Value Partners
Investing through discipline

2022 Market Outlook

Crouching Tiger, Hidden Gems

December 2021

Contents

Introduction

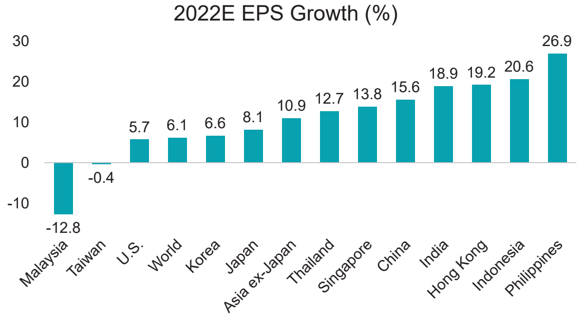
2021 was a year of divergence and extremes. Equity market performances were largely diverged, with developed markets, especially the U.S. and Europe, significantly outperforming emerging markets. This is also true within emerging markets, where there was a huge divergence in performances among countries. There were also big swings and rotations between cyclical value and growth styles.

Global economies transited from a V-shape recovery with a steeper yield curve to mid-cycle expansion with a flatter yield curve. While long-end Treasury yields were moving within a range, investor focus had been shifting between higher breakeven inflation and lower real yields.

We expect 2022 will continue to be a volatile year for equities. The U.S. and Europe will likely struggle with persistently increasing inflation, while growth may start to moderate in the second quarter as the economies enter late-cycle expansion. We anticipate a more hawkish tone from central banks in the first half, as their playbook will change from transitory inflation to curbing inflation. Although it is expected that demand will shift from goods to services and the supply bottlenecks will start to ease, inflation may be more structural in wage growth, food prices, energy costs, and housing prices. That said, tighter monetary policies may be offset by a record amount of fiscal stimulus, such as the infrastructure bill in the U.S. Amid slower growth globally and inflationary pressures, we will be favoring high quality growth companies with strong cash flows and pricing power.

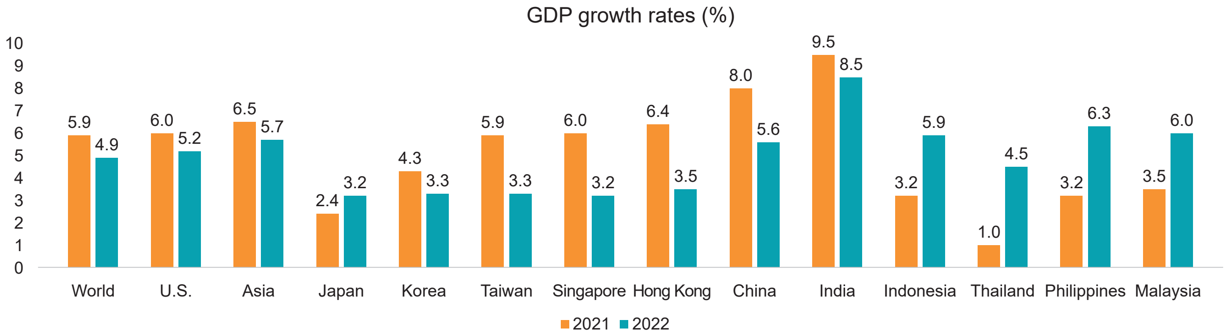
In Asia, although corporate earnings growth will further normalize at a gradual pace, we expect fewer bumps along the road in 2022. The Asia ex-Japan regional earnings (EPS) is expected to grow at 10.9% (Figure 1) amid growth moderation.

Figure 1: Asia ex-Japan earnings growth is more appealing than other regions



Source: FactSet, Jefferies, December 2021

Figure 2

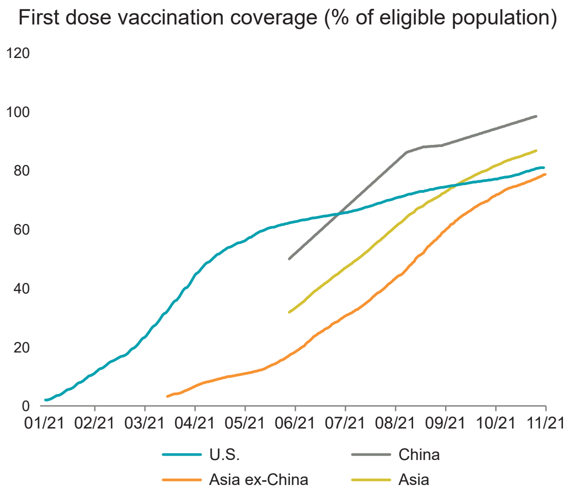


Source: International Monetary Fund estimates, World Economic Outlook, October 2021

Similarly, GDP will moderate in 2022 compared to 2021, while still maintaining decent growth levels (Figure 2).

One of the supporting factors in Asia is the improving pandemic situation across the region, including Southeast Asia and India, whose domestic economies were battered by resurging infections and strict on-off lockdowns. The increasing vaccination rates across these markets will continue to relieve strict pandemic measures, with a better chance for re-opening their borders (Figure 3). Similar to 2021, we continue to monitor the situation across the region as pandemic risks remain. We view that new variants, vaccination rates and their effectiveness, the willingness to get vaccinated and border controls are all factors to pandemic recovery.

Figure 3: Vaccination rates across Asia are improving



Source: Our World in Data, CEIC, Morgan Stanley Research

Sub-asset Class and Asset Allocation Views for 2022

Figure 4: Asset allocation views for the next 12 months

Equities		Bonds		Alternatives	
U.S.	→	U.S. Treasury	↓	Real Estate	→
Europe	↓	Other developed markets government	↓	Gold	→
Japan	↑	U.S./European investment grade	↓	Base Metals	↓
North Asia (ex-Japan)	↑	Asian investment grade	→	Oil	↑
South Asia	→	U.S./European high yield	↓	Cash	→
Other emerging markets	↓	Asian high yield	↑		
		Emerging markets bond	→		

↑ Add exposure → Remain the same ↓ Reduce exposure

Source: Value Partners, December 2021

Developed market equities

U.S. equities

We expect the Fed to be more hawkish with an immediate rate hike after tapering ends. The persistently high inflation numbers may affect consumer and business confidence. Corporate earnings growth will likely be much slower compared to 2021, while the downgrade cycle may start in the second quarter with a high base effect. Given these, we anticipate that some market correction will likely happen in the first half as valuations remain expensive. However, with the mid-term elections coming in 2022, the U.S. President would focus on achieving maximum employment and support growth. We expect that overall liquidity will not be tightened too much and the market shall perform better in the second half.

European equities

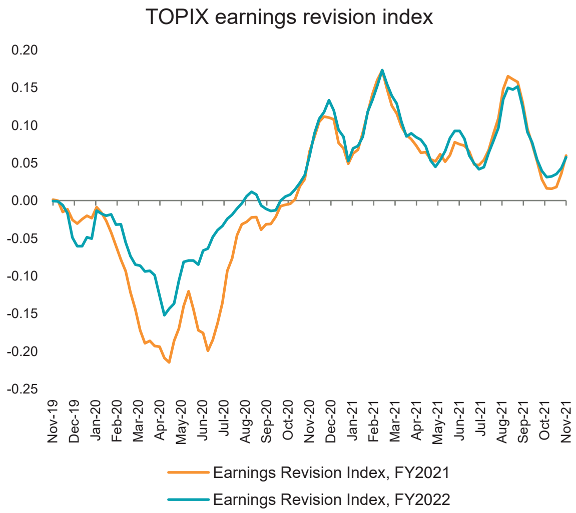
After a strong economic recovery in 2021, we expect growth to slow down significantly without additional stimulus. With the new Omicron variant, there will likely be diverged policies towards lockdowns and border controls among the different countries in Europe, as we have seen in recent months, which will impact economic recovery in the region. As a result, we view that earnings growth will moderate and expect downgrades. On the other hand, the European Central Bank will be more patient compared to the Fed in terms of tightening, but high gasoline prices will continue to drive inflation.

Japanese equities

Japan's economic recovery lagged significantly behind other developed markets in 2021. However, the huge economic stimulus package amounting to about US$490 billion that was passed in November should drive economic recovery and support the resumption of consumption growth and economic activities. However, investor sentiment towards Japan remains weak and needs time to pick up.

Corporate earnings will likely continue to recover and we view that Japan will be one of the very few countries that will continue to have earnings upgrades. Coupled with positive earnings revisions (Figure 5), as well as attractive valuations backed by strong corporate fundamentals, we continue to see pockets of opportunities in the Japanese market relative to its Asia-Pacific peers.

Figure 5: Japan is seeing positive earnings revisions



Source: I/B/E/S, Factset, Goldman Sachs Global Investment Research, November 2021

North Asia (ex-Japan) equities

China

We believe that China is set to yield better market performance in 2022. The country has been ahead of the economic cycle since the onset of COVID and will continue to play counter cycle compared to the west. As both the power outage and high commodity prices have started to ease, stagflation worries have diminished. Also, targeted easing has begun to roll out, with credit supply gradually picking up.

We expect the economy to bottom in the second quarter and more pro-growth policies will be released. Corporate earnings are also expected to bottom in the first quarter with a high base effect, and earnings upgrades will begin after the first quarter earnings season.

Although we expect that regulatory headwinds will remain, we view that it will be less surprising compared to 2021. We are also seeing a gradual improvement in the U.S.-China relationship, but China will likely continue to make investments that are in line with its goals of achieving energy and technology independence. We view that China A-shares will directly benefit from the country's economic recovery, as they have higher exposure to sectors that should benefit from targeted measures. In addition, domestic sentiment usually improves ahead of foreign investor sentiment. For offshore China equities, their performance is also supported by their attractive valuations (Figure 6).

Figure 6: Valuations of offshore China equities have become more attractive

Source: Factset, CICC Strategy Research

Hong Kong

Hong Kong's economy has gradually improved, but the pace of recovery will depend on when it plans to reopen its borders. We are finding domestically focused companies having attractive valuations and are expected to benefit from Hong Kong's gradual reopening. However, we expect the market to remain volatile, as Hong Kong will continue to be affected by external factors, including the consequential impacts of the new variant globally and U.S.-China relations.

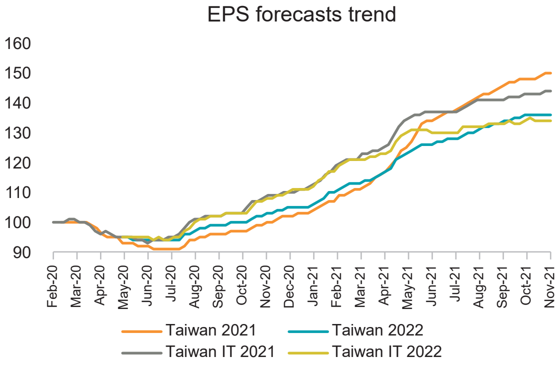
Korea

We are seeing several events that may add to market uncertainties in South Korea, which include the presidential election in March 2022, as well as the path of the Bank of Korea's rate hike cycle. Korea was the first Asia country to raise interest rates, with two rate hikes since August 2021. We expect that earnings growth will remain moderate after a disappointing 2021. The uncertainty in the memory chips cycle may add to the negative sentiment, while the strong U.S. dollar may not bode well for the Korean won. The return of foreign capital inflows will need to take time until we see more visibility from these uncertainties.

Taiwan

Although export and new orders growth will be slower compared to 2021, we view that the upstream technology hardware segment will continue to enjoy strong pricing power and sustained growing demand, as supply bottlenecks will persist at least in the first half of 2022. Earnings visibility remains the highest for companies in Taiwan, especially in the technology sector. While EPS growth consensus forecasts a negative growth for 2022, due to a high base and previous expectations of peaking demand, guidance from companies remains positive and earnings have been upgraded for 2022 (Figure 7). That is because peak demand expectations have been postponed, as the market continues to see strong demand that will last at least up to the first quarter. Valuations are also reasonable and quality companies will be most welcomed by investors given the global macroeconomic backdrop.

Figure 7: Taiwan corporate earnings growth remains on the uptrend



Source: I/B/E/S, November 2021

South Asia equities

ASEAN

We expect markets in this region to catch up as they reopen, with economic activities to gradually move back to pre-pandemic levels. Inflation in the region continues to lag the west, so most of the central banks will be patient with interest rate hikes. However, a strong U.S. dollar and tighter global liquidity are not favorable for their currencies. Among the ASEAN, we expect that Indonesia and Singapore to outperform.

Indonesia

Indonesia benefits from robust export growth of its resources, such as palm oil, rubber and nickel. The newly established Indonesia Battery Corporation (IBC) aims to create an added-value economy in the country's mining and energy industries, particularly in nickel, which is the main component of EV batteries. With Indonesia having the largest reserves of nickel in the world, the IBC should ramp up the country's mining capacity as well as gain market share globally. Meanwhile, the development of its internet and e-commerce sectors will also drive consumer spending.

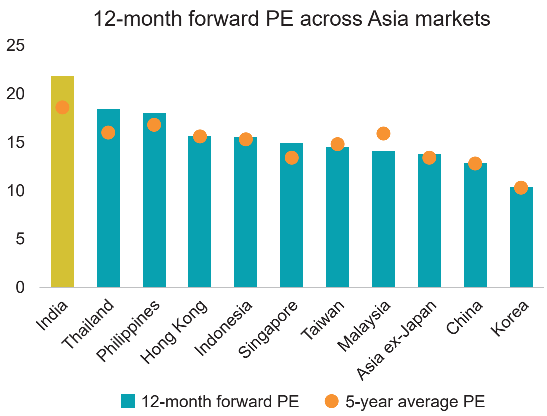
Singapore

Singapore is also on the path of digital transformation and we view that its economy to continue to pick up from reopening. We are also seeing opportunities in the banking space in Singapore, as they tend to benefit from a rising rates environment globally.

India

India saw its equities market rally in 2021, on the back of its improving pandemic situation and rising vaccination rates. Economic activity resurged across the country, with increased public spending and exports. We expect recovery to continue, driven by public capital expenditure on infrastructure. This should eventually lead to more private capex, benefiting the construction sector. Secular growth tailwinds, such as digitalization, should also benefit key sectors in IT services and pharmaceuticals. While India enjoys a long-term secular bull market with expanding new economy sectors and is still in the upward profit cycle, we are cautious as valuations are at extreme levels versus the rest of Asia (Figure 8).

Figure 8: Valuations of India equities are relatively more expensive than their Asia peers



Source: Bloomberg, November 2021

Other emerging market equities

Eastern Europe, the Middle East and Africa, and Latin America are facing higher risks amid vaccination rates remaining low and the spread of the Omicron variant. In addition, these countries are less supported by the expected lowering of cyclical commodity prices, except for oil, as supply is increasing but demand is softening. In addition to these headwinds, we expect that the performance of these regions will also be challenging under a strong US dollar and tighter global liquidity environment.

Fixed income and alternatives

Developed market bonds

We expect that the U.S. and Europe will struggle with persistent inflation and moderating growth. Their yield curves will likely shift upwards as the market expects the Fed and ECB will sound more hawkish to curb inflation. Bear flattening will remain amid moderating growth concerns, which will keep longer-term real yields negative. We expect that returns of government bonds will be unattractive. Credit spreads in both investment grade and high yield bonds have also been very tight and will likely widen as growth starts to slow down and earnings downgrades begin.

Asia investment grade bonds

Credit spreads remain attractive relative to the U.S. However, with yield curves shifting upwards with a more hawkish Fed, we remain neutral in the asset class and remain cautious of duration.

Asia high yield bonds

After a very volatile 2021 in Asian high yield, mostly driven by concerns over China's property sector, 2022 will likely provide a good investment opportunity for the asset class. Credit spreads between Chinese high yield bonds and other Asia high yield bonds, particularly in Southeast Asia, have also diverged. We expect this divergence to narrow, as we anticipate China's economy to bottom in the second quarter with more supportive measures. Valuations of Chinese high yield bonds are at record extremes versus the rest of Asia.

Alternatives

Cyclical commodity prices except for oil are expected to decline as amid softening demand and supply increasing. On the other hand, oil prices will likely be supported as the Organization of the Petroleum Exporting Countries have strong incentives to maintain it at high levels with tight production. In addition, a strong pick up in supply may be challenging given the low capital spending on oil extraction in the past few years. Meanwhile, the performance of gold will likely be capped by higher interest rates. Gold remains a good hedge against geopolitical uncertainties and usually benefits from easing fiscal policies.

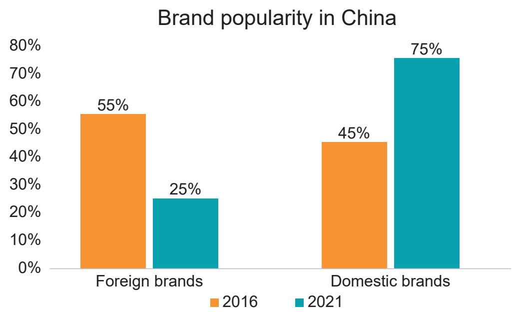
Equity Sector Focus

Consumption upgrade – China is still in a sweet spot

We remain positive about China's consumption upgrade story as the country pushes its agenda of domestic consumption to support a more sustainable economy. Under the current government agenda, China is set to narrow the income gap between rural and urban areas, and achieve an urbanization rate of 65% by 2025. The rising income of over 500 million rural population and the urbanization process would increase income per capita and expand the middle-class population, boosting domestic consumption upgrade.

We continue to look for opportunities from consumption upgrade beneficiaries, especially those domestic companies with the capability to establish premium brands. This is particularly crucial as the China Z generation's preference for domestic emerging brands (Figure 9) supports the pricing power of these companies in the mega consumption upgrade trend. That said, quality consumer brands could charge higher prices for their products, which are more innovative or of better quality and support margin upside. These premium branding companies have apparent advantages in the baijiu and sportswear sub-industries.

Figure 9: Popularity of international and domestic China brands

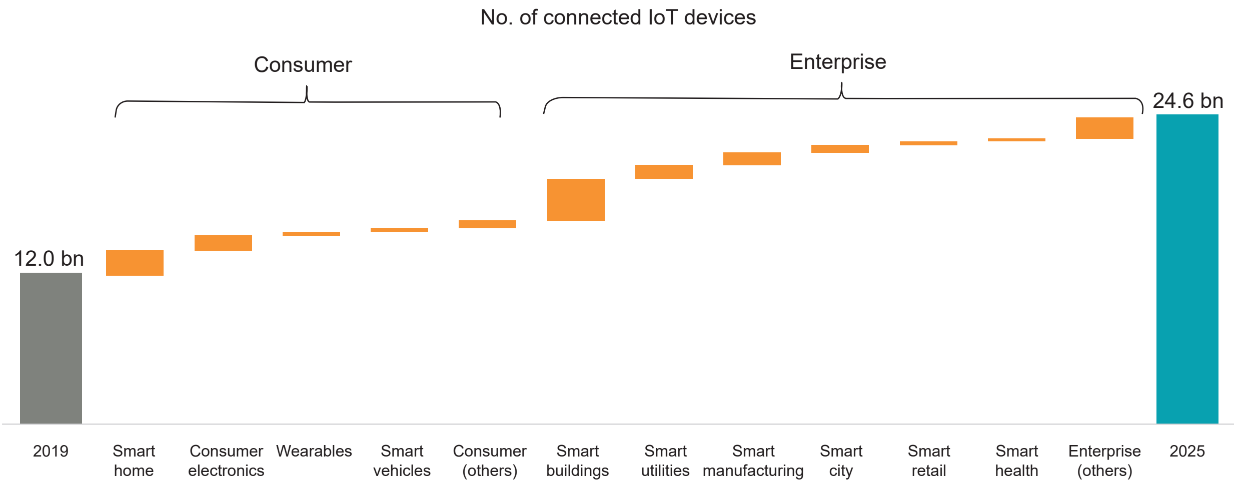


Source: Baidu, CICC Research

Asia technology leaders – Digitalization and electrification

Technology continues to provide long-term opportunities, driven mostly by the need to digitalize and adopt advanced and assistive technology in daily applications. The rollout of 5G has enabled technology to further evolve, driving rapid advancements in areas in cloud infrastructure and the Internet of Things (IoT). The number of connected devices, underpinned by 5G, is expected to double from 12 billion to about 25 billion in 2025 (Figure 10).

Figure 10: Over 12 billion incremental IoT device connections by 2025



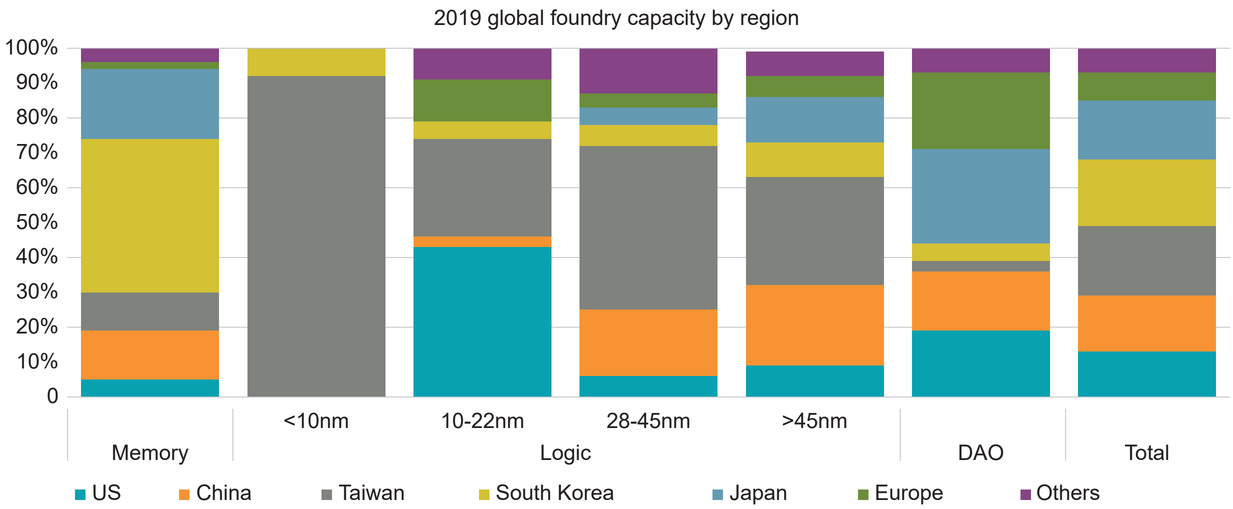
Source: GSMA Intelligence, March 2020

We are seeing a structural growth cycle in this digitalization trend. For instance, the global artificial intelligence (AI) market is expected to reach US$171 billion at a CAGR of 35% by 2025, as companies are investing and deploying AI into business models[1]. The IoT market, meanwhile, is expected to grow to US$1.85 trillion at a CAGR of 25.4% by 2028[2].

Asia is set to benefit from this rapidly growing market. The region, for one, is a market leader of high performance computing (HPC), which is the ability to carry out large scale computations to solve complex problems. When combined with AI, machines can make better and more informed decisions. Compared to other regions, Asia's HPC sales are expected to be double that of the world's in 2023[3].

Asia is also home to the leading foundries and integrated circuit (IC) designers, which manufacture, design or supply key components to IoT devices and other applications. In 2021 alone, Asia accounted for about 70.1% of global semiconductor sales globally, which compares with 52.5% in 2001[4]. In terms of foundry capacity, Asia accounts for 72% and 89% of the world's foundry capacity in 2019 and 2020, respectively, with all advanced logic capacity of under 10 nm (nanometers) located in Taiwan and South Korea (Figure 11). With limited competition and rapid demand for advanced logic capacity, we expect high-end semiconductor supply tightness to persist in the short-to-medium term, leaving room for price hikes.

Figure 11: Asia leads in terms of foundry capacity



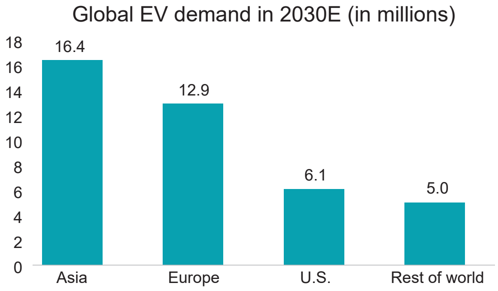
DAO – Discretes, analog and optoelectronics & sensors
Source: SIA, company data, BofA Global Research, November 2021

[1] Business Wire, August 2021
[2] Fortune Business Insights, September 2021
[3] TSMC, Intel, Value Partners Forecast, October 2021
[4] BofA Global Research, World Semiconductor Trade Statistics, October 2021

Besides digitalization, the electrification of daily applications is also a big trend.

This is especially true in the electric vehicle (EV) market, mostly driven by carbon neutrality goals by various economies globally. Globally, demand for EVs in Asia is expected to be highest, propelled by increasing awareness for climate change, subsidies and tax rebates (Figure 12). EV battery suppliers in Asia are also poised to benefit from this rising demand. In the region alone, Asia accounts for 80.5% of the EV battery market[5].

Figure 12: EV demand in Asia is the highest in the world



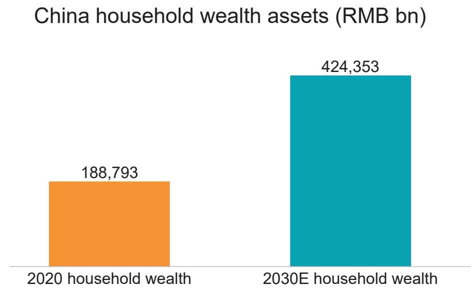
Source: Morgan Stanley, October 2021

With more consumers and enterprises across various sectors adopting advanced technologies, we are finding ample room for growth for the Asian technology leaders that enable the growing digital transformation trend.

Financials – Asset diversification towards financial assets in China

We continue to favor companies that provide wealth management services in China. The opportunity in the wealth management space is massive, as it is still at an early stage of development. This will be supported by growing household financial assets, which is expected to reach over RMB424 trillion by 2030 from RMB188 trillion in 2020 (Figure 13).

Figure 13: China's growing household wealth to support wealth management industry

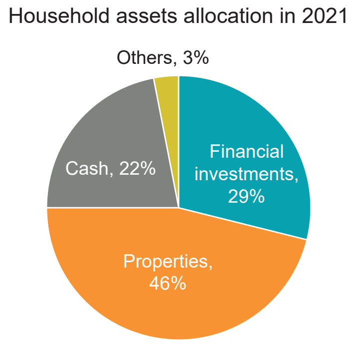


E = Morgan Stanley Research estimates, October 2021
Source: CEIC, WIND, PBOC, SSE, Trust Association, China Banking Association, AMAC, CBIRC, Morgan Stanley Research.

The room for growth in the asset and wealth management industry is huge, as a bulk of their household assets are in properties, followed by cash (Figure 14). However, this is set to change driven by needs from investors to diversify away from property investments to financial assets.

[5] BofA Global Research 2021

Figure 14: Property continues to dominate Chinese household assets but it is expected to shift to the underpenetrated financial investments



Source: HSBC Research, Value Partners, December 2021

Recent policy changes, for example, have prompted increasing diversification towards financial products from lackluster property sentiment. With the government's social prosperity agenda, regulations have started to tighten the property market in a move to ensure housing is affordable and to restrain the over-allocation of resources to the sector.

These measures include curbing property prices by tightening credit for developers and home mortgages. For example, the "three red lines" policy aims to control the amount of debt developers have. With most developers lowering their gearing ratios, Chinese real estate companies are expected to be less aggressive in their expansion plans as their profit margins have been squeezed by a series of cooling measures to hold in housing prices. Other measures include requiring domestic banks to limit the ratio between their outstanding property loans and total loans, as well as setting ceilings for the ratio of home mortgage loans. The government is also setting higher mortgage rates for second home purchases, in a move to further crackdown speculation. All these are expected to drive a more muted demand and supply in the property market.

In addition, around 70% of urban nationals already have their first home, and as the government curbs speculation investment in property, household assets could shift into the wealth management market, underpinning the tremendous demand growth of investment products especially mutual funds.

Given these factors, it is estimated that about RMB170 trillion of household assets will flow into the wealth management market by 2030[6]. This should more than triple the revenue opportunity for the asset and wealth management industry.

Among the major wealth management products, we expect mutual funds to be the key beneficiary. The mutual fund industry delivered solid growth of 33% amid the moderating growth environment in 2021. We remain constructive on the industry to gain most of the inflows in the years to come, generating more fee income, which will be a major earnings growth driver in the financial sector.

[6] CEIC, WIND, PBOC, SSE, Trust Association, China Banking Association, AMAC, CBIRC, Morgan Stanley Research, October 2021

Fixed Income Views

Inflation expectations in the driving seat

The latter half of 2021 was characterized by further growth normalization as fiscal stimulus and low base effect faded away. Global inflation, however, remains to be the dominating theme going into 2022, driven by ongoing supply chain constraints and high energy prices. Rising vaccination rates releasing pent-up demand and potential wage gains in the U.S. could accelerate inflation worries. We expect that supply chain issues may be resolved in 2022, which may alleviate some of these inflationary pressures.

However, emerging coronavirus variants may fuel uncertainty on growth recovery. Markets would therefore likely maintain the expectation for a very gradual Fed hiking cycle. There are scopes for the 10-year US Treasury yield, which is around 1.5%, to nudge a tad higher by the end of 2021, but we see the magnitude nowhere close to the extreme move in March 2021. Despite tighter financial conditions in the U.S., ample liquidity and sizable negative-yielding bonds amounting to US$11.7 trillion globally would continue to lure demand for yield-enhancing assets.

China policies take the spotlight

In China, policy drove much of the volatility in the second half of 2021. With the government's priority on controlling financial risks and leverage, credit growth would remain subdued. Nonetheless, we expect that credit contraction is bottoming and some marginal rebound should occur in the coming quarters. Slower growth momentum and People's Bank of China's (PBoC) keen maintenance on liquidity should limit 10-year Chinese government bond (CGB) yields, currently at 2.9%, to rise materially. Moreover, persistent foreign inflows into the onshore bond market and strong trade exports should mitigate cyclical headwinds for the renminbi, which should bode well for the Asia dollar bond market.

The recent PBoC narratives downplaying the concerns on inflation and the use of other monetary measures to maintain stable liquidity has diminished hopes for further RRR cuts. Specifically for the property sector, with more failed land auctions and cooling property sales, the PBoC guided banks to resume giving out mortgages in several cities and provide loans to ensure a healthy state of the sector. The potential launch of a nationwide property tax next year may affect sentiment. Overall, we believe the government will keep a tight stance with some marginal adjustments to avoid a material spillover effect from the Evergrande fallout and any systemic risks.

As policy and idiosyncratic risks are likely to stay on the horizon, we remain focused on credit quality in 2022. Asia's economic recovery remains intact as pandemic threats are abating. As rising U.S. Treasury rates remain a pressure point for Asian IG, especially when credit spreads are tight, shorter duration is preferred. China high yield credit spreads stood at 4 standard deviation above the last five years' average, indicating that a lot of the policy risks and sector consolidation have been priced in. Through our active management and bottom-up approach, we focus on searching for candidates that are long-term "survivors" but dislocated in terms of valuations. We believe they offer compelling value within the emerging markets space. As the Chinese property sector is undergoing consolidation with leverage control, this should anchor their credit profiles in the longer run.

Sector views

Onshore China

The RRR cut in early July and December 2021 aggravated market concerns on China's economic downturn. Regulations on real estate and local government financing vehicles have not been relaxed. We view that there are obstacles for PBoC to pursue more RRR cuts and monetary policy may only focus on marginal easing. That said, we cannot entirely rule out a cut amid the moderating economic outlook.

Rising U.S. Treasury yields are becoming constraints for the China bond market. However, we view that this affects sentiment more than actual flows. Foreign funds participation into the China bond market should remain robust, despite the narrower U.S.-China yield differential at 145bps, versus over 200bps at the start of 2021. More government-related bonds are expected to be issued in the fourth quarter, but that should be met with better liquidity. Hence, this factor alone should place limited upward pressure on bond yields.

Onshore corporate credit bond issuance was flat year-on-year (YoY), while financial bonds dropped sharply due to the new Asset Management rule implemented in April 2018. The rule requires all wealth management products to be valued at fair market value instead of amortized cost, which affects demand. This trend should prevail until year-end for financial bonds. Onshore corporate yield curves should remain steady.

Asia investment grade (IG)

China IG spreads bottomed out in the second quarter of 2021, aided by the bailout of Huarong. The planned capital injection of RMB50 billion by a consortium of state-owned enterprises and the asset disposal of RMB50 billion should provide some reprieve. Outside of China, Indonesia's macro-environment is underpinned by the acceleration of credit growth, while the commodity rally provides a tailwind and narrows the country's current account deficit. These should support the Rupiah despite a hawkish Fed. India is also another bright spot on reduced sovereign downgrade risks.

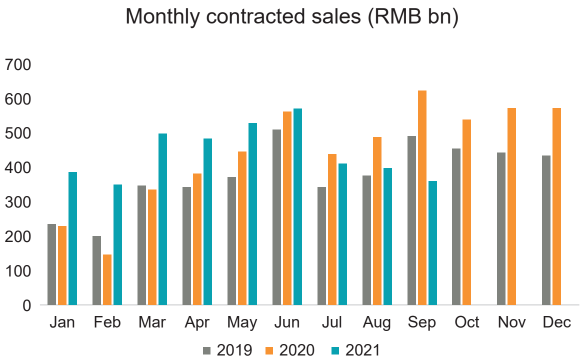
Overall, rising U.S. Treasury yields and the U.S.-China trade tensions would remain key pressure points. Pre-refinancing may bring additional issuance but this should be well absorbed by markets. We view that Asia IG credit spreads may start to widen in the midst of rates volatility and EM outflows. We stay underweight the segment and prefer short duration.

China property

The tighter policy on developers' financing under the "three red lines" and high land prices from concentrated land sales resulted in more failed land auctions. Weaker overall property sales and sluggish prices in lower-tier cities may persist in the fourth quarter. All these may prompt some marginal easing, although we do not expect this to be broad-based. Nevertheless, we believe rigid demand will support sales growth for those cities with increasing populations in the long-run.

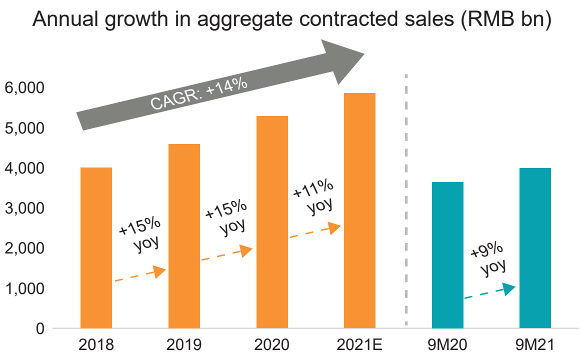
Among the 28 listed Chinese developers that we track, contracted sales growth in the third quarter declined by around 20% YoY (Figures 15 and 16) amid an overall tight policy, fewer property launches and weaker sentiment due to Evergrande. Most developers have achieved about 70% of their full-year targets and more launches are expected in the coming quarters. We believe those targets are achievable on marginal mortgage relaxations and sufficient saleable resources to support sell-through, which is vital for cashflow generation.

Figure 15: Monthly contracted sales



Source: Company data from 28 listed Chinese developers, as of September 2021

Figure 16: 9M21 contracted sales noted 9% YoY growth



Source: Company data from 28 listed Chinese developers, as of September 2021

In addition to the Evergrande saga, Fantasia's default in early October has induced collateral damage to market sentiment. This raises concerns on more defaults, especially for smaller developers or developers that rely on the offshore bond market. Some developers might opt for the debt exchange route if bond markets remain shut for refinancing purposes or opt for offshore asset disposal to raise capital. We believe the sector has priced in most of the downside risks and no policy easing.

As credit differentiation continues to play out, we focus on searching for candidates that are long-term “survivors” but dislocated in terms of valuations. We also have a preference for developers that have lower near-term refinancing needs until the year-end. We estimate that developers in our universe will have dollar bond refinancing needs of US$9 billion in the first quarter of 2022, and RMB bond financing needs of US$8 billion. Refinancing pressure remains heavy. In the medium term, we are more focused on picking developers with better landbank quality and strong sales execution abilities, healthy cash collection rate, and are less exposed to off-balance sheet liabilities. We underweight those developers with heavy reliance on the offshore bond market and short landbank life as most developers slowed down their land acquisitions in recent months.

Macau gaming

Macau gaming bonds have been affected by weaker sentiment in China high yield, slower than expected recovery and regulatory overhang. The degree of government intervention will form another overlay on sector outlook in the longer-run, despite the risk of concession non-renewal being low. Most operators have maintained sufficient liquidity buffer, which should avoid a major correction in bond prices and credit ratings. We avoid the sector as bond performance will likely be capped in the near-term, especially without good visibility on recovery of gross gaming revenue, which sits at 30% of the pre-Covid level.

Commodities

The metal and mining high yield sector had decent total returns thus far in 2021. Global demand for commodities will stay robust heading into 2022. The stimulus package in the U.S and Europe and the push for infrastructure investment from China in the fourth quarter should fuel demand. This should improve EBITDA generation and build up liquidity cushion for commodity players. We see that a huge loosening of supply/demand imbalance is unlikely to happen in the near term, unless the slowdown in China, in terms of infrastructure and property activities, lasts longer than expected. We stay invested in this space with the benefits of risk diversification.

Sovereign high yield

There are uncertainties on International Monetary Fund (IMF) discussions and criteria on taxation and power tariffs for Pakistan to unlock US$1 billion of IMF funds. Investors are also concerned about the steep decline in FX reserves in Sri Lanka. Recently, there was news that the sovereign is approaching Oman and Qatar for US$3.6 billion and US$1 billion of oil credit facility, respectively. For Sri Lanka, we believe the credit story remains binary, and the country’s ability to manage its short-term debt over the next 18 months remains questionable.

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