Markets

Asia's Best Credit Funds Say Junk Bonds Will Be Key in 2021

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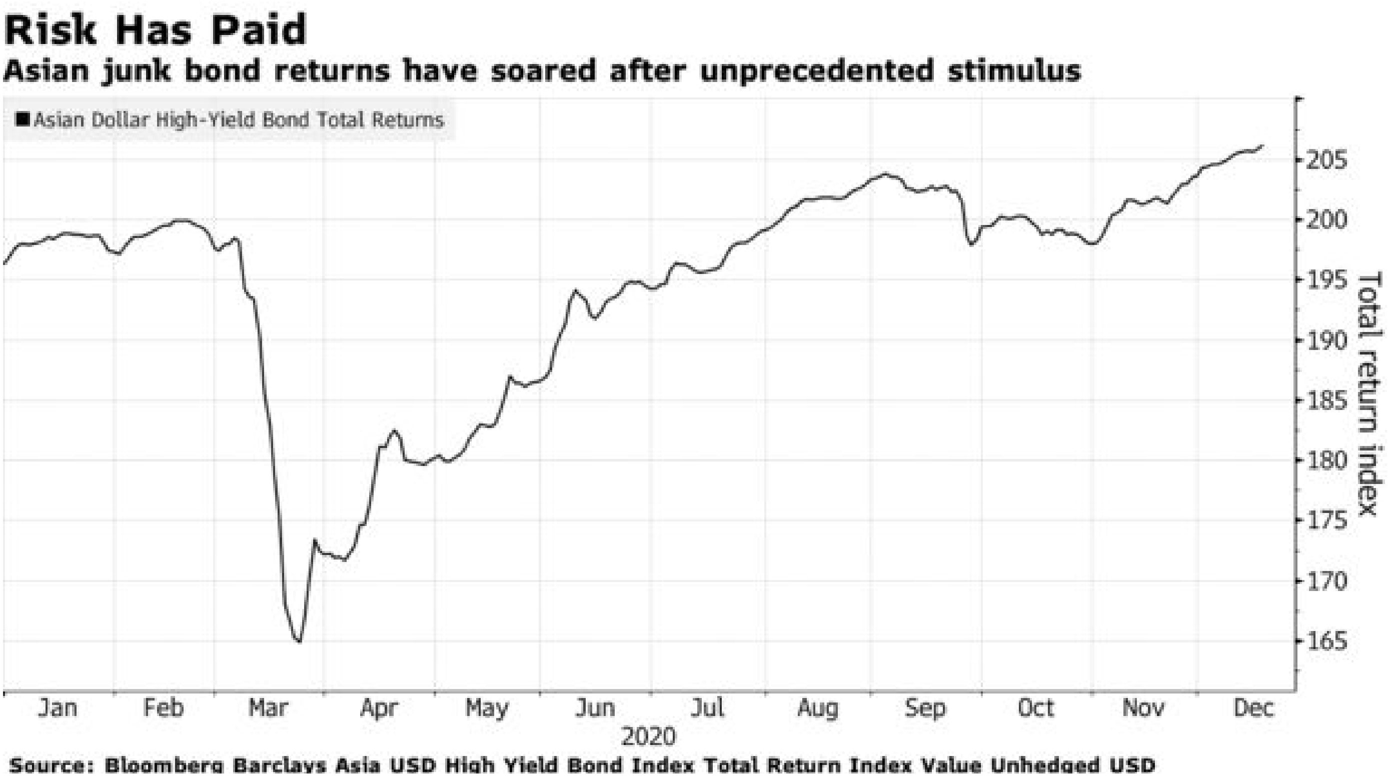
- Funds are flowing to high-yield Asia credit, Maybank says
- 'Misperception' that Asia is riskier, Tribeca's Stover says

When global bond markets dipped in February, fund manager John Stover dove in, predicting a rebound, only to watch prices collapse as the coronavirus pandemic raged on. Stover kept buying.

"It never feels good to buy at the bottom or when things are going down," he recalled earlier this month, describing hasty phone calls to portfolio companies checking how much money they had left.

The bargain hunting as panicked investors hit the sell button helped Stover's $50 million Tribeca Vanda Asia Credit Fund gain almost 21% this year as government stimulus kicked in -- well above the Bloomberg Credit Multi-Strategy Hedge Fund Index, which has been flat. The fund is among several that are bullish about trading opportunities in Asian bonds next year -- including those in the junk-rated space -- after generating returns during this year's volatility.



Despite a spike in defaults and a resurgence in the virus, some investors expect Asia's debt market to offer superior returns than their European and U.S. peers. Still, the prospect of a pullback in fiscal support and government efforts to force Chinese property companies to deleverage will make 2021 a difficult year for the region's credit funds.

"You're seeing fund flows come into Asian credit because it's still cheaper -- especially high-yield," said Rachana Mehta, who helps run Maybank Asset Management Singapore's fixed income team. Its Maybank Bluewaterz Total Return Bond Fund is up more than 9% since January. "We have positive real yield, which is very rare in this negative-rate environment."

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Tribeca's Stover, whose parent firm manages about $1.7 billion, remains similarly bullish on Asia. One of his favorite trades is Indonesia property developer Lippo Karawaci, despite S&P and Fitch Ratings both assigning it a negative outlook. But with the company cutting costs and property presales there on the rise, he is betting he can again beat the crowd.

"There's a misperception in the market that Asia credit is a lot riskier than other regions, whereas the data just doesn't support that and you're getting paid for that misperception," he said.

Today, about one-fifth of Stover's fund is in Chinese property-developer bonds such as Sunac China Holdings Ltd., which are under orders to deleverage. Another 20% is in travel and leisure providers -- up thanks to vaccines -- and he also holds positions in Indonesian property companies, renewable-energy providers and battery suppliers.

High Yield

Hong Kong-based L&R Capital's $650 million Asia-focused credit fund has returned almost 30% after fees this year through Dec. 15, according to a person with knowledge of the matter. Chief Operating Officer Francis Tan declined to comment on behalf of the firm, led by former Lehman Brothers Holdings Inc. portfolio manager Li Ran.

Part of the return came from bearish bets in February and early March on companies that had a high probability of running into liquidity, cash-flow or refinancing difficulties in the next six to 12 months, said the person, who asked not to be named because the returns are private. For example, it shorted some Asian commodity company bonds as lockdowns hit global demand.

The fund also profited from price dislocations on a relative-value basis, such as pairing long positions in high-quality, liquid dollar-denominated Chinese junk bonds with short positions in Indonesian and Indian peers. China's high-yield dollar corporate debt was trading at the widest spreads over domestic yuan bonds even as the economic rebound took hold, while outflows from offshore emerging-market funds were pressuring Indonesian and Indian credit.

It also bought some heavily sold-off bonds yielding 15% or more, betting they had high potential to rebound as fundamentals improved. For instance, the fund turned long on some commodity bonds in late March and early April, correctly anticipating a recovery in commodity prices in the second half.

China Property

Chinese companies defaulted on about $25 billion of onshore and offshore bonds this year and borrowers cancelled some 92 billion yuan of planned bond sales last month, the most since April 2017, according to data compiled by Bloomberg.

Triada Capital's Asia credit fund returned more than 10% through Dec. 11, said Hong Kong-based Chief Investment Officer Monica Hsiao.

It picked up cheap bonds, including China Evergrande Group and Kaisa Group Holdings Ltd. during the March selloff, and again when investors dumped them in late September as Evergrande faced a cash crunch.

"We believed the fundamentals in China property would continue to play out to support a fast rebound in prices, and we had two bites at the apple in playing this thesis," Hsiao said. "Next year we will see a lot more credit differentiation that will throw up more opportunities."

Australian banks and Chinese property were big winners for Maybank Asset Management's Mehta. Indonesian sovereign debt also generated strong returns, she said, adding she had already cut her exposure to high-yield bonds just before the start of 2020 in preparation for a downturn.

When bond markets tanked in March, Mehta moved to quickly cash out of several positions, even when they resulted in a loss, so that she could redeploy faster than rivals while hedging by switching to higher-duration bonds.

"Then the Fed came in and saved the world," she said.

As the U.S. dollar continued to dive thanks to the Federal Reserve's quantitative easing and record-low interest rates, she used the cash to buy local currency sovereign bonds in places like the Philippines, Thailand, Singapore and Indonesia. Green bonds in India also remained strong and will be a target next year.

(Updates with China bond defaults in 13th paragraph)

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