At a time of rapid global change, what does Asian EMD offer investors?

Once considered a niche of a niche, emerging market debt has come to the fore as a way to access the world's most dynamic region. Here's where we see the opportunity

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Emerging market debt (EMD) is no longer considered a niche asset class thanks to the substantial growth of its underlying regional asset sub-classes over the last few years. As the largest regional portion of the EM USD debt market, Asia offers a unique blend of scalable opportunities that deserves specific attention. The most widely used benchmark (the JP Morgan Asia Credit Index) measures the Asian USD bond universe at around US$900bn, comparable to other fixed income indices such as EMD hard currency corporate and US high yield index[1].

Potential diversification benefits

With a continuous flow of debt issuers from the growing economies around Asia, opportunities to diversify and capture value consistently present themselves. The market now provides access to more than 450 issuers across 16 different economies. While Chinese issuers used to constitute a majority of the market, nowadays they represent only c.30% of the index[2], offering the potential benefit of exposure to various other heterogenous economies across Asia.

Overall, EM corporate credit represents approximately 60% of the index[3], while sovereigns and quasi-sovereigns make up the remainder. Within corporate credit, financials account for just over a quarter of the market. This is followed by the utilities, industrials and technology, media, and telecommunications sectors. The overall credit rating of the index has steadily improved to an average above BBB, with over 85% of the issuers rated as investment grade[4]. This improvement reflects sovereign upgrades over the past few years, driven by stronger macroeconomic environments in countries such as Indonesia, the Philippines, and India. Additionally, improved Asian corporate fundamentals and the natural exclusion of lower-quality issuers have further improved the picture.

Balancing risk and returns

In a similar way to the broader EMD category, the Asian market's overall duration has remained relatively low for some time, hovering between 4 to 5 years over the past decade[5]. We think this could provide natural mitigation against benchmark interest rate movements, a good thing to have in a rising interest rate environment. Despite tighter spreads than in the past, at more than 6% we think all-in yields are still attractive for a predominantly investment grade universe, representing a pickup over developed market peers in the same rating buckets. Consequently, we believe that adding Asia credit to an otherwise diversified portfolio has the potential to enhance the risk to returns profile.

Looking forward

As per the International Monetary Funds' January 2025 growth projections, emerging and developing Asia is expected to grow by 5.1% for 2025 and 2026 with China and India forecast to grow by 4.6% and 6.5% respectively[6]. However, the Asian story is not just about the two continental giants: countries like Indonesia, the Philippines and Malaysia, which make up c.20% of the Asia market, are also expected to grow by over 4%.

The optimistic picture is added to by low default rates and the catalyst to growth that China's stimulus measures may deliver to its slowing economy. We expect technicals to remain supportive, with healthy demand from investors. As per recent trading data[7], we estimate about one third of global investment demand for Asia hard currency bonds originates locally from Asian clients. With a combination of domestic interest rates falling across the region and USD rates staying at relatively higher levels than in the past, we think interest from domestic investors within the region will continue to be strong.

In the current environment of tightening credit spreads and benign default expectations from high yield issuers, we favour strong issuers from the renewable energy and gaming sectors for their strong cash flow generation capabilities alongside restructuring stories in select sovereigns. Among investment grade issuers, we like select corporates from Korea and Taiwan for their robust balance sheets. In short, we have concluded the macroeconomic backdrop and the depth of the universe gives investors plenty of opportunities to build a diversified portfolio.

[1]Source: JP Morgan as at 31 January 2025
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[3]Source: JP Morgan as at 31 January 2025
[4]Source: JP Morgan as at 31 January 2025
[5]Source: JP Morgan as at 31 January 2025
[6]https://www.imf.org/en/Publications/WEO/Issues/2025/01/17/world-economic-outlook-update-january-2025
[7]Source: MarketAxess as at 31 January 2025