T. ROWE PRICE INSIGHTS
ON ASIA CREDIT

Asia Credit Markets: Capitalizing on Emerging Themes and Exciting Opportunities

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The last few years have witnessed major themes and events played out which resulted in profound structural shifts in the Asian region and its bond markets. While government crackdowns and property meltdowns may first come to mind, we have also seen exciting new opportunities emerge, particularly for active managers. A closer look could reveal plenty of reasons to be optimistic about Asia's economic prospects and the value of investing in the region's bond markets.

In this recent Q&A, Sheldon Chan, co-portfolio manager of Asia Credit Bond Strategy, reflected on how he navigated the markets in the past and review key lessons learned.

Q1: Beginning with China, what are the key events that have driven the investment landscape?

China is a natural starting point for this discussion, being the biggest market in the opportunity set and an important bellwether for the wider region. In China, the past five years have been characterized by mounting geopolitical uncertainty as well as significant domestic policy shifts. Therefore, we believe it is critical to consider the impacts of both the external and internal backdrops when investing in Chinese offshore credit.

In geopolitics, intensifying strategic competition between China and the United States (U.S.) has obviously emerged as a major theme. Relations began to strain when the Trump administration launched its "trade war" in 2018, which quickly escalated into a multi-layered dispute encompassing multiple issues. Tensions between the two countries continue to simmer amid differing stances on various issues, including the Ukraine-Russia conflict. All these likely suggest that the China-U.S. competition is structural and will remain in the headlines for years to come.

While geopolitical concerns tend to dominate headlines, changes to China's domestic policies merit attention too. We have been through a longer-than-usual period of regulatory tightening as part of Beijing's "common prosperity" goal, with strict scrutiny on large internet and platform companies as well as the private education sector. Recent trends seem to imply that we may be past the worst, but bonds from private sector companies are likely to remain volatile for now. Meanwhile, monetary policy changes, such as tightening in the shadow banking sector, were also critical. We think policymakers were attempting to reduce moral hazard and introduce more efficient pricing of credit, given how previous views of state-owned enterprises (SOEs) as effectively guaranteed by the state led to limited dispersion in the pricing of U.S. dollar (USD)-denominated SOE bonds.

Of course, the real estate sector has probably been the worst affected by Beijing's deleveraging drive. Tighter regulatory and monetary conditions have led to almost irrevocable scarring in China property high yield bonds – more than 60% of developers have defaulted or have bonds trading at distressed valuations.[1] In the past,

[1] Source: Bloomberg Finance L.P. and JP Morgan. As of 21 March 2023. Please refer to the Additional Disclosures section.

housing was an important channel policymakers would use to stimulate the economy, but it is increasingly evident that this is no longer the case.

Q2: We have seen growing activity in the environmental, social and governance (ESG) space in the Asian region. What is driving this momentum?

We have indeed seen an acceleration in ESG-labelled bond issuances, clearly reflecting growing demand to finance ESG initiatives across Asia (Figure 1). We believe there are clear structural factors at play. For instance, there has been more social bond issuances post-COVID as governments and the private sector sought funding for social reforms. However, the green bond segment has undoubtedly grown the fastest, fueled by the massive funding needs associated with the region's energy transition. Energy intensity is inevitably rising as populations grow and economies continue to develop, but this conflicts with many governments' commitment to reduce fossil fuels. Consequently, many countries will need to ramp up their renewable energy capacity to meet future needs, opening immense opportunities to increase issuance of green debt. An example is India's renewables sector, which is already about USD10 billion in size but is expected to expand rapidly given New Delhi's ambitious sustainability targets.

We believe a disciplined approach remains vital when investing in ESG-labelled bonds. As a relatively young asset class, certification or labeling standards still vary. Thus, to differentiate between "good" and "bad" green bonds, an investor should consider each issue based on: (i) transparency and disclosures; (ii) adherence to taxonomies; and (iii) direct and measurable impact. Investors should also look closely at each structure to ensure they invest in issuers who truly embed sustainability in their corporate strategy, rather than those that are merely paying lip service to raise capital.

Q3: How have the developments mentioned above influenced the evolution of Asian credit markets over the past five years?

In short, the makeup of the Asian fixed income investible universe today looks considerably different from five years ago, with meaningful changes in the market's composition. As of April 2023, China's share of the Asian credit market stood at approximately 40%, down from more than 50% five years ago (Figure 2, left chart). Similarly, while mainland corporates accounted for over 60% of Asian bond issuances in 2018, that proportion has dropped to about a quarter so far in 2023, though this is partially also a function of increased offerings from other parts of Asia (Figure 2, right chart).

Credit Markets Play Key Role to Fund Energy Transition

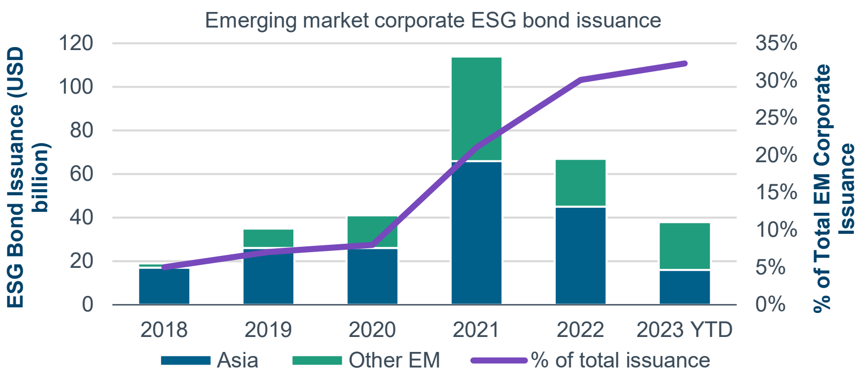
(Fig. 1)

Rising Asia energy consumption

50%+ of global CO_2 emissions, peaking toward the end of the decade	Energy generation to rise 3.9% per year until 2030
Coal continues to represent the dominant fuel source	Renewable energy capacity in China, India, ASEAN to grow 3x by 2030

Source: ADB (September 2022), JP Morgan.

Continued growth in ESG bond issuance



As of 31 May 2023.

In light of these shifts, we believe that Asian credit bonds continue to offer several compelling long-term advantages for investors:

1. The size of the Asian credit bond market has grown to USD1 trillion as of April 2023, roughly comparable to the U.S. high yield market.

2. Asian credit is the higher quality sub-segment of the wider emerging market bond universe, with IG issues comprising more than 82% of the benchmark, J.P. Morgan Asia Credit Index Diversified.

3. Asian credit functions as a diversifier within global fixed income portfolios, offering attractive risk-adjusted returns and better downside protection due to attractive yields and the region's unique credit cycle (Figure 3).

Q4: Despite the promising long-term prospects, uncertainty and volatility characterize today's markets. What is your outlook for the rest of 2023?

On the whole, we think global risk sentiment is still largely cautious. Much of the uncertainty stems from an unpredictable trajectory for the U.S. economy, inflation and interest rates. Recent stresses within the banking sector may also exacerbate the impact of tighter financial conditions.

That said, we expect Asian economies, and therefore risk assets in Asia, to be better anchored. The region's growth prospects appear brighter relative to both developed markets and non-Asia emerging markets. India and Indonesia remain important growth engines for the region, while China's reopening should continue to provide further support.

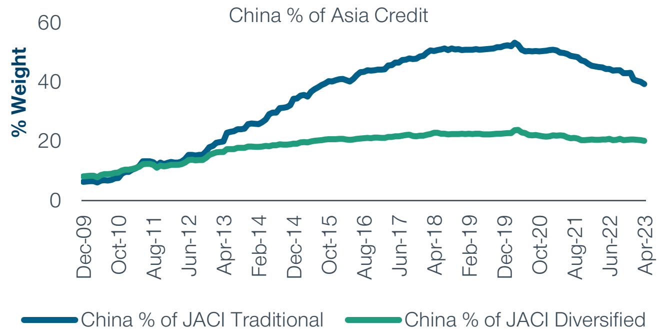
While we expect China's post-reopening rebound to continue, recent data points to a somewhat bifurcated recovery so far. Certain segments, including consumption of travel and services, are seeing strong momentum, whereas other areas, such as the property sector, have remained lacklustre. As a result, investors should continue to be selective, favoring credits and sectors that they think will benefit the most. For instance, there are opportunities in the consumer-related sectors that are likely to gain from rising domestic spending. Hardware technology is another area that we believe could be well-placed to benefit from recovering consumption.

We also remain optimistic about companies in South and Southeast Asia. Notably, we have observed healthy banking sector liquidity in several major markets, such as Indonesia, India and the Philippines. Corporate issuers in these markets thus have ample access to alternative sources of financing, which may soothe worries about upcoming maturities. In fact, some

Asia Credit is Becoming More Diverse

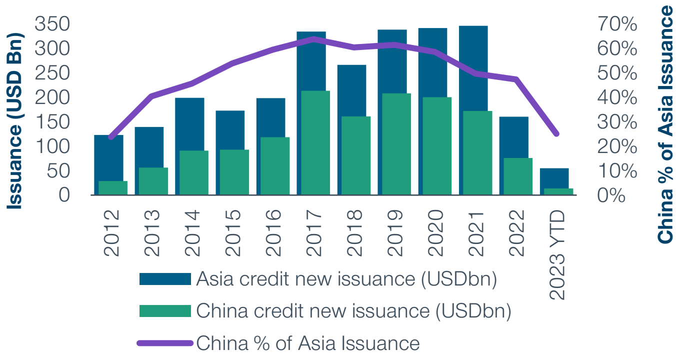
(Fig. 2)

China's share of the opportunity set is declining...



As of 30 April 2023.

... and non-China issuance is surpassing China supply

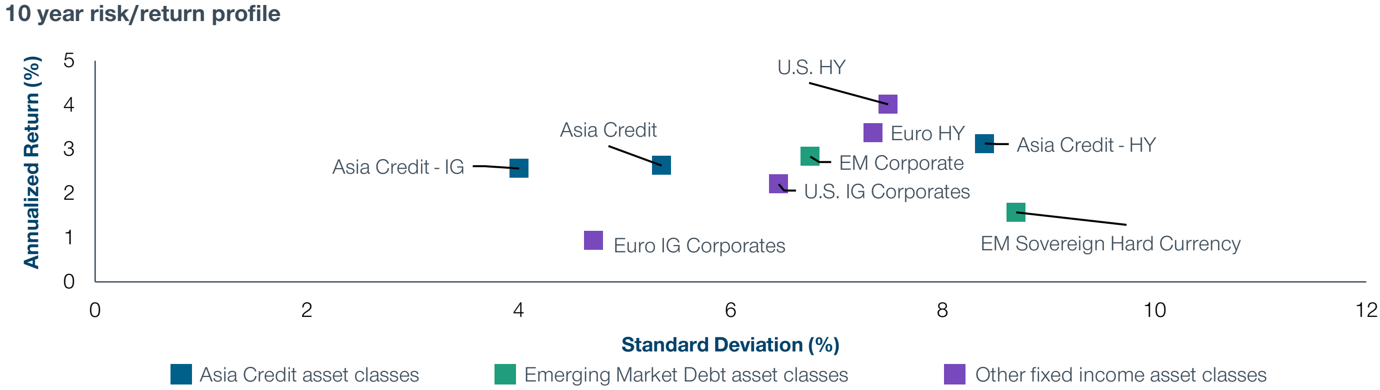


As of 10 May 2023.

Source: Bloomberg Finance L.P; J.P Morgan Chase. Please refer to the Additional Disclosures section.

Attractive Risk Adjusted Returns and Downside Protection

(Fig. 3)



As of 30 April 2023.

Past performance is not a reliable indicator of future performance.

U.S. IG Corporates: Bloomberg U.S. IG Corp. I.G. Index; U.S. HY: Bloomberg U.S. High Yield; EM Sovereign Hard Currency: J.P. Morgan Emerging Market Global Diversified Bond Index; EM Corporate: J.P. Morgan CEMBI Broad Diversified; Euro IG Corporates: Bloomberg Euro Aggregate Corporate Total Return Index Value Unhedged EU; Euro HY: Bloomberg Pan-European High Yield; Asia Credit: J.P. Morgan Asia Credit Diversified Index; Asia Credit IG: J.P. Morgan Asia Credit Index Diversified IG; Asia Credit HY: J.P. Morgan Asia Credit Index Diversified HY. This chart is shown for illustrative purposes only and does not represent the performance of any specific security, product or service. It is not possible to invest in an index. Source: Bloomberg Index Services Limited, JP Morgan, T. Rowe Price. Please refer to the Additional Disclosures section.

companies have even accessed loan markets to repay bonds ahead of time.

Finally, in terms of valuations, all-in yields offered within the Asian credit segment look compelling, especially when compared against long-term historical levels. At present, yields across the asset class are still in excess of 6% (as of April 30, 2023), the highest in over a decade, presenting investors with timely opportunity for income accrual from a largely investment grade universe (Figure 5).

Q5: Finally, what do you think are longer-term themes that will drive the markets, and what are some factors that would position Asian bond investors for success?

Looking ahead, it is clear we are entering an environment where global central banks are operating with a more constrained toolkit. Higher-for-longer interest rates and conditions of tighter liquidity are likely to contribute to persistently high levels of uncertainty and volatility. Investors thus need to be nimble in terms of identifying opportunities and allocating capital while seeking to mitigate downside risks.

From a more tangible perspective, investing in Asian credit based solely on market value today would result in a portfolio that is heavily exposed to China (Figure 6). We believe, however, that pursuing a diversified approach is more prudent; not only to lower concentration risks from the Chinese market, but also for investors to take advantage of exciting opportunities arising from other dynamic markets across Asia.

The Structural Case for Asian Credit

(Fig. 4)

The universe has grown to **US$1.0 trillion** now – an asset class that we believe investors should not overlook

~ 75% of USD bond issuance is purchased by Asian investors, helps explain why Asia credit has been relatively resilient to market setbacks

~ 82% of the index consists of **investment-grade (IG)** issues. The ratio is higher than the wider emerging markets bonds universe*

We believe **Security selection** among BBB-B rated securities is key to differentiated performance

Asia credit can offer **attractive risk adjusted return** and can act as **lower-volatility diversifier**

Asia credit spans a **diverse** set of markets and issuer types, offering a wide range of opportunities.

As of 30 April 2023.

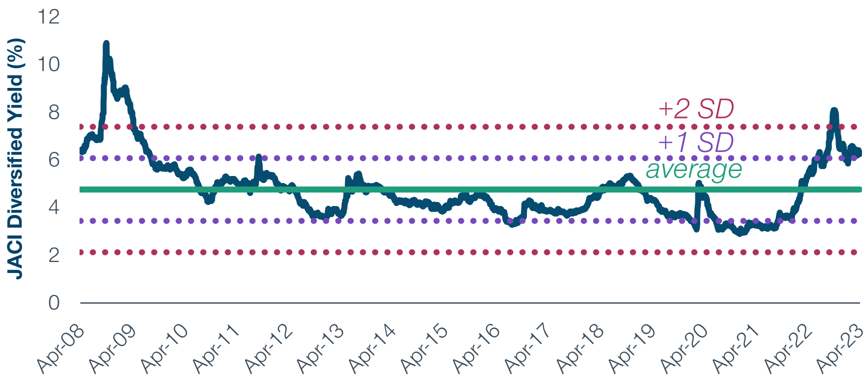
Past performance is not a reliable indicator of future performance.

* J.P. Morgan Asia Credit Index Diversified (which includes both hard currency sovereigns and corporates) has a higher IG weight than both the J.P. Morgan Emerging Markets Bond Index Global Diversified (hard currency sovereigns) and the J.P. Morgan Corporate Emerging Markets Bond Index Broad Diversified (hard currency corporates).

Source: T. Rowe Price. This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action. The views contained herein are as of the date shown and may have changed since that time.

All-in Yields are Attractive

(Fig. 5)



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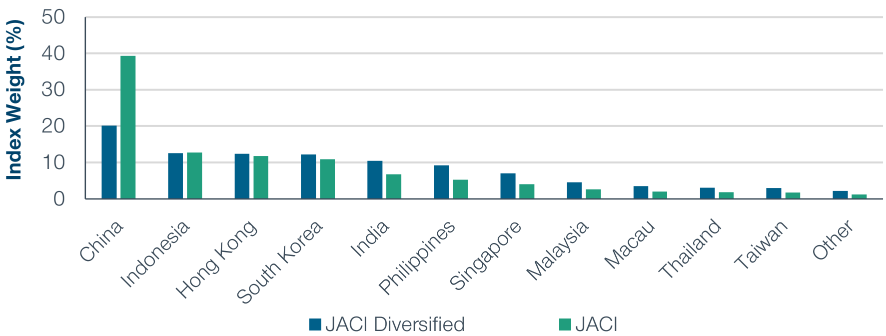
A More Prudent Approach to Investing in Asian Credit

(Fig. 6)



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