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Asian Credit Strategies

Fed tightens, PBOC eases, China property squeezes

- Inflation concerns hasten Fed's rate hike and balance sheet tapering timeline
- China property market meltdown is forcing policymakers to consider moves to stabilize sector
- Covid 19 remains a factor in both overall risk positioning and at the sector level

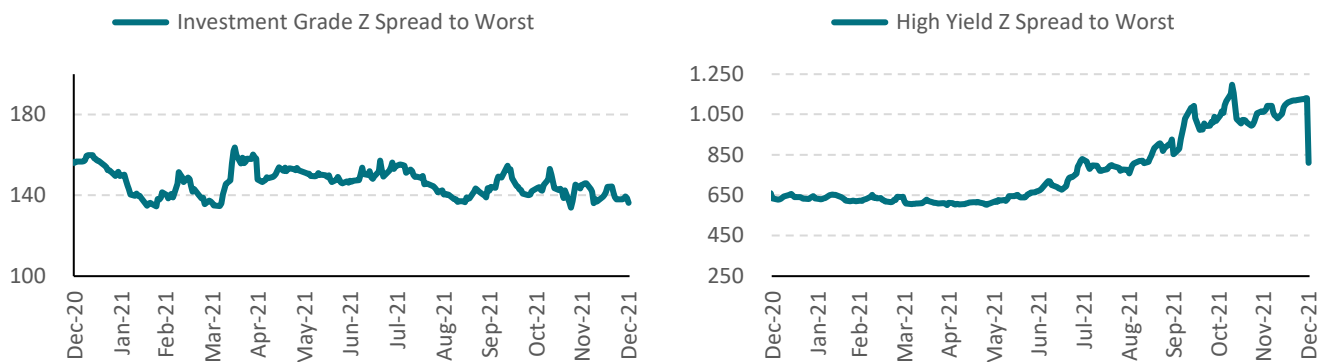
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What's happening?

The J.P. Morgan Asia Credit Index (JACI) posted negative total returns of -0.24% in December. During the month, Asian high yield underperformed investment grade (-0.94% for JACI HY vs. -0.24% for JACI IG). In particular, JACI China high yield had another weak month (-2.6% in total return) given the recent headlines on Shimao's overdue trust products. The most notable defaults were Evergrande and Kaisa missing USD bond payments in December. Non-China high yields were generally stable during the month. US rates sold off (+10bps) during the month due to inflation concern. The Fed has also quickened the pace of tapering in a broad hawkish tilt. Country wise, Indonesia and the Philippines were the top performing countries, while the sell-off in Sri Lankan sovereign bonds continued as the government has failed to decide whether to engage with IMF. JACI ended the year with total return of -2.4%. IG was mostly flat (-0.01%) whereas HY dropped 11%.

As of December end, the index was represented by 621 issuers, with a market capitalization amounting to US\$ 1.23 trillion. Chinese developers Evergrande and Kaisa Group were both removed from the index in the month end rebalancing.

Asian Credit Market* Valuation



Monthly Returns:

J.P. Morgan Asia Credit Index (JACI) -0.24%					
Investment Grade -0.07%			High Yield -0.94%		
Corporates -0.26%	Sovereign +0.89%	Quasi-Sov -0.19%	Corporates -0.94%	Sovereign -2.21%	Quasi-Sov +0.59%

Portfolio positioning and performance:

Key Strategy		Performance
Country /Sector:	UW to light positioning in China property's increasing group of distressed issuers helped to stabilize gross performance and drive relative performance. UW to China AMCs and Indian HY were slight offsets.	+
DTS:	UW DTS was not much of a factor in credit fund performance in December.	=
Bottom-up:	Relative performance of high conviction UWs offset drag from underperformance of high conviction OWs.	=

*Refers to the J.P. Morgan Asian Credit Index
Source: J.P. Morgan, as of 12/31/2021.

Outlook

In the context of quite a pivot from the Fed, we adjust our policy outlook. We raise our expectations of hikes for next year from one after the last meeting (and two after the recent Congressional hearing) to three. We consider a March move as still too soon, particularly given the balance of risks from the uncertain impact of omicron on activity and employment growth over the coming months. As such, we expect the Fed to start to raise the Fed Funds Rate in June and pencil in hikes in September and December, taking policy to 0.75%-1.00%. We acknowledge that the Fed could move sooner, but think disappointing GDP growth (we forecast Q4/Q4 GDP growth at 3.5% vs the Fed's 4.0%) and COVID risks will dissuade them. We then forecast three hikes in 2023 (with a risk of four) and we would expect the Fed to continue tightening into 2024. Finally Chair Powell stated that the Fed had begun to discuss the balance sheet run-off. For now he said that no decisions had been made. However, with our now faster assumed

pace of tightening, we would expect the Fed to announce balance sheet plans by the end of next year and to begin to unwind gradually in 2023.

Major China property developers' contracted sales dropped over 30% Y-o-Y in December 2021. Despite recent signs of easing, market sentiment remained weak. In addition, we continued to see a clear differential between SOE and POE developers in terms of sales growth. This shows that homebuyers are also increasingly sensitive to the liquidity condition of developers. In our view, this will lead to a vicious cycle where distressed developers will find it harder to survive and asset disposals will be the only way out. We have slightly reduced our China property exposure.

We have also further reduced our exposure (or exited for different strategies) in the Macau gaming sector. With each wave of Covid-19, the magnitude of correction has escalated and the recovery path has taken longer than previously expected. This has resulted in higher leverage for casino operators caused by extensive cash burn over the past two years. Regulatory risk for the sector has also heightened given the licence concession deadline in June 2022 and the proposed gaming reforms. In addition, the recent clampdown on junket operators in Macau will have a negative impact the VIP segment for the sector.

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