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Chinese debt defaults are not nearly as bad as US bankruptcies

◆ Reported default of Chinese developer China Fortune Land has impacted Asian high-yield bonds.

◆ So far, US\$3.6 billion of offshore bonds from Chinese companies have gone into default, a record.

◆ This number, however, pales in comparison to, for instance, the US\$124.3 billion in bond defaults that happened in the US in 2020.

◆ At a yield of nearly 7%, Asian high-yield bonds offer enough return to accommodate the growing risks.

◆ The FAB AAC is overweight in equities, IG and EM bonds, and gold, and is underweight in alternatives.

Until 2012, even as the number of global bonds from Chinese companies kept growing exponentially, there had never been a default in the modern history of the country. That year, one company defaulted, as newly instated Chairman of the Communist Party Xi Jinping said that China needed to accept some defaults if it wanted to have free markets.

Much has changed in the nearly 10 years since that first default, but, considering the depth and size of the Chinese market, defaults remain very low. Yesterday, news reports said that China Fortune Land had joined the very small list of real estate companies from China that had missed payments on dollar bonds.

The report was weighing on the performance of the Bloomberg Asian High-Yield index, but, so far, the impact was relatively marginal.



As this default ages, and the news reports around it multiply, there could be more of an impact on the asset class. Nearly a third of the index is comprised of dollar bonds issued by Chinese real estate developers, so when one of them fails, it ripples across Asian high-yield.

The amount of offshore bonds issued by Chinese companies that defaulted has doubled year-on-year to US\$3.6 billion so far this year, too. The growth may be scary, but the numbers are not.

China is the second largest bond market, behind the US, at nearly US\$12 trillion. That is onshore. Last year, Chinese borrowers sold US\$212 billion of offshore bonds, US\$47.5 billion of which were rated below investment grade. Hence, US\$3.6 billion is not so much after all.

All added, last year US\$4.5 billion of Chinese offshore bonds went into default, while US\$124.3 billion of American bonds went sour in the same period.

After plunging a year ago, the Asian high-yield index has been hitting records lately

Meanwhile, the Bloomberg US Corporate High-Yield index is paying a yield of about 3.9%, compared to almost 7% for the Asian High-Yield index. Hence, there is a lot more return for the risk in Asian junk bonds than there is in the US equivalent.

There is one measure by which the US is safer when it comes to junk bonds: volatility and liquidity. The high-yield market in the US is far more liquid, and, hence, the American index is less volatile. Plus, defaults are old acquaintances of American investors.

Looking at the numbers and ignoring the noise, Asian high-yield bonds seem to offer good value. And even if there is a lot of noise about them, defaults in China are still relatively tame.

Investment Strategy Update

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