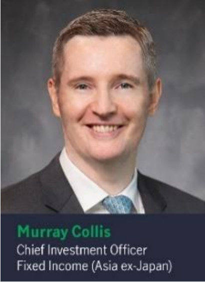
Manulife Investment Management

Investment Note

3 March 2022



Russia's invasion of Ukraine has increased market volatility across asset classes. However, Murray Collis (Chief Investment Officer, Fixed Income, Asia ex-Japan) believes the impact of recent events on the pan-Asia bond market should be mostly indirect and regional fundamentals remain largely intact.

Asian fixed income should take geopolitical events in its stride

As the Ukraine situation escalated on 24 February, we saw a knee-jerk effect that initially weakened global credit markets before they stabilised then partially recovered overnight. The next day, some follow-through weakness in Asian credits remained, but the widening was contained within the 5-15 basis point range. Investors are mostly sitting on the sidelines as they await further updates. The weak sentiment also spilt over to the Asian high-yield (HY) market – particularly non-China credits that had already been pressured by global HY since the beginning of the year.

On the currency front, risk-sensitive currencies, such as the Korean won and Thai baht, underperformed and were weaker against the US dollar. Meanwhile, the Indian rupee was the most negatively impacted by higher energy prices. Conversely, the Malaysia ringgit was relatively stable as it tends to outperform in periods of elevated energy prices.

Asia's credit fundamentals remain largely intact. Having said that, in the near term, investment sentiment should remain driven by global risk appetite and further geopolitical developments. As such it's important to stay nimble and actively manage portfolios to protect them from risk-off and capitalise on risk-on sentiment. We were positioned more defensively ahead of recent market events, allocating more weight to higher-rated Asian credits and tactically extending portfolios' duration.

Top-down regional analysis

On the back of higher oil prices, Asian markets, such as Indonesia and India, may see pressure from higher energy import bills. However, these should be partially offset by exports of other commodities. Historically these countries have demonstrated higher volatility amidst uncertainties.

Indonesia's local bond market has been most susceptible to outflows in previous risk-off events driven by global risk aversion. Yet, foreign ownership is now half that of pre-pandemic levels, which has notably decreased volatility amongst local-currency bonds, and we saw a modest softening over the past week.

Besides, China government bonds will likely see little impact, supported by monetary-policy easing and their safe-haven properties.

Bottom-up credit views

Asian issuers generally do not have direct exposure to Ukraine or the surrounding area, so any direct impact was limited. On the contrary, specific regional names may benefit from higher commodity prices and the constrained supply of basic materials in Europe. We remain positive on Asia dollar credits and have diversified across high-quality names. That said, we've been cautious of Asian currency volatility.

We believe China will still be the key value driver within the Asian HY space, which may have a lower correlation with the broader market. Given the relative strength of China's economy and its robust trade position, we see a better chance for Chinese credits to outperform and weather any potential shock in the broader space, especially the high-quality state-owned issuers.

We also think that the global geopolitical uncertainty will likely be a non-event for most Chinese credits. For example, China's property sector dynamics are locally related, i.e., primarily driven by policy updates and developers' interaction with local and international creditors.

While the unfolding Russia-Ukraine crisis is expected to create significant short-term volatility, the uncertainty may potentially result in entry points to add to value names.

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Manulife Investment Management

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