Manulife Investment Management

Market Note

3 Feb 2020

Investors have reacted in a risk-off manner to the uncertainty surrounding the economic impact of the coronavirus outbreak. Endre Pedersen, Chief Investment Officer, Fixed Income (Asia-Pacific), believes that Asian fixed income markets are awaiting further information to assess the economic impact on China and the rest of the region.

Global risk-off market sentiment prevails

The recent decline in US Treasury yields confirms the team's view that US Treasury yields would likely remain range-bound. This scenario gives investors the opportunity to trade the range tactically. The US Federal Reserve (Fed) continues to monitor the potential risks to both the US and global economy; however, we believe that the current impact of the coronavirus outbreak should not impact the previously communicated Fed policy on interest rates.

Gaming sector and tourism-related credits most affected, so far

In Asian credits, we have seen some spread widening offset the gains in Treasuries, with high-yield (HY) credits underperforming investment-grade (IG) issues in the US-dollar market. Certain at-risk sectors (see below) have driven the underperformance of HY relative to IG. We are not surprised by this trend in the current uncertain market environment, given the very strong start in Asian credits year-to-date.

Local-currency regional government bond yields have trended lower, which also reflects the uncertain economic backdrop. Chinese government bonds are the most likely to maintain these gains, as the People's Bank of China is expected to provide additional policy support in the coming months.

With the majority of its bonds in the HY space, Macau gaming has been the most impacted of the meaningfully sized sectors so far[1]. Tourism and retail-related areas of the market (including car rental and shopping-mall operators in China) are also likely to be directly affected[2]. We are closely monitoring the situation and developments.

Asian currencies are generally weaker against the greenback

Asian currencies have broadly weakened against the US dollar due to the economic implications of the spreading virus. The Thai baht has been the worst performer so far, reflecting Thailand's dependence on tourism. We expect that the Chinese renminbi will set the direction for other regional currencies, with the potential for lower near-term growth in China impacting the Korean won and Singapore dollar. The high-yielding South Asian currencies, such as the Indonesia rupiah, India rupee, and Philippine peso, have remained resilient and are showing relatively little impact at this point. They are likely to perform well in a low global interest rate environment.

[1] The Macau gaming sector accounts for roughly 1.2% of market capitalisation of the J.P. Morgan Asia Credit Index (JACI), as of January 2020..

[2] Gaming, retail and tourism collectively contribute 1.4% of market capitalisation of the JACI, as of January 2020.

The trajectory of the virus will drive the market's reaction

Overall, the spread of the coronavirus has introduced significant uncertainty and volatility in the Asian bond market. While the SARS outbreak in 2003 provides a convenient analytical comparison, we believe that the current situation is very different. In addition to the different characteristics of the coronavirus, the Chinese economy has changed (both in size and composition), and the response of government authorities to contain the spread has been relatively swift. That said, it is difficult to assess the impact relative to SARS without further information.

Beyond the immediate reaction, we believe that regional fixed-income markets are awaiting further information to fully assess the economic effects on China and the rest of the region. At this point, it is difficult to know how long the uncertainty will persist. We will also continue to monitor the events closely, and if markets experience meaningful spread widening, this may be a buying opportunity for Asian credits.

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Manulife Investment Management

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