A growing role for China bonds in global portfolios

Macro and geopolitical uncertainties make it more important than ever to understand China's economic, political and regulatory agendas – and, in turn, the potential that both onshore and offshore bonds offer investors.

In a market as large and diverse as China, there are numerous opportunities and driving forces to support exposure to bonds.

In particular, for investors who want to enhance their fixed income yields, diversification and returns, allocating to China bonds remains appealing.

More specifically, among major global bond markets, onshore CNY bonds provide a higher yield with historically lower currency and bond price volatility[1]. Further, China's credit markets are diverse and differentiated. Plus, China bonds are under-represented in investor portfolios.

Mainstream index inclusion is set to change this. The potential to access a wider universe as well as to go long or short in China has grown since the 2019 inclusion of renminbi-denominated bonds from the sovereign and some other government entities into the Bloomberg Global Aggregate Index.

Further, the tide might be turning after a challenging period for these assets, such as property bonds, among others. "Now would be a good time for investors to look again at the sector, given that valuations are more attractive, technicals have dramatically improved and it is now less crowded," said Alan Siow, Portfolio Manager at global asset management firm Ninety One.

Alan Siow
Portfolio Manager – Fixed Income
Ninety One

Beyond the noise

Inevitably, it has been a difficult year for Chinese risk assets, especially offshore US dollar-denominated bonds exposed to the domestic property sector. The key to investing in China, as with any market, is to take a longer term view.

Optimism can, however, be found in the export-led nature of the economy, with the value and volume of the goods China sells to the rest of the world outperforming what it imports.

Chinese policymakers also still have monetary and fiscal tools at their disposal which remain unused. "Beijing has not yet pursued any material fiscal stimulus or monetary easing. If it does, and this works, it will be good news for China bonds," added Siow.

The appeal of the asset class is also strong amid the debate over whether the world is at a turning point in terms of globalisation. In any scenario, China bonds potentially offer an attractive hedge for portfolios, as a balance against the overall allocation.

Ultimately, it comes down to the risk of not owning onshore bonds. "China is a story investors don't want to miss out on," said Siow.

Sustainability counts

China also offers notable potential for allocations to green bonds. With the transition to a low-carbon economy a core plank of government policy, including initiatives to encourage bank lending to energy transition projects, the ground rules are in place for a surge in investment in this space.

"Climate change is also a key area where China is aligned with the West, and a lot of green and sustainable financing is required, with fixed income key to this," said Wilfred Wee, Portfolio Manager at Ninety One.

Riding this trend, even more Chinese issuers are expected to tap the green bond market in 2022.

All-in for China

Green or not, finding reliable and long-term opportunities in China's bond markets depends on the right partnerships.

At Ninety One, this exists in two key ways. Firstly, the firm combines knowledge, experience and expertise across its fixed income teams in both the sovereign and corporate bond universe. And secondly, it analyses China in the context of the overall emerging markets (EM) landscape.

"China is not a stand-alone market. Our golden rule is to ask whether bond valuations in China make sense in the context of the inflation and growth outlook, not just domestically or even compared with the rest of EM, but also benchmarked against developed markets," said Wee.

This reflects the firm's holistic approach to unlocking opportunities across onshore and offshore Chinese bonds – with the focus on maximising the investment universe to seek to achieve an attractive combination of yield and credit quality.

"It is about function over form," said Wee. "We care less about labels and more about the ultimate impact."

It helps that Ninety One has a 30-year history rooted in EM; this offers the benefit of being able to assess China through a differentiated investment lens.

Advantages of investing in Chinese bonds

- Accessing the 2nd largest bond market
- Providing attractive yield
- Offering portfolio diversification

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[1] **Investors should note that lower volatility does not necessarily mean lower risk.**