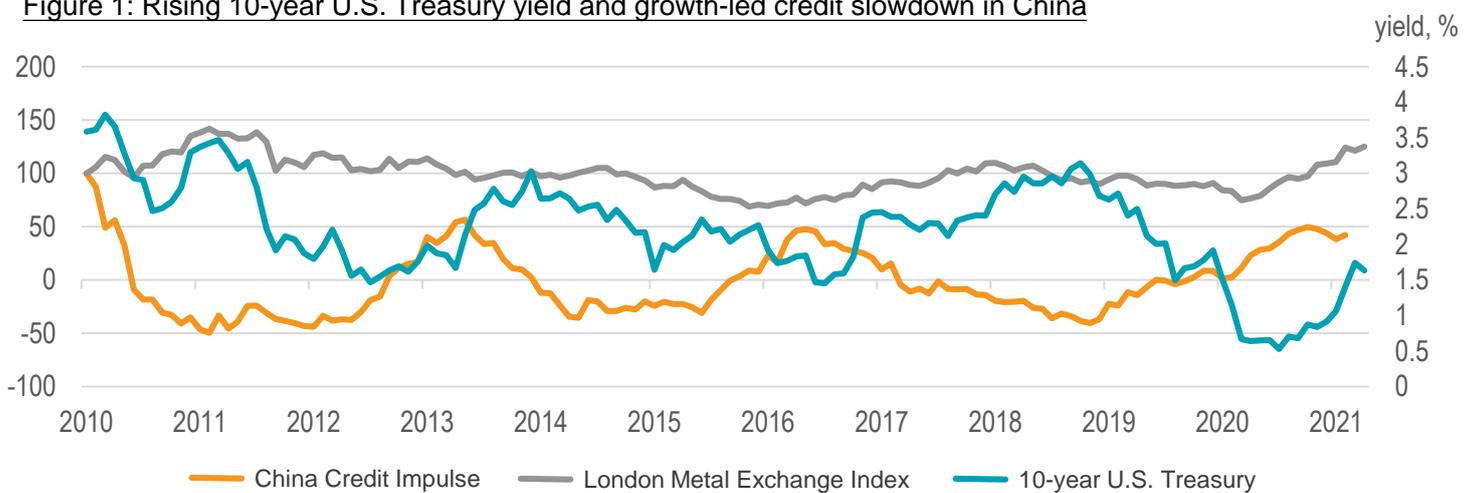


April 2021

1Q 2021 market review

The volatility in the U.S. rates, buoyed by the USD1.9 trillion fiscal stimulus and inflation fear, had picked up materially in 1Q 2021. The sharp move of 80bps in 10-year U.S. Treasury yield (Figure 1) during this period has caught the market off-guard as it resembled a sell-off in the 2013 taper tantrum. Higher vaccine rates, better Purchasing Managers' Index ("PMI") and job data in the U.S. all signal a fast momentum of economic recovery. To further stimulate growth, the U.S. administration has proposed a new fiscal package (infrastructure, health care) to be approved later this year. Given this plan is multi-year, the immediate fiscal impact could be less relative to the extraordinarily large amount in 2020-21.

Figure 1: Rising 10-year U.S. Treasury yield and growth-led credit slowdown in China



Source: Bloomberg. China Credit Impulse and London Metal Exchange Index rebased to 100, as of end March 2021

China's economic activities rebounded strongly in January – February 2021 from a low base, led by exports, property investment and industrial production. The National People's Congress set GDP growth target at "above 6%" for 2021, but there is upside bias on this guidance (markets expect c8.5-9%). It emphasized supportive macro policies to the economy and not to turn sharply. The balancing need for growth recovery and risk control should see credit slowdown persisting. This implies tighter liquidity and regulatory measures, e.g. control of shadow credit, more stringent supervision of financial holding companies and Fintech.

Robust demand from China, supply disruptions and "reflation trade" inflows have supported commodity prices in 1Q 2021. Copper and aluminum outperformed while gold lagged. Oil prices also witnessed a strong rebound (+23% year to date) on collaborative Organization of the Petroleum Exporting Countries ("OPEC") cut and pick-up in demand. A widely expected trend will be sharp accelerations in inflation in the coming months globally and in Asia. With inflation in Asia unlikely to move sharply, central banks' policies should remain loosened except China.

Asian credit valuations

Despite the strong reflationary backdrop, credit spreads of J.P. Morgan Asia Credit Index Investment Grade ("Asia investment grade index") and J.P. Morgan Asia Credit Index High yield ("Asia high yield index") tightened 25bp and 40bps, respectively. Within the Asia high yield index, non-China credits outperformed that of China amidst onshore tightening conditions. A pullback in total return (-1.6% year to date) in the Asia investment grade index was led by the rise in 10-year U.S. Treasury yield and longer duration, while the Asia high yield index fared better at 1% year to date.

Emerging markets exhibited fund inflows in hard currency bonds year to date (Figure 2) except in early March 2021 with a notable move in 10-year U.S. Treasury yields. Lagging growth in emerging markets ex-China versus developed markets and U.S. rates volatility may risk outflows. Nonetheless, Asia should prove to be resilient than its emerging markets peers and faced less redemption pressure. In developed markets, the U.S. Investment Grade bond inflows slowed from March 2021 (+USD81 billion year to date) and outflows (-USD4 billion year to date) was noted in the U.S. high yield bond.

Overall, the prospects for growth recovery in Asia, manageable default rate and the strength in CNY should bode well for the region's dollar bond market and attract fund flows. Asia high yield bond is preferred over Asia investment grade bond on a shorter duration, and from a total return perspective as credit spreads remain at c1 standard deviation (s.d.) cheap over the last five years, or 4.6x over Asia investment grade bond currently (Figure 3&4).

Figure 2: Steady emerging markets fund flows

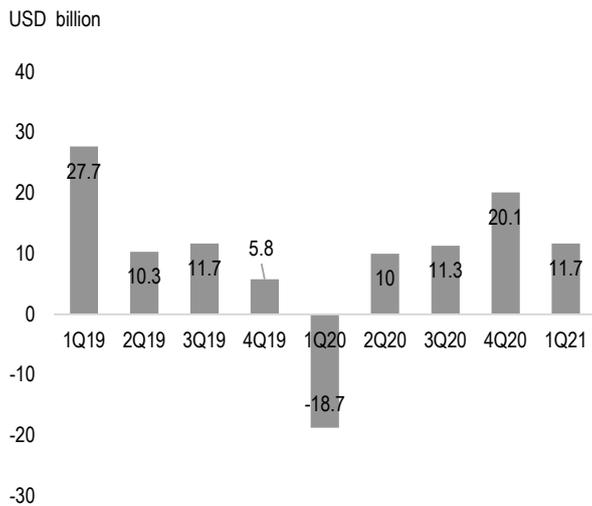
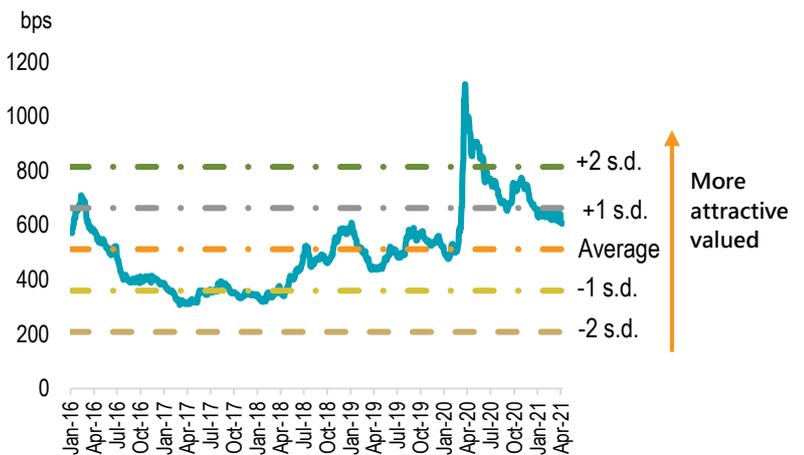


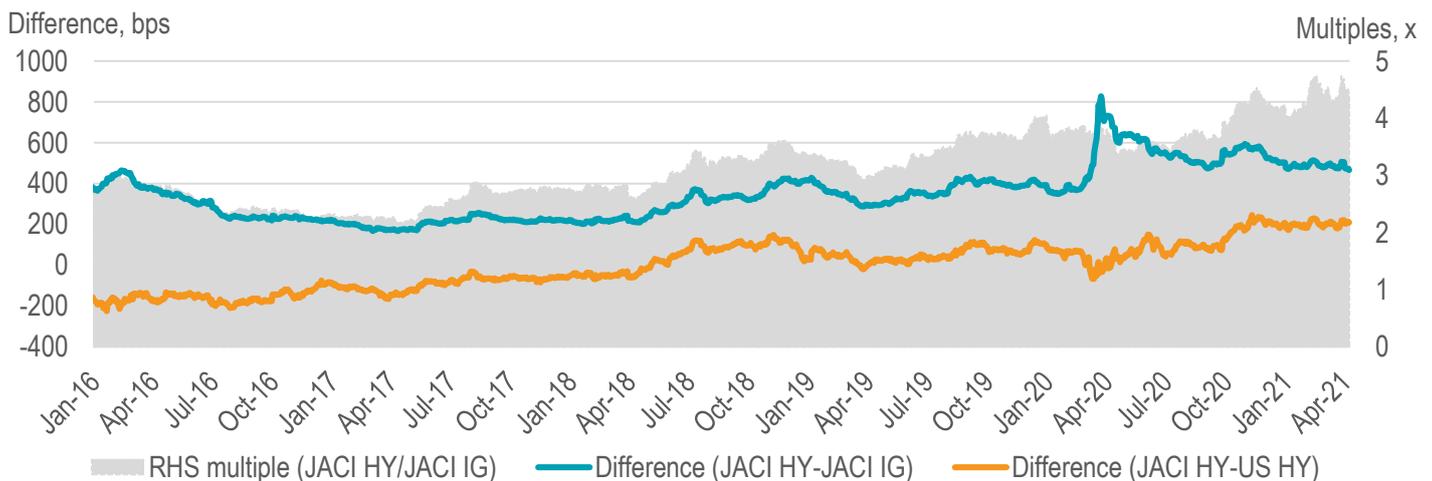
Figure 3: Asia high yield index credit spreads are relatively more attractive



Source: EPFR, Bloomberg, as of end March 2021

Source: Bloomberg, as of end March 2021

Figure 4: Asia high yield index offers attractive value over Asia investment grade index and U.S. high yield index



Source: Bloomberg, as of end March 2021

2Q 2021 outlook and strategy

We believe there are still scopes for 10-year U.S. Treasury yield to go higher at end-2021, though some consolidation may occur in the meantime on flows repositioning, etc. Disappointing data and vaccine pace in the U.S., or yield curve control, may cap the U.S. rates, none of which, however, seems imminent for now. The market will stay cautious on a tapering and rate hike timetable and look for a shift in tone at June/September 2021 Federal Open Market Committee (“FOMC”) meeting. Fed will debate around whether inflation trend is transitory or not, and versus average inflation target (“AIT”) of 2%. Near-term U.S. rate hike remains very remote, in our view.

China’s policy normalization is ongoing and the monetary tone will unlikely turn dovish as growth accelerates in 2Q 2021. Economic activities should accelerate sharply quarter on quarter in 2Q 2021. This is despite GDP year-on-year growth is likely to slow as the base effect fades. **Under this backdrop, we stick with our bottom-up approach on bond selection and focus on more liquid bonds in 2Q 2021, as beta remains high under a growth-led tightening regime in China and as we are closer to a taper discussion. We also adopt a strategy to balance China property exposure with non-China and commodity credits.**

Sector view - Chinese property

Figure 5: China property - monthly contracted sales

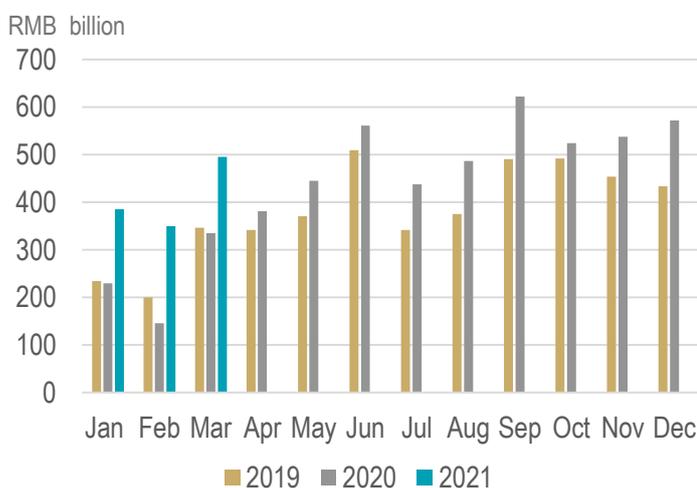
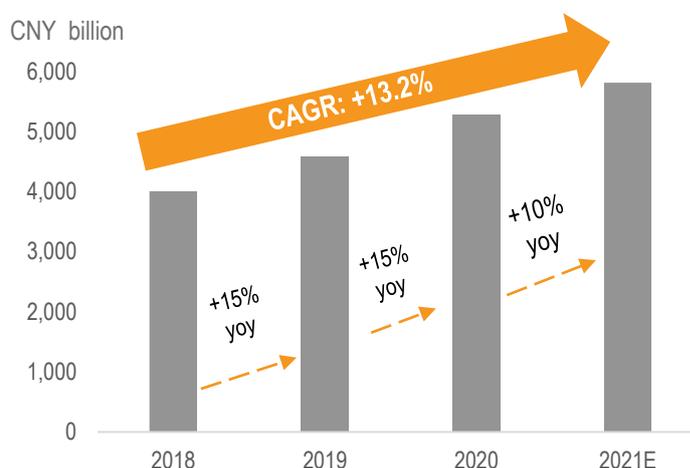


Figure 6: China property - growth in contracted sales



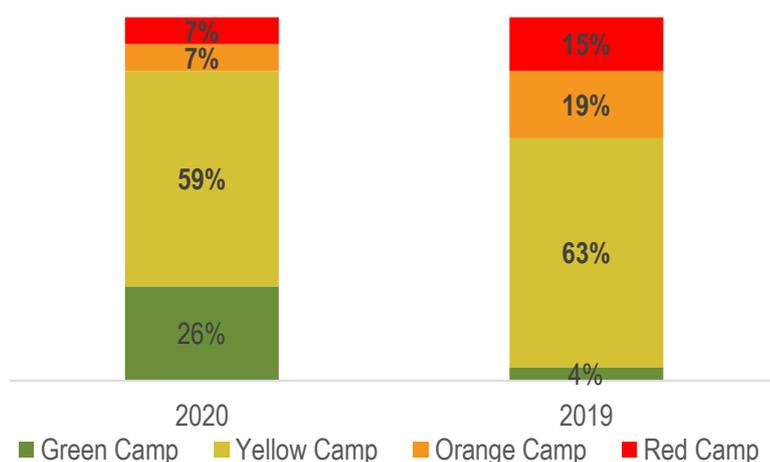
Source: Company data from 27 listed Chinese developers, as of December 2020

Fundamental: Among the 27 listed Chinese developers we track, contracted sales growth in 1Q 2021 was robust (c90% year on year) due to a low base, and c50% versus 1Q 2019. Developers guided for an average of c10% year-on-year growth in contracted sales for 2021 (Figure 5&6), which we believe is achievable based on sufficient saleable resources. With nationwide contracted sales estimate at -2% year on year for 2021 (11% year on year in 2020, 10% year on year in 2019), developers in the USD bond universe should continue to outperform. FY 2020 results for 27 developers were characterized by lower margin and slower revenue growth but we take comfort in a healthy cash collection rate at c70-80% and a disciplined land banking strategy. These should anchor developers’ credit profiles, in our view.

Margin compression in FY 2020 should not be surprising given high land costs in previous years. Those developers with a competitive edge on Greater Bay Area and urban redevelopment projects are better protected on margin. In 1Q 2021, we noted developers’ land capex shrunk to c30% of contracted sales, from c50-60% a year ago. Tighter financing channels and “three red lines” policies will prompt less aggressive land acquisitions but also modestly erode future growth.

Developers' compliance with "three red lines" noted an improving trend on their FY 2020 results (Figure 7). We are mindful of those developers with the rising deployment of off-balance sheet items to achieve that policy goal. Also, under the new concentrated land supply policy, some developers' top-line growth will decelerate given the increasing amount of non-consolidated joint venture/associates' projects and weaker execution ability on sales booking. A potential spin-off of property management arm and disposal of investment properties are also ways to improve leverage ratio.

Figure 7: China property - compliance on 3 red lines



Source: Bloomberg, % denotes out of 27 Chinese developers, as of end March 2021

Figure 8: China property – net issuance of offshore USD bonds

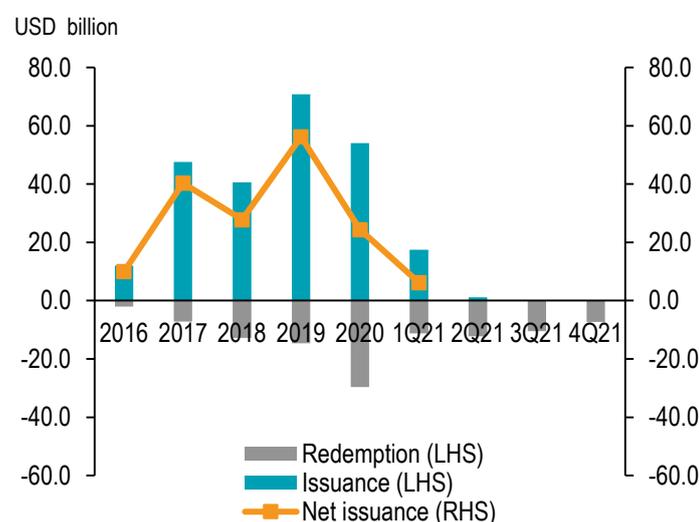
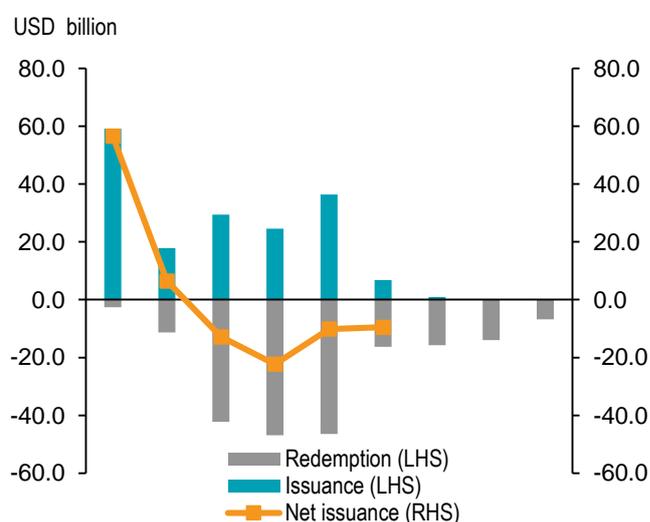


Figure 9: China property - net issuance of onshore RMB bonds



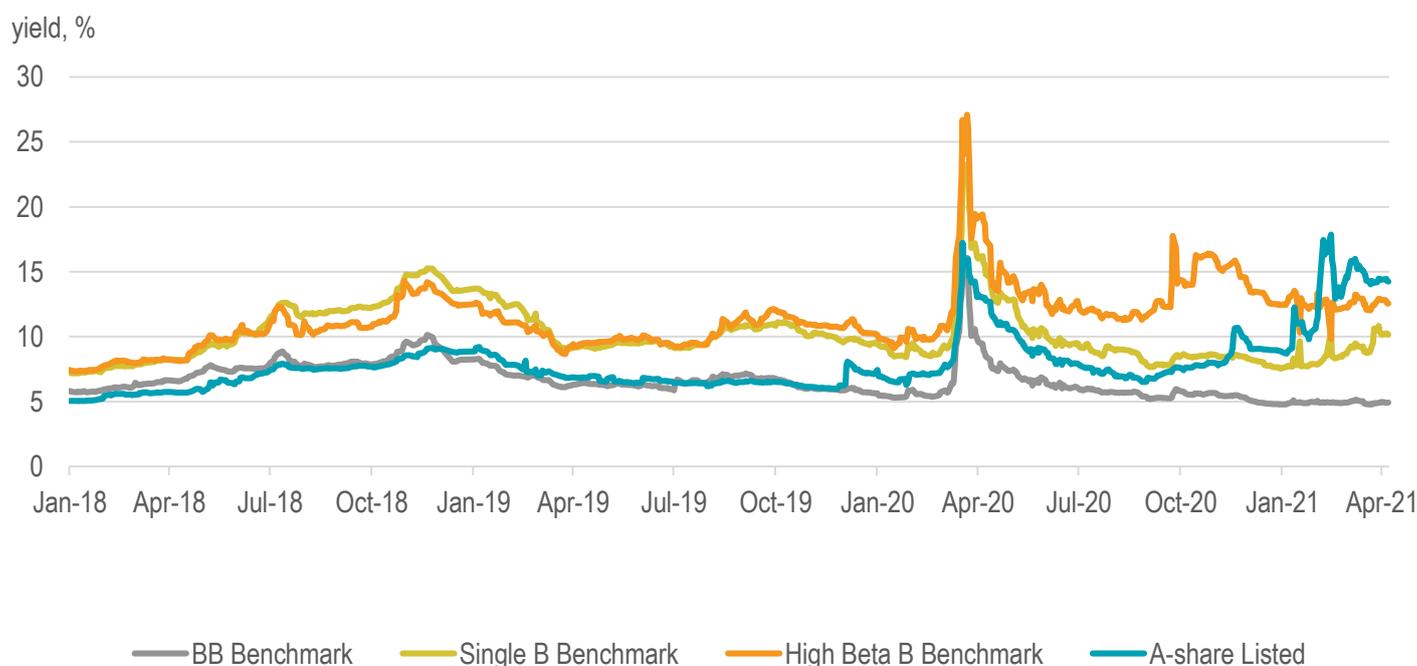
Source: Wind, Bloomberg, as of end March 2021

Issuance/refinancing: Developers managed to raise USD bonds before sentiment turned in February 2021 on the U.S. rates volatility and onshore tightening. The sector recorded positive net issuance in 1Q 2021. We estimate that the sector has cUSD\$12 billion of offshore refinancing needs in 2Q 2021 (+9% quarter on quarter, Figure 8&9), and should be well absorbed by the market on the search for yield and strong sales year to date. In a similar manner, onshore refinancing needs will fall modestly in 2Q 2021 (-4% quarter on quarter). Developers might resort to alternative funding channels, faster cash collection by accelerating project launches or asset disposal to repay its debt due, if the onshore bond channel is shut for refinancing purposes.

Policy update: As credit and leverage usage are widely deployed in the property supply chain, the non-standard financing channels (e.g. trust loans), and broadly, mortgage growth and price cap in selective cities, were under close scrutiny in 1Q 2021 to avoid overheated land market and financial risks. The concentrated land supply policy in 22 cities (released on February 2021) is expected to increase transparency and stabilize land premium. Nonetheless, developers with reliance on the land auction market will require better financial management on the allocation of more capital during the auction period as they could face more competition on the overlapping of project launches amongst developers. This could also alter the seasonality of the sales pattern.

Valuations and preference: The sector's USD high yield bond returned -1.6% in 1Q 2021, and yield levels continued to be driven by credit differentiation (Figure 10). A-share listed developers underperformed as sentiment waned post sell-off of China Fortune Land and tighter onshore conditions. Yield differential of B over BB-rated developers also widened to 520bps, from 290bps at year start, on Yuzhou's surprised earnings miss. We believe the case of Yuzhou is extreme given its super aggressive revenue booking practice and heavy use of joint venture/associates. However, we would also be mindful with the issuers who have low contracted liabilities to revenue coverage and extensive use of joint venture/associates structure. **Valuations in selective B and high beta B credits remain compelling relative to U.S. high yield/ Corporate Emerging Markets Bond Index ("CEMBI"). Recovery in China will accelerate in 2Q 2021 and the monetary tone will be on a tightening bias. Hence, we focus on selecting developers a) that prioritize financial discipline and liquidity management over growth; b) with the ability to execute sales and record decent cash collection as growth will slow under current tightening environment; c) with decent landbank quality, including sufficient resources for development; and d) with not so heavy off-balance sheet liabilities.**

Figure 10: Relative value of China property USD bonds



Source: Bloomberg, as of end March 2021

Sector view – onshore China

Rates bonds: China onshore yield fell in January 2021 but reversed course after as liquidity conditions tightened. Despite a rise in government bond yield globally, 10-year China Government Bond ("CGB") yield was range-bound at 3.2%-3.3% in 1Q 2021. We draw comfort that People's Bank of China ("PBOC") will provide support to the onshore bond market and maintain adequate liquidity support.

Heading into 2Q 2021, we believe the tailwinds of the onshore bond market have not been fully released. Economic recovery is on track but the monetary tone remains on a tightening bias. Heavy net supply of rates bonds in 2Q 2021 (1Q 2021: RMB1.2 trillion, 2Q 2021: RMB2.9 trillion) and tax payments in April 2021 will put short-term pressure on liquidity. We believe the 10-year CGB yield will nudge higher at 3.5% in 2Q 2021, and fall in 2H 2021 on more normalized economic growth. Hence, we believe 2Q 2021 presents a good allocation window for CGB bonds. Much stronger domestic credit growth and property market (house prices continued to rise month on month) could pose upside risks on government yield as monetary policy would turn more hawkish.

On credit bonds, gross issuance rebounded to RMB3.2 trillion in 1Q 2021, and net issuance turned positive. On a segmental basis, net issuance of investment grade rated credit bonds increased but lower rated ones lagged on reduced risk appetite. The amount of maturing credit bonds, mostly state-owned enterprise (“SOE”) bonds and local government financing vehicle bonds, will increase modestly in 2021 before tapering off. The onshore credit market has shown some recovery but the aftershocks from SOE default have not been fully eliminated. We are mindful of issuers with lower credit quality and prefer the long-end of higher rated credit bonds.

Sector view - others

China investment grade bond: Credit spreads of China sanctioned investment grade names moved sideways in 1Q 2021. A Chinese state-owned asset management company (“AMC”) was under the spotlight recently due to the delay of its FY 2020 results, and may sell its non-core and loss-making units. Its USD bonds sold off massively. We believe risk appetite will be thin for China AMCs and bonds with keepwell agreement going forward.

China high yield corporate bond: The sector performed well in 1Q 2021, led by commodity related names, which were boosted by strong commodity prices and an optimistic economic outlook. Benchmark BB names were resilient. We overweight some consumption names to take advantage of the ongoing recovery of the economy.

Indonesia/India high yield corporate bond: year to date, Indian Rupee (“INR”) and Indonesian Rupiah (“IDR”) depreciated c5% and c3% against USD. We noted banks exerted a cautious stance on small and medium-sized enterprise (“SME”) loan exposure in Indonesia, after a textile company failed to garner bank support on loan extension in 1Q 2021. That said, we noted some issuers managed to renew their loan exposure with relationship banks.

Indian high yield bond sectors like non-bank finance corporates (“NBFC”), renewable energy and steel were largely stable in 1Q 2021. Domestic demand recovery and supply constraints have helped Indian steel companies to improve cash flow and deleverage. In China, environmental-related supply side reform will likely curb production in Tangshan and boarder Hebei region, and this should push steel prices higher. On NBFCs, the Reserve Bank of India (“RBI”) is committed to providing liquidity to the sector by extending the maturity of the scheme of support from March 2021 to September 2021. Moreover, an Indian oil and zinc producer completed a tender offer exercise for its shares and this should help the company to upstream more cash to the holdco (or bond) level for debt servicing.

Slower vaccine rollouts, renewed risks of lockdown in emerging markets and rising developed markets/ emerging markets ex-China growth differential are risks to emerging markets. The need for diversification should lure more demand in non-China bonds. We prefer Asian commodity names as prices should remain at elevated levels. This will facilitate better earnings growth and deleveraging. We prefer to stay away from longer duration Indian high yield USD bonds given US rates risks and tight valuations.

Data sources are attributed to Bloomberg unless specified.

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