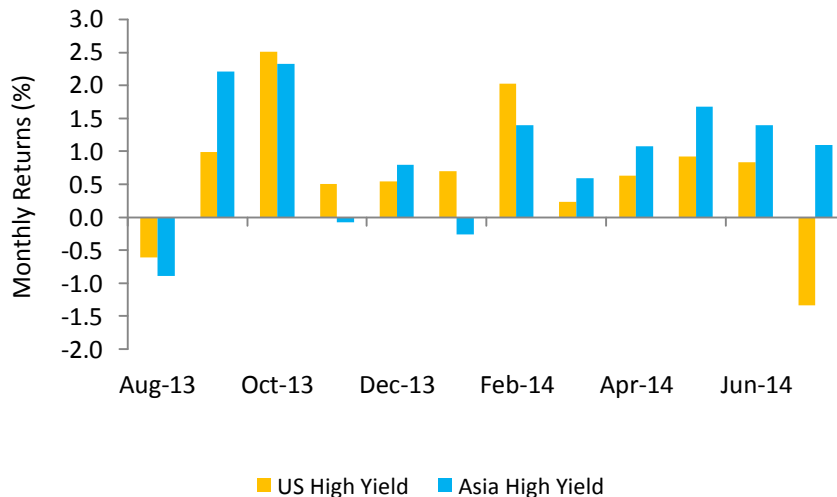


Commentary on the Impact of US High-Yield Bonds Sell-off on Asian Credits

In this article, we share our views on the impact of the recent US high-yield bonds sell-off on the Asian Credit markets.

US high-yield funds, both exchange-traded and mutual funds, have seen heavy outflows in July with almost USD 10bn of outflows in the month, according to Standard Chartered Bank Weekly Fund Flows reports. In search for yield, investors have piled money into the high-yield market and they are now reducing their allocation. Consequently, US high-yield spreads rose in July with the Barclays Capital US Corporate High Yield Index’s spread widening by 57 basis points (bps) to 430bps. The index also had its first negative monthly return for the year at -1.33%. The sell-off has been driven by flows and is not on a fundamental credit deterioration of high-yield issuers.

Chart: Monthly Returns of US and Asian High Yield Indices



Source: Barclays Capital US High Yield Index, JP Morgan Asia Credit Index (JACI)-Non Investment Grade, as at 31 July 2014, in USD terms.

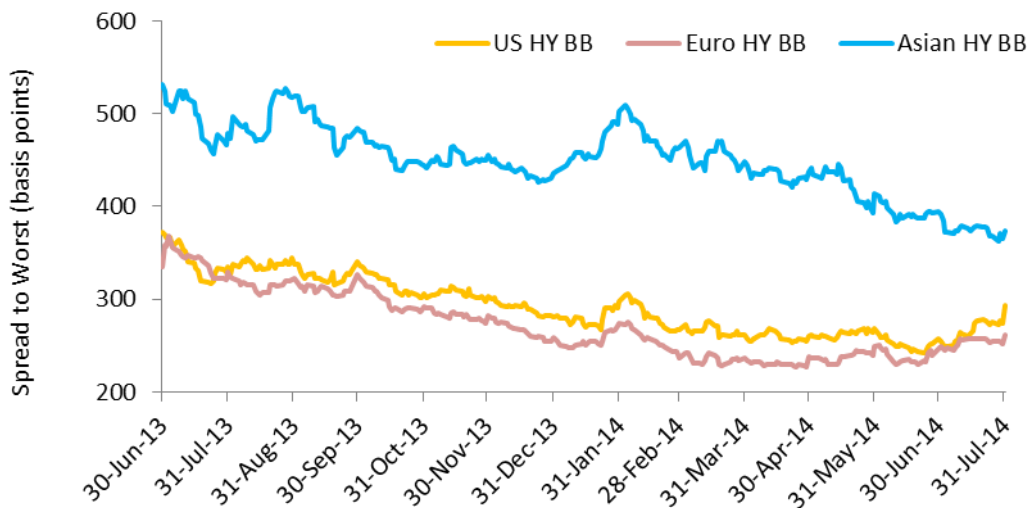
Market Impact on Asian Credits

Amidst the sell-off in US high-yield, Asian high-yield remained supported with spreads tightening by about 5bps for the JACI High Yield Index with 1.10% total returns in July. As shown two charts below, US and Euro high-yield spreads widened last month, whereas Asian high-yield remained supported. This is due to different investor base for Asian high-yield versus that of the US high-yield market. Also, Asian high-yield is still priced higher as shown by the higher spreads versus that of the similarly-rated US and Euro high-yields.

Despite the support in July, the outflows from US high-yield funds and consequent widening spreads could still have a potential knock-on impact on Asian high-yield credits. While the sell-off observed is healthy given the significant rally which brought valuations to expensive levels, a sharp and significant widening in US high-yield spreads from sizeable outflows could have an impact on Asian high-yield market. However, we still expect Asian high-yield to outperform the US high-yield market in this sell-off environment.

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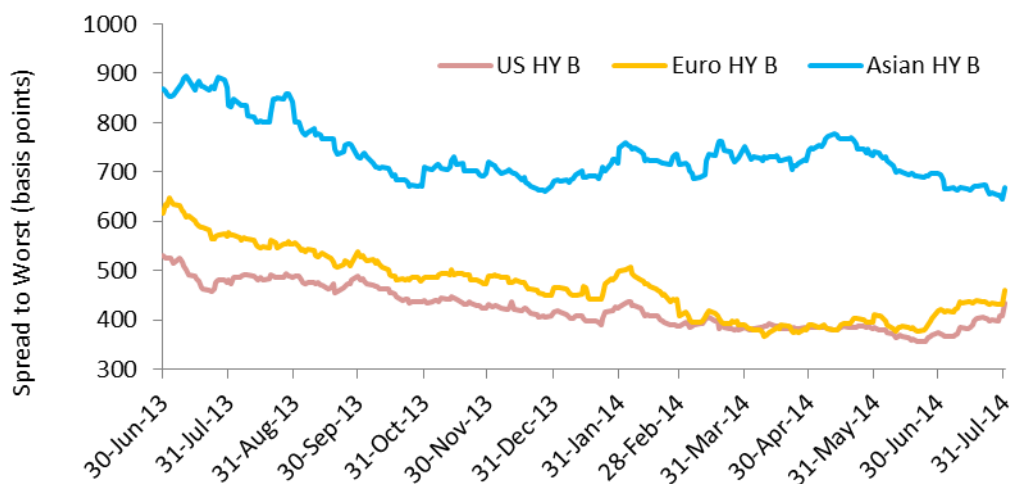
Chart: US, Euro and Asian High Yield Spreads (BB-rated)



Source: Bank of America Merrill Lynch Global Research, Bloomberg, as at 31 July 2014.

China high-yield bonds, which represent a significant portion of the Asian high-yield market, have been well-supported from a strong retail bid and on expectations of looser housing policies in China. Asian credit as a whole has been underweighted by US investors. Therefore, the potential sell-off by US investors of Asian credits will not be as significant. Any selling of Asian credits by US investors will be from low-beta credits such as Indonesia and Philippine sovereigns/quasi-sovereigns. Furthermore, we continue to see support on the emerging market (EM) bond markets, with hard currency EM bond flows now positive on a year-to-date basis.

Chart: US, Euro and Asian High Yield Spreads (B-rated)



Source: Bank of America Merrill Lynch Global Research, Bloomberg, as at 31 July 2014.

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