Economics

DBS Flash

Top-10 investment strategies for 2019: #4 Support for high grade credit, especially BBB

Group Research

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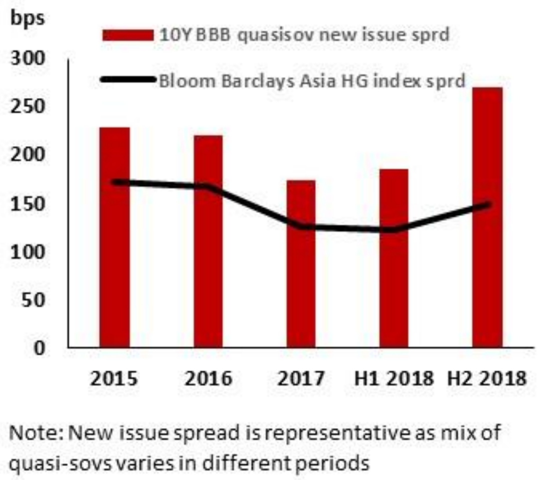
#1 Bet on more rate hikes by the Fed
#2 Looking for USDSGD to hit 1.40
#3 Long Indonesian equities

- *Investing in BBB credits is a key part of our broader recommendation to position defensively in Asian credit, given expectation of volatile markets.*
- *While performance so far in 2019 has taken some sheen off HG valuations, it still is our preferred trade with potential opportunities in the primary market.*
- *Concerns around credit quality are fairly limited among BBB credits with the key risk to the trade being an unexpected spike in treasury yields.*

In the credit space, we have been recommending a defensive positioning in Asian credits in order to mitigate market volatility and reduce exposure to credit events for some time now. Our recommendation has been to focus on predominantly investment grade credits, especially in the BBB space. We believe valuations in the high-grade space improved significantly following the widening in credit spreads during 2018, and especially new issues that hit market in late 2018 offered good value (see chart below). In particular, some of the quasi-sovereigns that priced in Q4 (e.g. Inalum, Power Finance) came well wide of secondary market levels, offering opportunity to pick up significant new issue premium (NIP).

Improving high grade valuations



Source: Bloomberg, DBS Group Research

While market performance so far in the year on the back of expectations of a dovish Fed and de-escalation in trade tensions has taken some sheen off high grade valuations, BBBs remain our preferred trade in Asian credit. This is more so given that the likelihood of a change in risk sentiment remains high. The new issue market will likely once again provide opportunities. For example, several Indian high-grade issuers are considering issuing USD bonds in the near future. Indian Oil priced a USD900mn 5Y bond and although NIP was less generous than seen in Q4 2018, the deal left something on the table for investors and performed in secondary.

We believe the key risk to the trade is more rates than credit. Our rates strategist expects the 10Y UST yield to be around 3% by end 2019. Barring an unexpected spike in US treasury yields beyond these levels, we believe high grade credits will be well supported. We also see downside risk to spreads (that is significant spread widening) to be low, given credit quality of BBBs generally remains healthy.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).