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Fundamentals Flash

Asset Management

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AFFIN HWANG CAPITAL

Fixed Income Outlook 2019: Asian Bonds Back in Vogue

In the following interview Esther Teo, Director of Fixed Income, Affin Hwang Asset Management shares her outlook for the Asian bond market as conditions start to ease after a turbulent 2018 and why credit selection is key in a late-cycle.

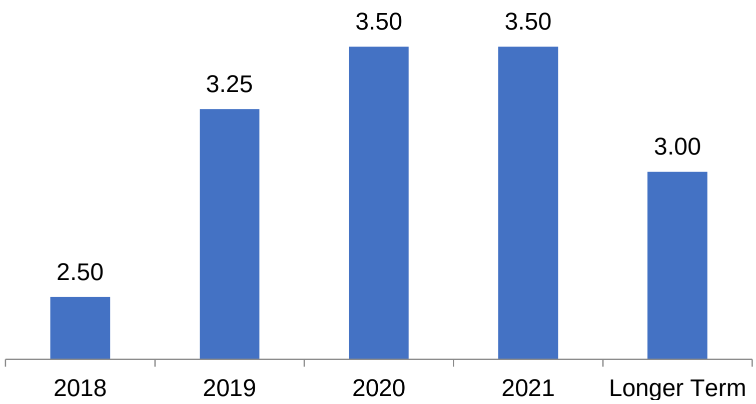
1) What are your expectations and outlook for the fixed income market in 2019?

The global fixed income space endured a challenging stretch over the past year as the US Federal Reserve continued to hike rates in 2018. Emerging market bonds sold off sharply due to a surge in the USD and specific EM country currency crisis such as in Turkey and Argentina, which prompted a reversal of flows from EMs back to the US. Heightened trade tensions between US and China also dampened sentiment in the region.

Looking forward to 2019, we expect to see some of these headwinds recede as we approach the end of the tightening cycle. More dovish comments from Fed Chair Jerome Powell suggests that the central bank would be more patient and accommodative in steering its rate-hike cycle and unwinding its balance sheet.

Currently, Fed funds futures are pointing towards zero rate hikes for 2019 and a chance of a rate cut in 2020. We expect fixed income to deliver positive returns in 2019 and we see attractive valuations in EM bonds. We also expect EM currencies to be more stable as USD strength is near its peak.

US Fed Fund Rate Projection by Federal Reserve



Source: US Federal Reserve, Bloomberg, Dec 2018

Downward Revisions

Expect downward revisions in rate projections:

- Fed Funds Futures pricing-in a pause to tightening in 2019
- Core inflation to hover +/- 2%
- Narrowing growth divergence between US and the rest of the world

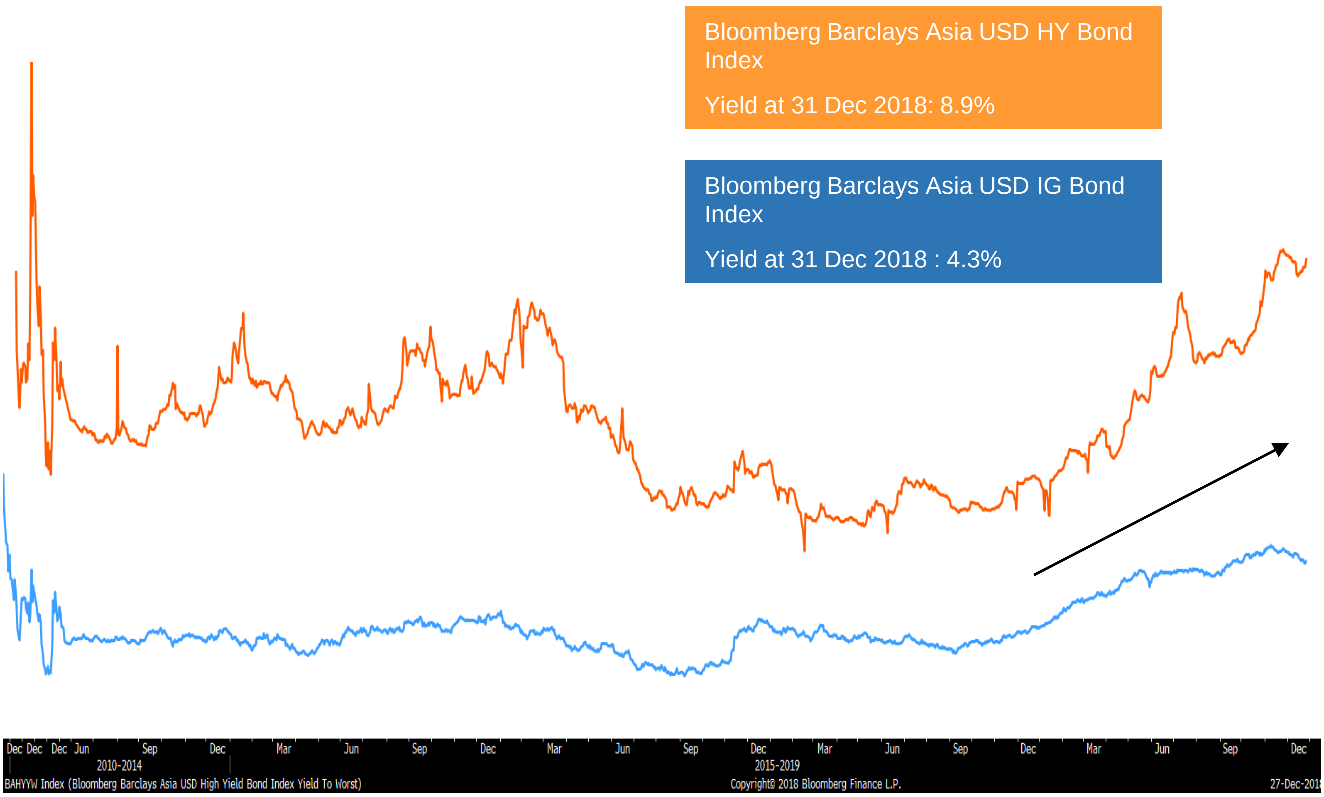
On the domestic front, we expect the same market drivers from 2018 – i.e. strong domestic liquidity and lack of supply to continue to support the local bond market in 2019. We expect GDP growth to moderate to 4.5% - 4.8% this year with lower domestic consumption and a lack of major infrastructure spending as the government tighten its belt. Expectations of a rate cut by Bank Negara (BNM) in the 1H’19 could prop-up demand for government bonds and also bode well for the MGS market.

2) On the credit-side, do Investment Grade (IG) bonds or High Yield (HY) bonds look more appealing?

Bonds have come back in favour as valuation are looking more attractive overall. Post sell-off in 2018, valuations have corrected to far more palatable levels especially within the HY-space with some issuers even offering yield levels of above 10% in the region.

However, credit selection will be key as default rates tend to rise going into a late cycle. The Chinese onshore space may be more vulnerable to defaults as fundamentals deteriorate and refinancing pressures increase. However, we have since seen the People's Bank of China (PBoC) cutting the reserve requirement ratios (RRR) and pumping-in liquidity to shore up the bond market.

We will stay prudent in our credit selection process with a focus on quality and liquid names. In terms of portfolio duration, we intend to have a shorter duration bias, given that the Treasury yield curve is still relatively flat.



3) How should investors position their portfolios then for 2019? Should investors tilt their exposure towards bonds over stocks?

We believe that investors should have a long-term asset allocation plan and be diversified across asset classes. Bonds have a valuable role to play in a portfolio as they provide an added measure of stability by providing regular income streams. Drawdowns in bond prices are also less severe compared to drawdown in equities by providing an anchor to one's portfolio and provide capital preservation

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