

## Asian Bonds Beating Bunds

Asia's emerging market bonds delivered double the returns of U.S., German and Japanese debt this year, drawing record inflows as budget deficits widened in developed nations.

Nations that were bond-market pariahs during the currency crisis of 1997-98 are now relatively safe because of mounting issuance in the U.S., Europe and Japan. Moody's Investors Service upgraded its debt rating for South Korea and raised its outlook for Indonesia in the second quarter, while cutting Greece below investment grade and warning the U.S. may lose its top ranking.

"They used to be risky assets," but "now investors see them as a safe haven. Economic growth in Asia is still doing well."

Bond funds focused on Asia excluding Japan have taken in a record \$2.4 billion in 2010, compared with net withdrawals of \$679 million in the same period of last year, according to EPFR Global, a U.S. research firm that tracks investment flows.

### Outperforming Bunds

JPMorgan Chase & Co.'s index of Asian local-currency debt excluding Japan returned 12.8 percent in 2010. Global sovereign bonds returned 4 percent in that period, Bank of America Merrill Lynch indexes show. Bonds gained 6.1 percent in the U.S., 6.4 percent in Germany and 2.3 percent in Japan. An index tracking Greece, Ireland, Italy, Portugal and Spain fell 1.7 percent.

Asian bonds beat stocks by the most since JPMorgan started tracking the figures in 2003 as the MSCI Asia Pacific Index of shares excluding Japan fell 5.3 percent, including reinvested dividends. China's yuan debt gained 3.2 percent in 2010, according to an HSBC Holdings Plc index, while the Shanghai Composite Index of stocks dropped 22 percent as the government curbed lending to avert a real-estate bubble.

Clients in Europe and America are showing increased interest in diversifying toward Asian bonds as regional shares underperform, said Rajeev De Mello, the head of Asian debt for Western Asset in Singapore.

## **‘Asia Is Safer’**

“People aren’t getting much from stocks, and at least they’re getting an income stream from bonds,” said De Mello, who helps oversee \$482 billion at Western, the Pasadena, California-based fixed-income unit of Legg Mason Inc. “People are looking at debt-to-GDP figures, and they’re seeing that Asia is safer.”

U.S. publicly traded debt has risen to a record \$8.1 trillion, 57 percent of gross domestic product. The similar figure for Japan is 197 percent, or \$9.7 trillion. By contrast, India’s is \$417 billion, 36 percent of its GDP, and Indonesia’s is \$89 billion, or 17 percent, according to data compiled by Bloomberg.

Moody’s raised South Korea’s rating by one level to A1 in April, citing a “relatively small” deficit. It boosted its outlook on Indonesia’s Ba2 grade last month, forecasting “sustained strong growth.” The U.S.’s top ranking will come under pressure unless additional measures are taken to reduce projected record budget deficits, Moody’s said in May.

## **Foreign Reserves**

Asia’s developing nations have accumulated \$5 trillion of foreign-exchange reserves. China has \$2.45 trillion, the world’s biggest holdings, while Taiwan, South Korea, India, Hong Kong and Singapore also rank among the top 10.

“Asian currencies look very stable in comparison with other emerging-market currencies because of their record reserves,” said Masataka Horii, a money manager in Tokyo for Kokusai, which runs Asia’s largest debt fund as part of its \$56.2 billion in assets and is bullish on India and Indonesia.

Regional bonds remain risky because prices for goods and services may rise as economies improve, eroding the value of their fixed payments, said Sergey Dergachev, who helps manage about \$6 billion of emerging market debt at Union Investment in Frankfurt, Germany’s third-largest money manager.

## **Inflation Risk**

“Due to increasing inflationary pressures, there is risk of a tightening monetary policy environment,” Dergachev said. “Rising interest rates will hurt direct bond performance.”

In China, consumer prices climbed 2.9 percent in June from a year earlier and 3.1 percent in May, the biggest increases since October 2008, official figures show. India’s wholesale price index has recorded increases of more than 10 percent in each of the last five months and the central bank raised interest rates for the third time this year on July 2.

The Bank of Thailand raised borrowing costs on July 14 for the first time since 2008, joining central banks in South Korea, India, Malaysia and Taiwan in having increased rates in the past month. Singapore, which reported record economic growth of 18.1 percent for the first half, is targeting a “gradual appreciation” of its currency to combat inflation.

De Mello, whose most recent purchases include bonds in Malaysia, predicts economic expansion will fuel currency gains and support the region’s yield advantage. Asia’s developing economies will expand 9.2 percent this year, outpacing growth of 3.3 percent in the U.S. and 1 percent in the euro area, based on IMF projections published on July 7.

## **Currencies, Yields**

Malaysia’s ringgit, Indonesia’s rupiah and China’s yuan are among the 10 best-performing emerging-market currencies this year. Ten-year government bonds yield 3.91 percent in Malaysia, 4.92 percent in South Korea and 8.19 percent in Indonesia, compared with 2.95 percent on U.S. debt.

Faster growth will lead to “a sustained tendency for currencies to appreciate versus the euro, yen, and the U.S. dollar,” said Michael Hasenstab, who oversees more than \$80 billion as co-director of international fixed income at San Mateo, California-based Franklin Templeton Investments. The company’s fixed-income group manages \$573 billion globally.

Mitsubishi UFJ Asset Management Co., a unit of Japan’s biggest publicly traded bank, bought Singapore dollars in April and plans to purchase Indonesian rupiah, said Hideo Shimomura, the chief investor.

“We are confident that Asian currencies are quite safe,” said Shimomura, who helps oversee the equivalent of \$56.2 billion in Tokyo. “They are good for hedging against the U.S. dollar and the euro.

*Source: Extracts from Asian Bond Beating Bunds Leads Pictet to Triple Fund Assets.*

*By Wes Goodman and Lilian Karunungan July 20 (Bloomberg)*

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