

Schroder ISF* Asian Bond

Monthly Fund Update

In summary

Market volatility persisted during April as concerns over Chinese economic policies and difficulties in the eurozone resurfaced. Asian government bond prices rose, while Asian investment grade corporate bonds only generated muted performance. Against this background, the fund posted positive returns, with its local currency bond holdings in Korea, Singapore and Malaysia and exposure to US treasuries adding value. While the Asian bond asset class is relatively young, it is one that is growing rapidly, presenting many opportunities for investors. Looking ahead, we believe Asian economies are, on the whole, better placed to benefit from the global economic recovery.

The market and the drivers of fund performance

In April, better-than-expected global economic data and US corporate earnings kept overall risk appetite relatively resilient, despite rising financial regulatory risks and persistent jitters in China and Europe. US Treasury yields fell sharply. Many Asian local government bond yields also declined, as China's property measures and increased vigilance against excessive credit growth are expected to cap both growth and inflationary pressures going forward. Asian currencies continued to trade well, buoyed by capital inflows and the willingness of specific central banks (e.g. Singapore and Malaysia) to embrace some currency strength. After a period of very strong performance, Asian credits were more muted in April with credit spreads tightening only marginally. The fund generated a positive return, with its local currency bond exposures to Korea, Singapore and Malaysia contributing to performance. In addition, the fund's US treasury holdings added value as yields fell. Exposure to Asian US dollar corporate bonds also contributed positively to returns. We continued to avoid currency risk during the month.

The market outlook and portfolio strategy

Interest Rates: Many Asian central banks may be more dovish than market expectations in terms of actual rate hikes, given the uncertainties about final demand globally following the withdrawal of stimulus measures. We see value in selected short-dated local bonds where rate hikes have been discounted (e.g. Hong Kong and Korea). We also believe there are tactical opportunities for selective longer-dated bonds (e.g. Singapore) given the curve steepness and the lack of supply concerns.

Currencies: The broader US dollar is expected to continue appreciating, reflecting better relative economic performance and sovereign concerns in peripheral Europe. We will look for opportunities to explore exposures in 'short-US dollar' strategies, as the US' longer term fiscal challenges and elevated domestic leverage will return to haunt the US dollar at some point.

Credits: Ongoing debt concerns in Greece and a large issuance calendar in Asian corporate bonds has had a limited effect on Asian credits so far. The fund's current net credit exposure (about 10%) sits at the low-end of its historical range, and is mainly focused on high yield corporate and bank holdings for their sound bottom-up fundamentals and good relative value. An expected increase in new issuance from more varied sectors (such as manufacturing, consumer) should present fresh investment opportunities for the fund in coming months.

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