FREQUENTLY ASKED QUESTIONS

Asia Pacific Fixed Income Market Outlook

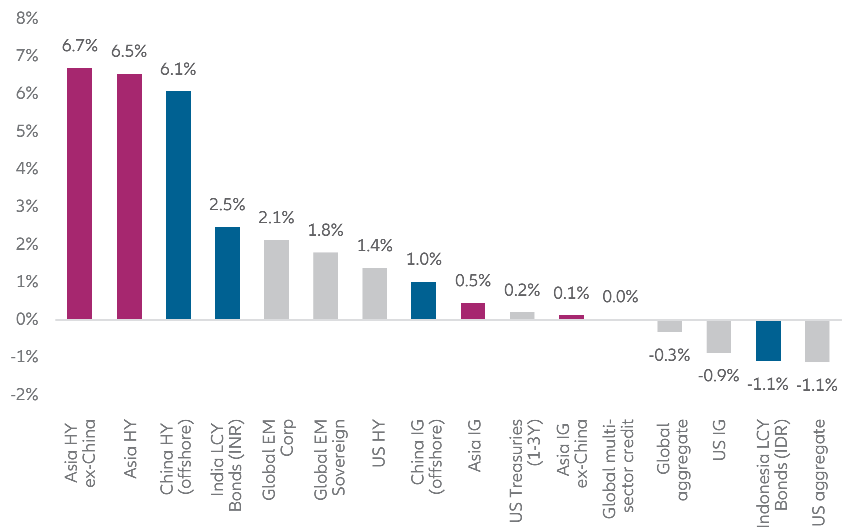
1. Asia fixed income assets have performed well year-to date. You mentioned about favourable macro conditions in Asian economies – please elaborate.

We are constructive on Asia's macro prospect, for both this year and for the years ahead **(Exhibit 1)**.

In the near term, inventory normalization of electronic products and demand for AI chips are expected to support a moderate

Exhibit 1: Year-to-date Asia fixed income has outperformed other fixed income markets

Total Return (%)



Source. Bloomberg, ICE BofA and JP Morgan indices; Allianz Global Investors, as of 25 March 2024. Index returns in USD-hedged, unless otherwise stated. Estimates for Asia IG/HY ex-China are derived from calendar year 2023 returns, using the formula : (Returns of Asian bond reference index (J.P. Morgan Asia Credit Index) – returns of China reference index X weight of China in reference index) / weight excluding China in reference index.

KEY TAKEAWAYS

- Asia Fixed Income has delivered stellar outperformance over other fixed income markets since the start of the year.
- Looking beyond, we believe Asia has entered a multi-year virtuous cycle, as stronger economic fundamentals, pro-reform governments, superior infrastructure eco-system, favorable demographic positioning, and relative political stability will enable the region to capture new growth opportunities and attract large capital inflows. In turn, this will lead to lower FX volatility and significant reprice of local bonds and credits.
- We like Asian credit due to the sweet spot credit cycle and as the default cycle is coming to an end. For investors who want to have stable carry or income, Asian credit may continue to provide stable and competitive carry. We are also constructive on Asia high-yield market, with opportunities for investors to pocket an attractive yield as default cycle is coming to an end.

Jenny Zeng
Chief Investment Officer, Fixed Income Asia Pacific

recovery of the technology cycle in Asia. Cyclical growth will pick up among the electronics exporters in Asia, while the ongoing structural tailwinds from electronics supply chain diversification continue to support fixed capital formation in ASEAN countries. For the other economies, resilient domestic demand will continue to support relatively high growth rates. According to International Monetary Fund (IMF), Asian countries will contribute approximately 62% of global growth this year **(Exhibit 2)**.

Moreover, unlike many Organisation for Economic Co-operation and Development (OECD) countries where core inflation remains stickily high, disinflationary trends in Asia will continue into 2024, with core inflation momentum remained subdued for most countries in Asia. Therefore, benign growth and inflation dynamics this year provides a solid macro backdrop for Asia fixed income assets to outperform this year.

Looking beyond the near term, we concur with the World Bank which expects Asian economies to experience the highest productivity and potential growth for this decade. We've observed a tremendous sovereign rating upgrade in this region over the past 20 years with typical examples of Indonesia, Philippines, Vietnam and India. We expect such a trend to continue for the next decade **(Exhibit 3)**.

As a result, we expect a virtuous cycle to be kicked-start in this region, which will eventually lead to significant reprice of fixed income assets, including lower FX volatility, tighter spreads, and lower correlation with other markets.

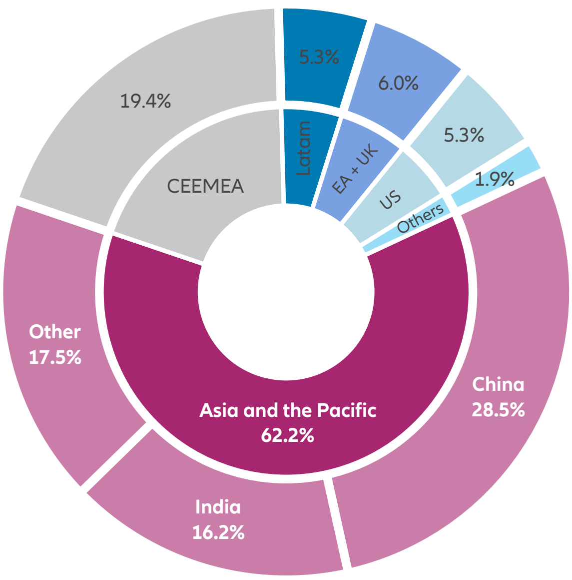
Therefore, we believe Asia fixed income market not only is positioned for outperformance this year, but also there to provide decent and diversified potential returns for investors in the years to come.

2. Given the strong year-to-date performance, how do you view current valuations in the Asia fixed income market/ Asia credit market?

Unlike some other emerging market region such as Latam (Latin America) and some major developed economies, Asian central banks have pursued a much less aggressive rate hiking cycle during the post-pandemic inflation spike. Instead, Asian countries deployed multiple policy tools to mitigate inflation shock, such as, FX reserve intervention, capital flow measures, supply-side policies, as well as quasi-fiscal subsidies to smooth the energy shock.

Exhibit 2: Asian countries will contribute approximately 62% of global growth this year

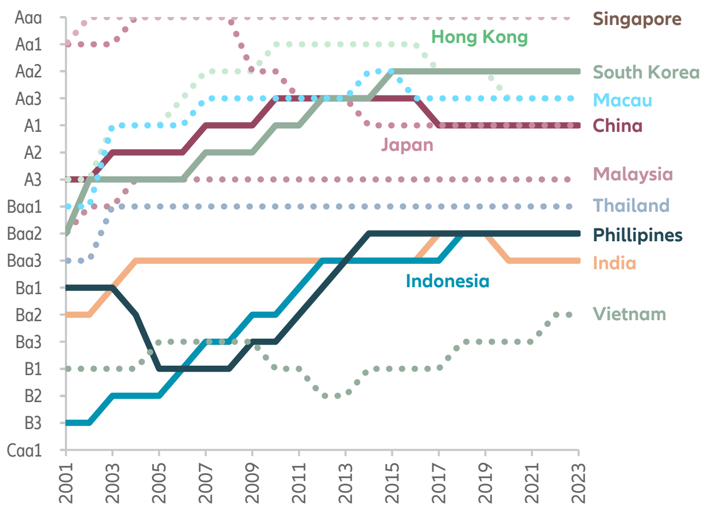
IMF GDP Growth Forecast 2024



Source: IMF, Allianz Global Investors, as of 30 September 2023.

Exhibit 3: Positive ratings trajectory for Asian Sovereigns

Trends in sovereign credit ratings over the past 20 years



Source: Bloomberg, Allianz Global Investors, as of 31 December 2023.

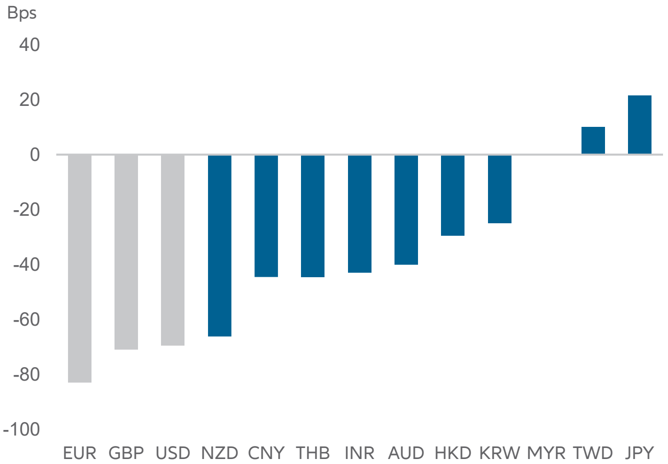
Overall, Asia's inflation and inflation surprises consistently undershot other regions and many Asian countries have reached their inflation targets much earlier. As a result, Asian central banks will also ease much less than other developed markets, particularly with more resilient growth **(Exhibit 4)**.

Against this backdrop, Asian bonds will enjoy more favourable yield differentials versus developed markets (DM) bonds this year, and therefore attract capital inflows into Asian local bonds, which underpins further potential outperformance when the US Federal Reserve (Fed) starts to cut. In our base case, we expect the first Fed cut to be in July.

For Asian credit, while it has outperformed year-to-date, the total yield remains quite attractive vs other credit markets **(Exhibit 5)**. For example, by end of February, J.P. Morgan Asia Credit Index[1] (JACI) - was still yielding at 6.4% vs 5.5% of J.P. Morgan US Liquid Index (JULI) [1], which is the US Investment Grade (USIG) index and 3.8% European Investment Grade (IG)[1]. Given its low volatility nature underpinned by strong technical, Asian credit will continue to provide stable carry to investors.

Exhibit 4: Asian central banks to ease less than other developed markets

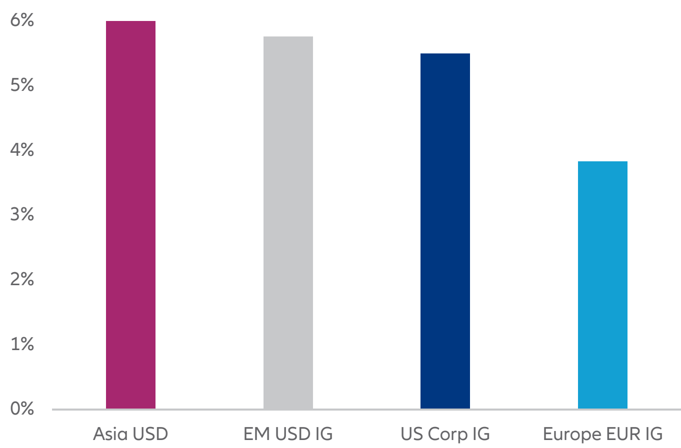
Market pricing of implied policy rate change by December 2024



Source: Bloomberg, Allianz Global Investors, as of 29 February 2024.

Exhibit 5: Yields for Asian credit attractive versus other regions

Yield to Worst



Source: Bloomberg and JP Morgan indices; Allianz Global Investors, as of 29 February 2024. Asian USD bonds refers to JP Morgan JACI Composite. EM Corporate refers to JPM Corporate EMBI BD. EM Sovereign refers to JPM EMBI GD. US IG refers to JP Morgan JULI. EU IG refers to Bloomberg Euro Aggregate. Returns based in USD except for EU IG which is based in EUR.

3. How about the fundamentals of Asian credit?

In fact, one of the key reasons that distinguish Asian credits from other credit markets is our credit cycle **(Exhibit 6)**.

Majority of Asian credit sectors are currently in the sweet spot part of the credit cycle, i.e. repair and recovery - such as Macau gaming, Indonesian industrials, China manufacturing, China technology, India infrastructure, where issuers have a right-sized business, improving margins and decreasing leverage.

Even for sectors that are in the expansion cycle, such as Indian utilities and Indian cyclicals, strong capital structure and balance sheets with solid sponsorship mitigate excessive capex and releverage risks.

There are only a few sectors, such as China real estate and HK real estate, which are still in the downcycle, but better liquidity support and availability in both markets with supportive policy stance can mitigate default risk in those sectors.

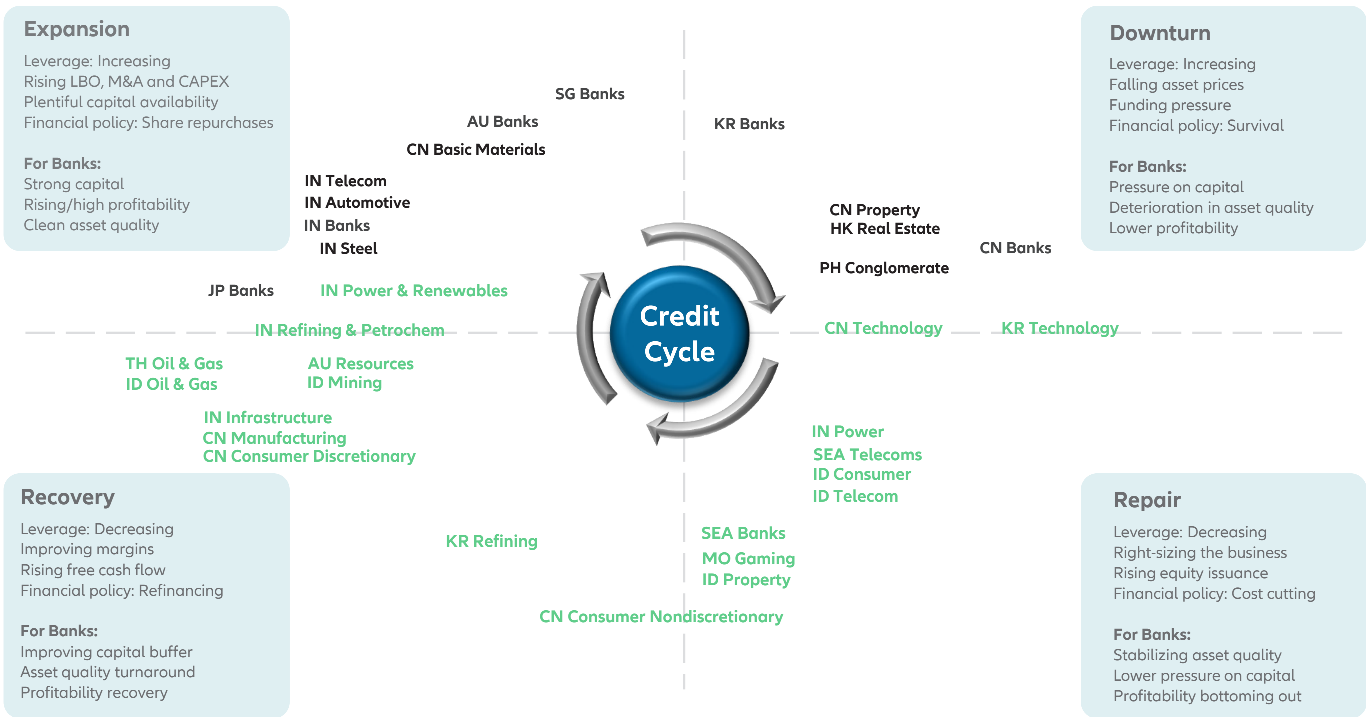
This is critical in investing in credit because being in the sweet spot of the credit cycle means less credit rating downgrade risk, with limited default risk. Therefore, investors investing in Asian credit would truly enjoy the 'carry'.

4. Let's talk about the elephant in the room, China. What's your view on the macro growth prospects and what are the implications for China fixed income?

While bearish sentiment towards China remains high, as a fixed-income investor, we beg to differ.

Since last year after China reopened from the pandemic, it has become quite clear to us that the Chinese leadership has clearly made up their minds to move away from the old growth model, which relies excessively on borrowing and channeling excess savings into unproductive investment to boost gross domestic product (GDP), towards a new 'high-quality' growth model. This is the core

Exhibit 6: Most Asian credit sectors are in a sweet spot



Source: Allianz Global Investors, as of 7 February 2024.
LBO: Leveraged buyout
M&A: Mergers and Acquisitions
CAPEX: Capital expenditures

foundation that guides China's policy making from now and into the foreseeable future.

The good news is, China has enough policy tools to provide a floor to economic growth and buy time for this transition period. The not-so-good news is, this ambition of multi-faceted 'high-quality' power building, coupled with structural challenges and seemly unreconcilable paradox in the long-term goals vs short-term issues, will likely constrain the magnitude and the effectiveness of most conventional economic policies.

With the long-term priority in mind, this period of unexciting macro situation can be best exploited within fixed-income asset class, particularly for investors in search of real portfolio diversification and superior alpha opportunities. We believe China government bonds are still in the middle of a structural bull market. China IG will continue to deliver stable and competitive risk-adjusted return thanks to strong fundamentals and technicals, and we also see attractive credit alpha opportunities in the China high-yield space, which can be exploited with bottom-up credit research **(Exhibit 7)**.

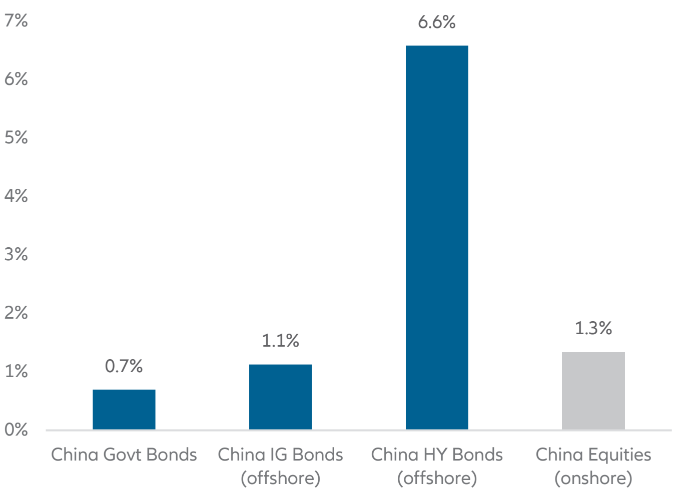
5. How about China's real estate sector? Do we expect more defaults?

A real estate crisis is not unique to China, but China's current real estate crisis has its unique features. China's real estate crisis is manifested primarily through the unique presale system in the country, and subsequently triggered by the loss of confidence on the creditability of developers to deliver presold units after some of the largest developers in the country went belly up over the past 2 years. As a result, demand side policies, such as lifting home purchase restrictions across cities and mortgage relaxations, will only have limited effectiveness, unless the issue around developers' credibility can be addressed and buyers' confidence is restored.

Coincidently, this presale crisis is further compounded by the fact that China's real estate market is due for a structural adjustment. We believe the primary property market will continue the downward adjustment for a few more quarters before it reaches the new equilibrium sales level for the next 3-5 years **(Exhibit 8)**.

Exhibit 7: China fixed income have delivered competitive performance year-to-date

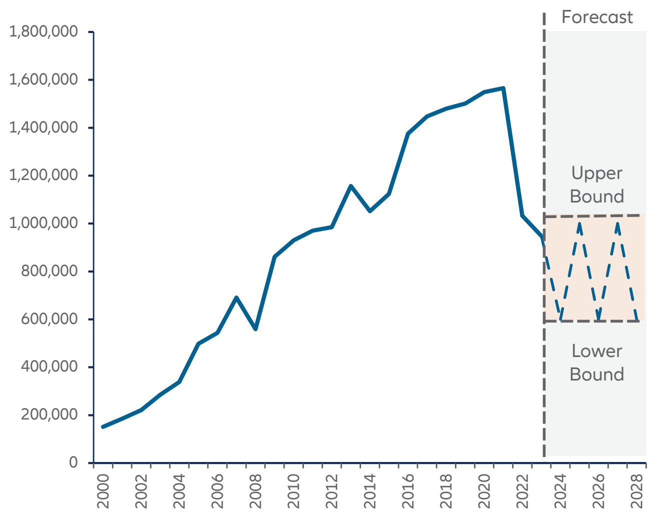
Total returns in USD



Source: Bloomberg, Allianz Global Investors, as of 31 March 2024. China Govt. Bonds refer to Bloomberg China Treasury TR Index expressed in USD. China IG Bonds refers to J.P. Morgan JACI China Investment Grade TR. China HY Bonds refers to J.P. Morgan JACI China High Yield TR. China Equities refers to Shanghai Shenzhen CSI 300 Index.

Exhibit 8: China's housing market is due for a structural adjustment

China primary home sales (yearly) - Gross Floor Area (GFA) sold (sqm)



Source: UBS, Allianz Global Investors, as of 31 December 2023.

This explains why liquidity support to developers, particularly privately-owned developers, is crucial in reviving the primary market. Since the Politburo meeting in July 2023, we have seen the turning point in policy with commitment to provide liquidity support to developers to complete and deliver unfinished projects. Such measures should help alleviate liquidity crunch developers have been suffering and buy time for developers to go through the downcycle and rebalance supply and demand once excess inventories are cleaned up.

In all, we believe privately-owned developers that are still standing have weathered through the worst-ever credit downcycle and should come out much stronger over time in terms of operations, brand name, market share and financial healthiness.

But such developers are the minority. Therefore, relentless bottom-up credit research and a disciplined investment process will now be key to identifying and capturing such opportunities.

6. What's the best way to capture the opportunities you just talked about in Asia fixed income?

We like Asian credit as a whole, due to the sweet spot credit cycle and as the default cycle is coming to an end. For investors who want to have stable carry or income, Asian credit may continue to provide stable and competitive carry.

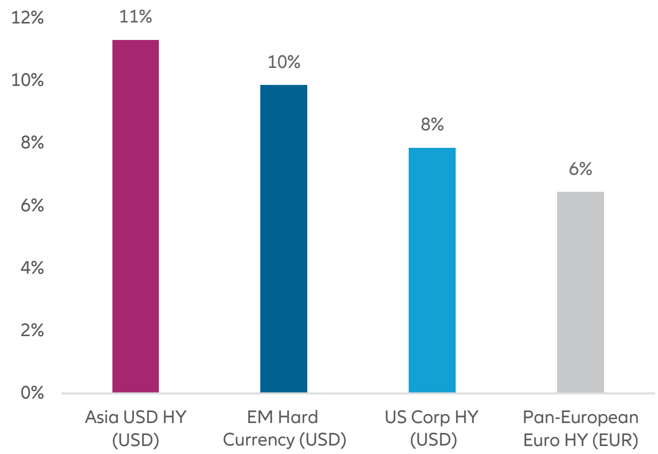
Specifically, we are constructive on Asia high-yield market that is still yielding at double digit, despite year-to-date outperformance **(Exhibit 9)**. We think it is time for investors to pocket that yield as default cycle is coming to an end.

We believe an investment strategy to build the core position in the portfolio with corporates and financial institutions which are in repair and recovery cycles, may provide decent carry and minimal default risk. On top of that, taking advantage of market dislocation in China high yield for alpha opportunities may help to enhance return.

That said, such alpha opportunities can only be captured with relentless bottom-up credit research and a disciplined investment process. Gone are the days when credit research was based on 'headlines' and 'market chatters'. Meanwhile, to capture such credit opportunities requires portfolio managers to have the mentality of 'underwriting to maturity', particularly given liquidity constraints in any high-yield market.

Exhibit 9: Asian high yield (HY) remains the highest yielding fixed income (FI) market

Yield to worst of various HY markets



Source: Bloomberg, Allianz Global Investors, as of 29 February 2024.

[1] Source: J.P. Morgan. JACI refers to the J.P. Morgan Asia Credit Index – Composite. EUR IG is proxied by JPM Global Credit Index (IG portion) in EUR terms, as of 29 February 2024.

[2] Source: J.P. Morgan: JACI Non Investment Grade Index yield to maturity as of 29 February 2024.

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