Investing for a world of change

Sentiment disconnect creates opportunities

Alan Siow
Portfolio Manager

Tom Peberdy
Investment Director

How has the asset class fared in the global bond bear market?

China is normally a strong portfolio diversifier, but 2023 was different. Like other global fixed income markets, Chinese fixed income had a very challenging year, and this was the result of domestic economic pressures. But outcomes across this diverse investment universe have not been uniform.

Onshore Chinese government bond yields have been remarkably resilient. Faced with positive yields – in contrast with some major developed-market peers – China's policymakers were able to cut rates and add additional support to the economy (on top of fiscal loosening), and this helped bond prices.

In the onshore credit market, debt issued by state-owned enterprises (SOEs) performed well, but debt issued by private companies came under pressure, particularly in the real-estate sector given the ongoing challenges there.

A similar bifurcation was seen in the offshore US dollar bond market, with SOE debt generally performing well but real-estate sector bonds struggling.

The content of this communication is intended for readers with existing knowledge of financial markets.

Is market sentiment around China's growth outlook a fair reflection of reality?

Although nowhere near the double-digit growth rates seen in years gone by, the world's second-largest economy is still growing at a much healthier pace than much of the developed world. But perceptions in the market have swung from overly optimistic to depressingly downbeat. There is a clear disconnect between the narrative among the international investment community and what's happening on the ground. This is resulting in some heavily discounted valuations in parts of the asset class that active investors can look to take advantage of.

What can we expect from policymakers?

Gradual policy easing is happening – reflecting a cautious approach and pursuit of a sustainable growth path. Yet frustration among many market participants reflects unrealistic expectations, in our view. We will not see huge and costly stimulus programmes in China like those rolled out in many developed economies in response to COVID (and other crises). Investors should expect China's policymakers to continue seeking to stabilise growth at a lower level as opposed to returning it to its prior trajectory; a longer-term mindset is required.

How are geopolitics and global supply-chain shifts affecting China's economy?

While shifts have taken place as countries like the US increasingly focus on their geopolitical allies for trade flows, China is still ultimately benefitting from global export trends. China is investing in the likes of Vietnam, the Philippines, Indonesia and Mexico, which are starting to produce intermediate inputs for Chinese exports, but with a large part of the upstream and downstream supply chains still originating in China. While this is likely to grow in complexity, we think the general trend will ultimately support the further development of fixed income in Asia, given the investment and funding needed for these initiatives.

How do you view the investment case for the asset class for the year ahead?

Structurally, China remains an important destination for investors seeking a balanced portfolio, given its sheer size and importance in global trade and global supply chains. Cyclically, it is a challenging time, but it is starting to feel like the worst is largely behind us, although with so much uncertainty and the inherent unpredictability of geopolitical and geo-economic considerations, patience is key.

While short-term currency pressure is likely to remain, with China's growth supported by policy and re-opening activity and its export mix moving quickly up the value chain, the medium-term outlook for the renminbi remains constructive. Current valuations and high trade surpluses support its long-term value.

We think an uneven growth recovery and muted inflation will keep Chinese monetary policy supportive for yields. The onshore Chinese yuan (CNY) bond market should continue to reflect domestic dynamics, making it a useful portfolio diversifier.

At current valuations, select segments of the offshore US dollar bond market provide a good yield opportunity; meanwhile, we think that distressed real-estate sector bond valuations do not accurately reflect ultimate recoveries.

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Australia
Level 28 Suite 3, Chifley Tower
2 Chifley Square
Sydney, NSW 2000
Telephone: +61 2 9160 8400
australia@ninetyone.com

Botswana
Plot 64289, First floor
Tlokweng Road, Fairgrounds
Gaborone
PO Box 49
Botswana
Telephone: +267 318 0112
botswanaclientservice@ninetyone.com

Channel Islands
PO Box 250, St Peter Port
Guernsey, GY1 3QH
Telephone: +44 (0)1481 710 404
enquiries@ninetyone.com

Germany
Bockenheimer Landstraße 23
60325 Frankfurt am Main
Telephone: +49 (0)69 7158 5900
deutschland@ninetyone.com

Hong Kong
Suites 1201-1206, 12/F
One Pacific Place
88 Queensway, Admiralty
Telephone: +852 2861 6888
hongkong@ninetyone.com

Luxembourg
2-4, Avenue Marie-Thérèse
L-2132 Luxembourg
Telephone: +352 28 12 77 20
enquiries@ninetyone.com

Namibia
Am Weinberg Estate
Winterhoek Building
1st Floor, West Office
13 Jan Jonker Avenue
Windhoek
Telephone: +264 (61) 389 500
namibia@ninetyone.com

Netherlands
Johan de Wittlaan 7
2517 JR Den Haag
Netherlands
Telephone: +31 70 701 3652
enquiries@ninetyone.com

Singapore
138 Market Street
CapitaGreen #27-02
Singapore 048946
Telephone: +65 6653 5550
singapore@ninetyone.com

South Africa
36 Hans Strijdom Avenue
Foreshore, Cape Town 8001
Telephone: +27 (0)21 901 1000
enquiries@ninetyone.com

Sweden
Västra Trädgårdsgatan 15,
111 53 Stockholm
Telephone: +46 8 502 438 20
enquiries@ninetyone.com

Switzerland
Dufourstrasse 49
8008 Zurich
Telephone: +41 44 262 00 44
enquiries@ninetyone.com

United Kingdom
55 Gresham Street
London, EC2V 7EL
Telephone: +44 (0)20 3938 1900
enquiries@ninetyone.com

United States
Park Avenue Tower, 65 East 55th Street
New York, 10022
US Toll Free: +1 800 434 5623
usa@ninetyone.com

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