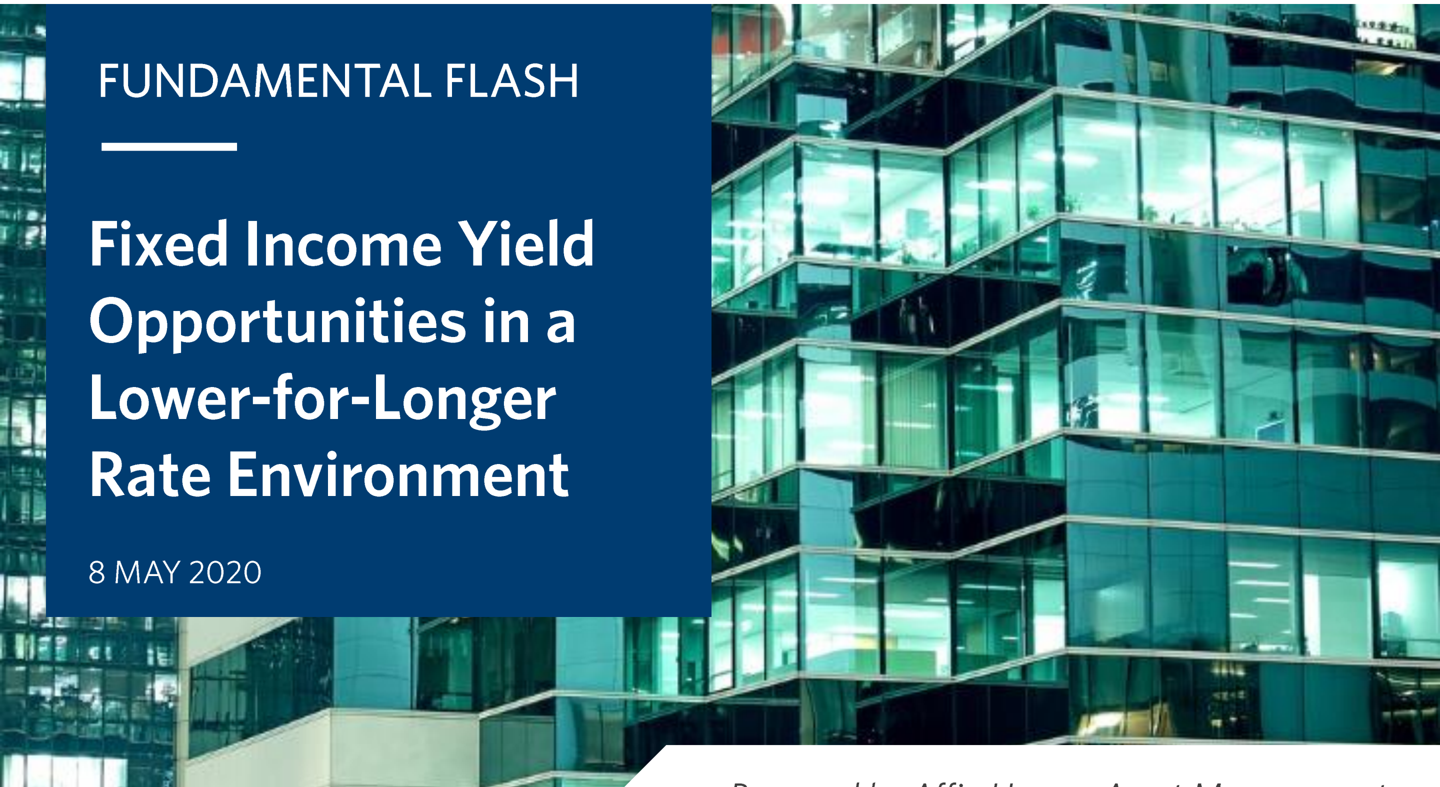

FUNDAMENTAL FLASH

Fixed Income Yield Opportunities in a Lower-for-Longer Rate Environment

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Prepared by Affin Hwang Asset Management

Accommodative Policy Supportive of Bond Markets

Interest rates will stay lower-for-longer as global central banks embark on synchronised monetary easing to gird its economy from the impact of the coronavirus. Globally interest rates are seen dipping to new lows since the 2008-GFC as borrowing costs are lowered in the absence of inflation. Locally, Bank Negara Malaysia (BNM) slashed rates by 50 bps at its recent policy meeting.

Policymakers are doing whatever it takes to shelter the economy as the pandemic forces countries into a virtual standstill due to city lockdowns. Central banks have embarked on a swathe of measures ranging from relief packages, loan facilities and asset-purchases to mitigate the financial impact of the outbreak.

Such stimulus largesse has helped fuel a recovery in many asset classes since the market rout in mid-March, when there was a dislocation in financial markets. Recall during the height of the selloff, we saw a sharp spike in credit spread of investment grade (IG) bonds, where Asian IG bonds were offering yields 400 bps above the risk-free Treasury rate. Similarly, Asian high-yield (HY) bonds were trading above 1000 bps signalling distressed levels.

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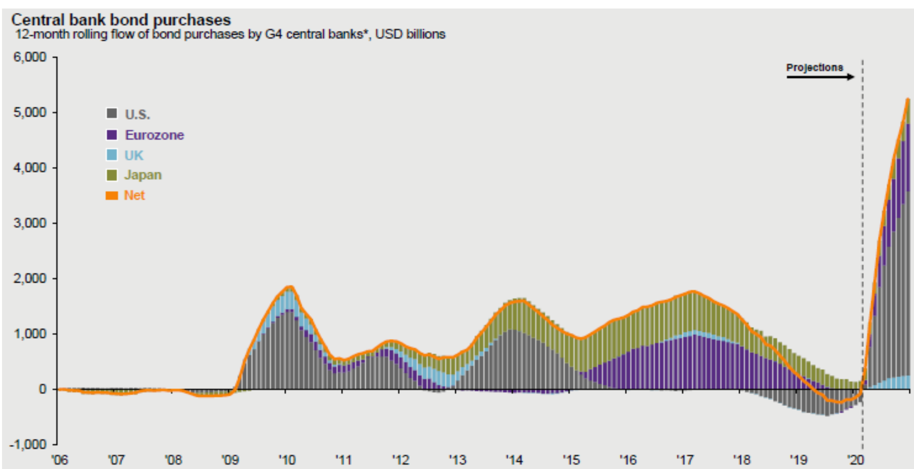
However since April, the fixed income market has stabilised and credit spreads have narrowed again as we see the return of quantitative easing (QE) with major central banks like the US Federal Reserve (Fed), European Central Bank (ECB) and the Bank of Japan (BoJ) ramping-up bond purchases.

In an unprecedented move, the Fed also announced the extension of their purchases into corporate IG and HY bonds effectively stepping in as a buyer of last resort. This influx of liquidity will be supportive of fixed income as corporates are able to tap the bond market for financing without fear of a liquidity crunch.

A low interest rate environment coupled with expectations of further rate cuts will also **be supportive of bond prices and offers a good entry point** for bond investors to gain exposure. Bond yields have become more attractive since the price dislocation in March and offers a good pick-up over fixed deposit (FD) rates that is expected to trend lower as central banks remain accommodative.



Source: JP Morgan, as of 31 March 2020

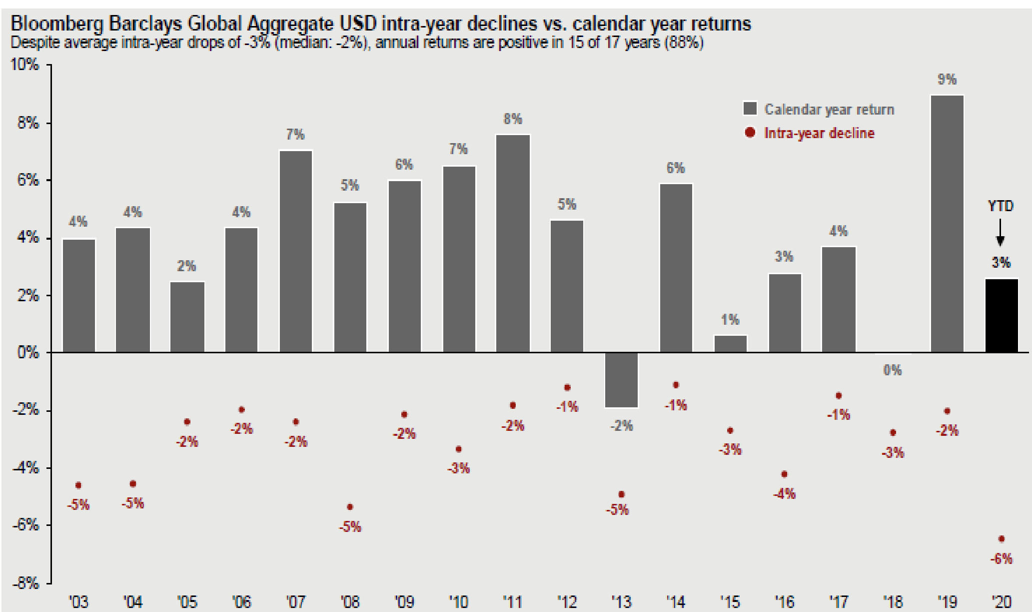
Whilst, we could see risks of defaults and credit downgrade rising as issuers face strain over their cashflows and struggle to repay debt, this is partly mitigated by a volley of fiscal and monetary stimulus measures by governments and central banks that collectively exceed US$8 trillion globally. Various forms of wage subsidies, loan guarantees and quantitative easing programme can help issuers stem the tide and recover from this economic shock. The fixed income market have also priced-in some of these downgrade risks that lay ahead which would cushion downside.

In such an environment, it is imperative to stick with quality and resilient names to weather through this period. Internally, our robust investment process will continually assess the macro landscape and stress-test the holdings in our portfolios under various scenarios to give a true picture of their credit profile.

Economic recovery will be gradual as we see various countries start to ease lockdowns and return to a new-normal state. However, strict social distancing measures in place would prevent business and activity levels from returning to full-scale, without an effective medical treatment or vaccine available.

Importance of Fixed Income

With market volatility here to stay, the role of fixed income as a defensive asset class has gained its stature by providing a measure of stability in one's portfolio. With lower drawdowns in bond prices compared to equities during periods of market turbulence, fixed income can help cushion losses during a downturn given its low correlation to other asset classes. In 24 years of negative equity returns, bonds have stayed resilient and only posted 3 negative years in the period. Bonds have also never had 2 years of consecutive negative returns.



Source: JP Morgan, as of 31 March 2020

Fixed income also helps provide predictable returns in a portfolio through a steady income stream. This can be beneficial during heightened periods of volatility. Investors can also be ensured of capital preservation as the issuer is contractually obliged to repay the principal upon maturity.

As part of a diversified strategy, fixed income plays an important role in providing a useful counter-balance in a portfolio. By building exposure in this asset class through bond opportunities across different segments and sectors, investors can potentially reap an attractive risk-adjusted return that can help one meet their financial goals.

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