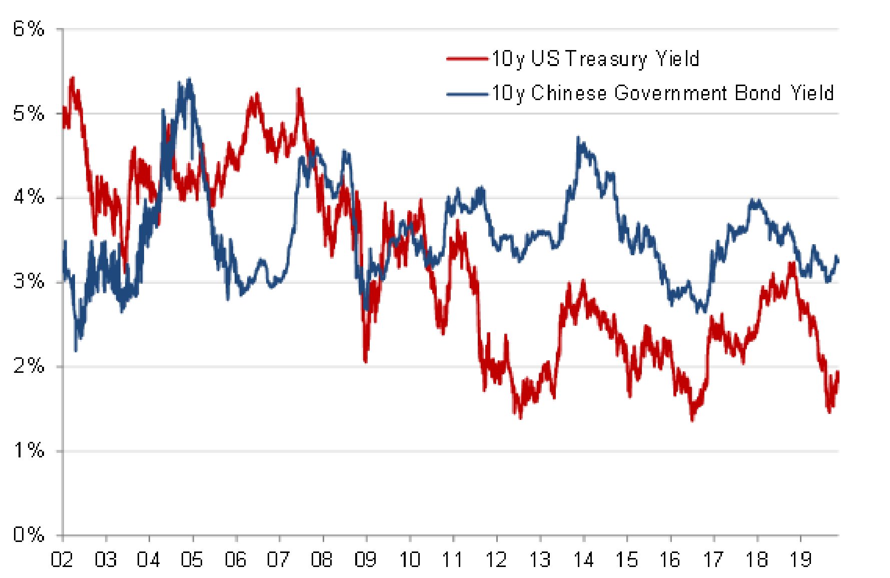
Figure 7: Government bond yields, inflation and real yields

	China	US	Germany	Japan
10-year Government Bond Yield	3.17%	1.78%	-0.36%	-0.07%
Core CPI	1.4%	2.3%	1.3% (Eurozone)	0.7%
Real Yield	+1.77%	-0.52%	-1.66%	-0.77%

Source: JP Morgan

- In 2019 as the CGB yield hasn't followed the rally of US Treasury yield, the yield difference between 10-year CGB and UST has been approaching the widest level in 5 years (See Figure 8).
- However, we believe that 2020 is going to be a year of trading with ~100bps' range in 10-year CGB yield, considering the potential stabilization of China's economy in the near term. As a result, we prefer to actively two-way trade the potential 2.5-3.5% range for the whole year.

Figure 8: China rate gap looks attractive versus US



Source: Bloomberg

E. LOCAL RATES: INDONESIAN LOCAL GOVERNMENT BONDS STILL ATTRACTIVE

INDIAN AND INDONESIAN RATES - BEING SELECTIVE IS KEY

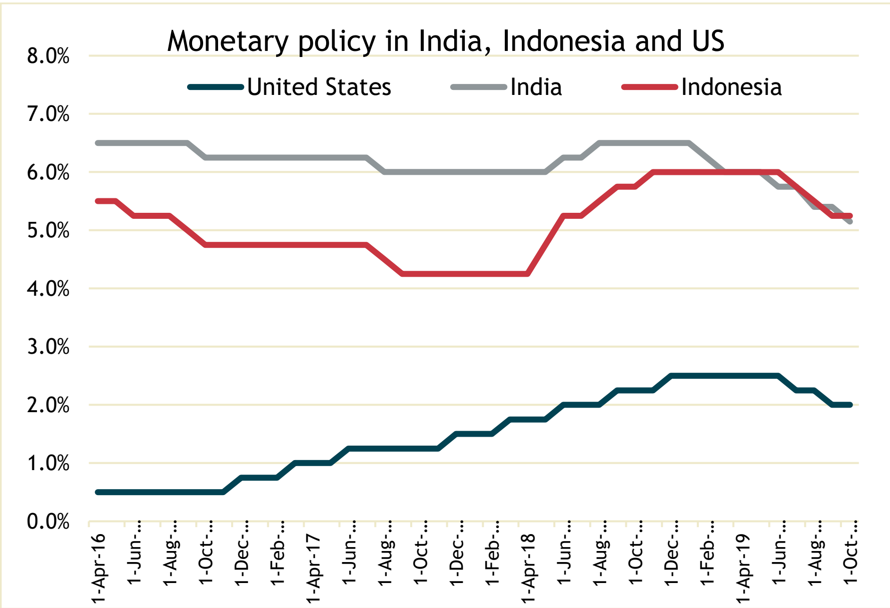
INDONESIA

- Growth estimates are holding up better in Indonesia, with 2020 growth expected to match the 5.0% in 2019.
- However, Bank Indonesia has cut rates 100 bps in 2019, reversing part of the emergency rate hikes seen in 2018.
- We continue to remain positive on Indonesian local bond markets, with more easing likely in 2020.

INDIA

- Consensus growth target for the year ending Mar-2020 has been downgraded to 5.6% from 7.0%.
- A large part of the weakness is due to stress in the Non-Banking Financial Company sector, which has affected credit availability.
- The central bank has responded by cutting rates 135 bps in 2019; further, the government has announced a slew of tax measures to encourage private sector investment.
- We look for a slow recovery in growth rates – and look for credits to benefit from this.
- We are neutral on rates as we think the RBI will remain on hold next year.

Figure 9: Rate cuts in India and Indonesia



Source: Bloomberg

F. KEY RISKS: GLOBAL ECONOMIC SLOWDOWN, US-CHINA TRADE TENSIONS & US ELECTIONS

KEY RISKS WE MONITOR

We see three major risks that can sway the world economy from our outlined base case scenario and impact our trade convictions:

1. **GLOBAL SYNCHRONISED ECONOMIC SLOWDOWN**

   The US economy has been the driver for global growth. Should the US consumption fades due to US-China trade tensions or election uncertainties, we can see a global slowdown in economic growth.

2. **SHARP DETERIORATION IN NEGOTIATION**

   If US-China relations deteriorate derailing trade negotiations, a major correction can occur in the US equity market currently trading at historical highs.

3. **US 2020 ELECTIONS**

   Polls currently suggest Joe Biden as the front runner Democratic Party candidate to challenge Trump for the presidency in 2020. However if Elizabeth Warren were to become a more likely candidate for 2020 presidential election, market could price in much higher risk premium for her taxation policies.

Materialization of any of these 3 risk factors could easily have a severe negative impact on risk assets, given the high valuations (see Figure 2 above). We would be looking to mitigate the negative impact through credit and cross hedges where strategies allow.

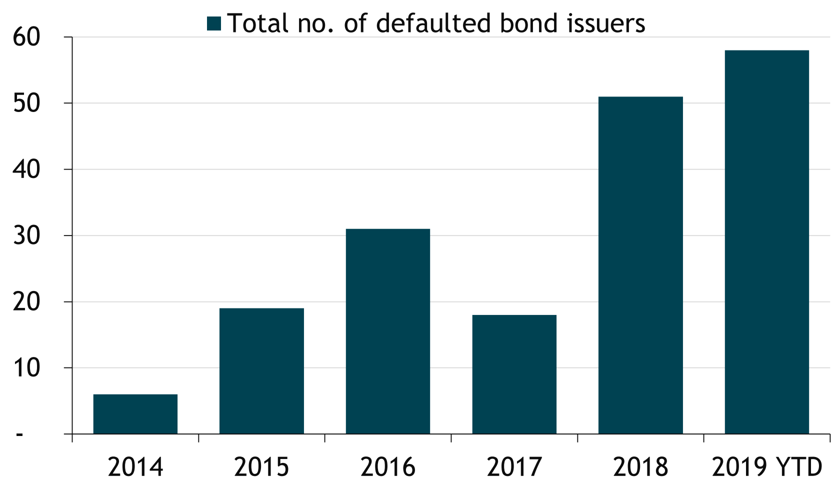
Additionally, risk free rates would likely rally, with the 10Y US Treasury likely breaking below 1.0%.

APPENDIX 1 – DEVELOPMENT OF CHINA ONSHORE DEFAULTS IN 2019

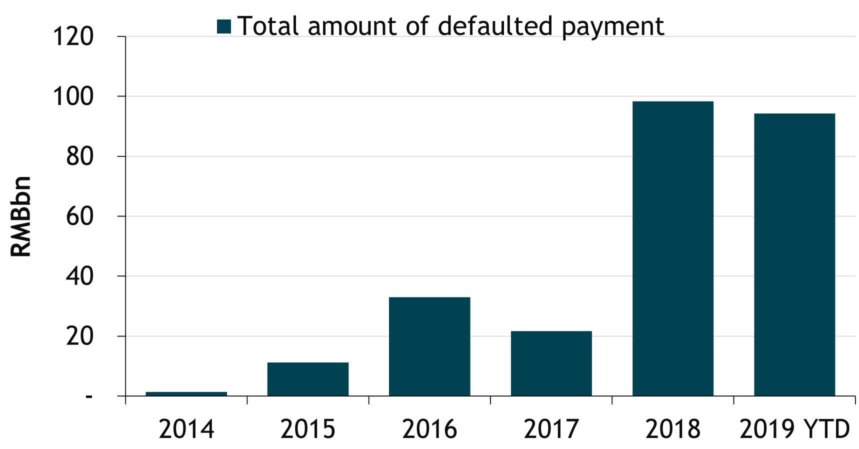
By early December the number of entities that have defaulted in the onshore market this year is already higher than in 2018 (see Figure 10). All these issuers are corporates – no financial institutions have defaulted on their bonds.

Figure 10: China onshore defaults

Number of defaulted issuers



Total defaulted by notional payment

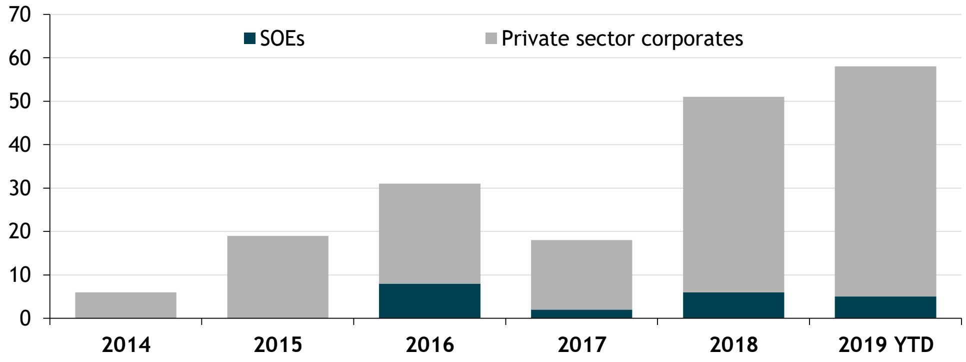


Source: HSBC

It is evident that private sector corporates have a much bigger chance of defaulting than SOEs. Among the 58 names that have defaulted this year, only five are SOEs (see Figure 11). Of the five, two are under the same group, and the other three are not SOEs in the strictest sense. Guoan Group is considered an SOE because 21% of its shares are held by CITIC Group, a central SOE. China Huayang Economic and Trade Group is controlled by an industry association instead of central or local SASAC. And Peking University Founder Group Corp is jointly owned by a university and a POE.

Figure 11: Onshore defaults SOE vs private sector (number of defaults)

Number of defaulted issuers



Source: HSBC

APPENDIX 2 – DEVELOPMENT OF OFFSHORE USD BOND DEFAULTS IN 2019

By contrast, the default rate in Asia USD bonds has actually declined to 1.1% in 2019 (as of 10th Dec 2019) from 2.5% in 2018. There have been 8 defaults totalling USD 2.89 billion

The biggest default of 2019 is New Cotai, which failed to pay USD830 million bonds, the other cases were smaller sizes between USD200 million to USD500 million.

As mentioned earlier, China has experienced numerous POE defaults – this has been the same case in the offshore space, with names including Huiyuan Juice, Kangde Xin, MIE and China Minsheng Investment (see Figure 12).

Figure 12: Offshore defaults in USD bond market in 2019

Issuer	Country	Sector	Amount (USD million)
Huiyuan Juice	China	Consumer	200
Kangde Xin	China	Consumer	300
MIE	China	Energy	316
New Cotai	Macau	Gaming	830
China Minsheng	China	Diversified	500
GCX	India	TMT	350
Haikou Meilan Airport	China	Infrastructure	200
Delta Merlin Dunia Textile	Indonesia	Consumer	300

Source: HSBC