

# Asian Credit Strategy

## Valuation: rich or cheap?

Emerging Markets

### Asia credit spreads have reached a new historical tight

Year-to-date, Asia IG (EMIA index) spread has tightened by 15bps to 105bps, which stands at 0<sup>th</sup> percentile for the past 10 year, already inside the last tight of 111bps back in Jan'18 (Exhibit 1); while average spread of Asia HY ex China property (EMHA index ex China property) has tightened by 115bps to 360bps, which stands at 3<sup>rd</sup> percentile for the past 10 year, only slightly above the last tight of 341bps back in Jan'18 (Exhibit 2). From a spread perspective, Asia credit has also outperformed US credit. Spread pick-up over US has declined from 16bps to 9bps for Asia IG (vs. 5 yr avg of 27bps) and from 136bps to 26bps for Asia HY ex China property (vs. 5 yr avg of 146bps) (Exhibit 3 & Exhibit 4).

### While all-in yields are still at the higher end of the range

The tightening in spread has partly happened in response to the back-up in rates. In fact, in the case of Asia IG, the tightening in spread has been more than offset by the increase in rates, resulting in an even higher average yield-to-worst, from 5.25% end-23 to 5.49% now, which stands at 90<sup>th</sup> percentile for the past 10 years (Exhibit 5). For Asia HY ex China property, spread has tightened more substantially than the rates have increased due to constructive stance on credit fundamentals, expectation of extremely low default (credit loss) and almost no new supply. Average yield-to-worst for Asia HY ex China property has declined from 9.14% at end-23 to 8.01% now, which still stands at 67<sup>th</sup> percentile for the past 10 years (Exhibit 6).

### Total return prospects are still attractive

Assuming that rates will reach the year-end level forecasted by our rates strategist (Exhibit 7) and that credit spread remain unchanged, total return for the rest of the year is estimated to be 5.8% for Asia IG and 8.3% for Asia HY ex China property, bringing the 2024 full-year return to 5.3% and 12.1% respectively. With all-in yield still at around 5.5% for IG and above 8% for HY, new supply is likely to be limited as Asian issuers could fund at lower costs in domestic market. The attractive total return prospects, the positive technical and stable credit fundamentals are likely the factors to support the market. See Exhibit 8 for details on our return calculation.

### But most of the return will come from treasuries for IG

While estimated total return is high for both IG and HY, we note that, most of the total return for Asia IG will come from treasuries: excess return is estimated to be only 1% out of the estimated 5.8% total return. A widening of Asia IG spread by 20bps to 125bps will be enough to wipe out all the excess return. HY offers slightly more spread cushion. Average spread of Asia HY ex China HY property will need to widen by 115bps to 475bps in order to wipe out the 3% estimated excess return for the rest of the year.

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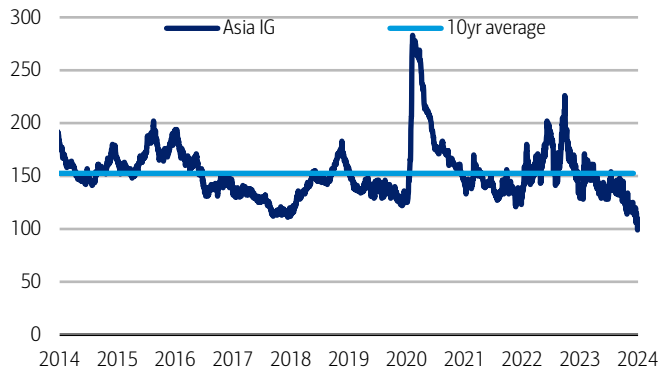
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# Valuation

## Exhibit 1: Asia IG spread history

Asia IG is now trading at 105bp, 0th percentile for the past 10 year



Source: ICE Data Indices, LLC

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## Exhibit 2: Asia HY excl. China property spread history

Asia HY ex China property is now trading at 360bp, 3rd percentile for the past 10 year

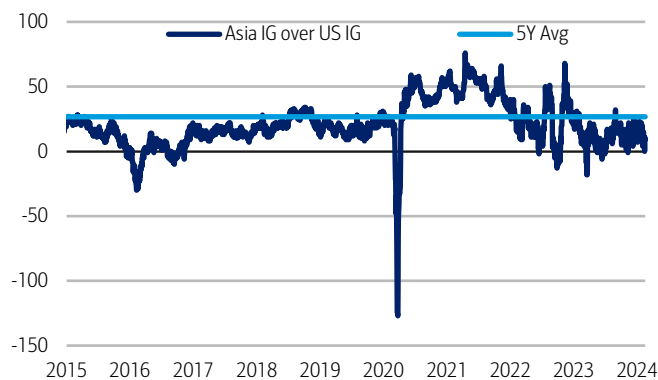


Source: ICE Data Indices, LLC

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## Exhibit 3: Asia IG spread vs. US IG

Spread pick-up of Asia IG over US IG is 9bp now, below 5yr average of 27bp

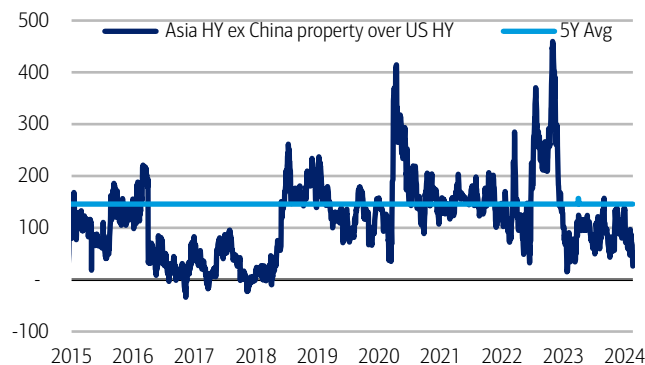


Source: ICE Data Indices, LLC

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## Exhibit 4: Asia HY excl. China property spread vs. US HY

Spread pick-up of Asia HY ex China property over US HY is 26bp now, below 5yr average of 146bp

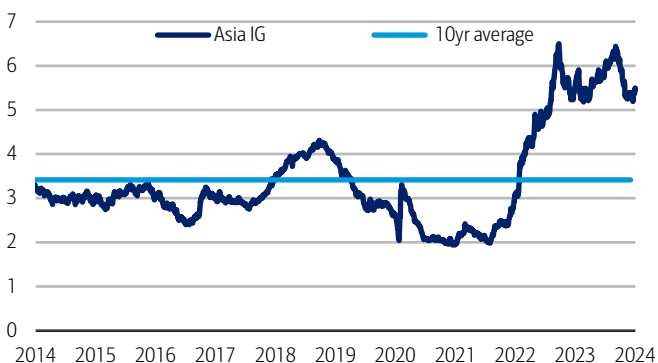


Source: ICE Data Indices, LLC

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## Exhibit 5: Asia IG yield-to-worst

The YTW of Asia IG is 5.49% now, 90th percentile for the past 10 years



Source: ICE Data Indices, LLC

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## Exhibit 6: Asia HY excl. China property yield-to-worst

The YTW of Asia HY ex China property is 8.01% now, 67th percentile for the past 10 years



Source: ICE Data Indices, LLC

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**Exhibit 7: Latest level and rate forecasts**

Our US economic team now expects rate cut cycle to begin in June, with total 75bp cuts in 2024, and 100bp cuts in 2025

	Current	1Q24	2Q24	3Q24	YE 2024	YE 2025
<b>Fed Funds Target</b>	<b>5.33</b>	<b>5.25-5.50</b>	<b>5.00-5.25</b>	<b>4.75-5.00</b>	<b>4.50-5.75</b>	<b>3.50-3.75</b>
2-year Treasury Note	4.65	4.75	4.50	4.25	4.00	3.75
5-year Treasury Note	4.29	4.50	4.40	4.25	4.15	4.00
10-year Treasury Note	4.31	4.40	4.30	4.25	4.25	4.25
30-year Treasury Note	4.44	4.70	4.65	4.65	4.75	4.75

Source: BofA Global Research

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**Exhibit 8: FY24 Return calculation**

Based on our rate forecasts and assume credit spread remain unchanged at the current level, FY24 total return would be +5.3% for Asia IG and +12.1% for Asia HY ex China property

	Assume spread remain unchanged at the current level			Breakeven: no excess return for the rest of the year			Based on our FY24 spread target		
	Asia ex China HY property	Asia IG	Asia HY ex China HY property	Asia ex China HY property	Asia IG	Asia HY ex China HY property	Asia ex China HY property	Asia IG	Asia HY ex China HY property
Current Spread (bps)	130	105	360	130	105	360	130	105	360
YE24 Target (bps)	<b>130</b>	<b>105</b>	<b>360</b>	<b>160</b>	<b>125</b>	<b>475</b>	<b>171</b>	<b>135</b>	<b>500</b>
Change (bps)	0	0	0	30	20	115	41	30	140
Duration (yrs)	4.2	4.4	2.4	4.2	4.4	2.4	4.2	4.4	2.4
Yrs to Maturity (yrs)	5.7	6.0	3.2	5.7	6.0	3.2	5.7	6.0	3.2
Tsy Change (bps)	-13	-12	-44	-13	-12	-44	-13	-12	-44
Total Yld Chg (bps)	-13	-12	-44	17	8	70	28	18	95
Capital Gain/Loss (bps)	54	54	106	-70	-34	-168	-119	-78	-228
YTW (%)	5.7	5.5	8.0	5.7	5.5	8.0	5.7	5.5	8.0
Price (\$)	92.3	92.2	92.5	92.3	92.2	92.5	92.3	92.2	92.5
Coupon (%)	3.6	3.4	5.4	3.6	3.4	5.4	3.6	3.4	5.4
Mkt Val (US\$bn)	668	601	67	668	601	67	668	601	67
Default Rate (%)	0.06	<b>0.0</b>	<b>0.6</b>	0.06	<b>0.0</b>	<b>0.6</b>	0.06	<b>0.0</b>	<b>0.6</b>
Credit Loss (bps)	4	0	42	4	0	42	4	0	42
Total Return, YTD24 (%)	-0.1	-0.5	3.8	-0.1	-0.5	3.8	-0.1	-0.5	3.8
Excess Return, YTD24 (%)	1.1	0.8	4.2	1.1	0.8	4.2	1.1	0.8	4.2
Total Return, from now to end-2024 (%)	6.0	5.8	8.3	4.6	4.8	5.4	4.1	4.4	4.7
Excess Return, from now to end-2024 (%)	1.2	1.0	3.0	0.0	0.0	0.0	-0.7	-0.4	-0.6
<b>Total Return, YE 2024 (%) F</b>	<b>5.8</b>	<b>5.3</b>	<b>12.1</b>	<b>4.5</b>	<b>4.3</b>	<b>9.1</b>	<b>4.0</b>	<b>3.8</b>	<b>8.5</b>
<b>Excess Return, YE 2024 (%) F</b>	<b>2.3</b>	<b>1.8</b>	<b>7.2</b>	<b>1.1</b>	<b>0.8</b>	<b>4.3</b>	<b>0.4</b>	<b>0.4</b>	<b>3.6</b>

Source: BofA Research Estimate

Note: based on pricing as of Feb 16, 2024

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