2025 Midyear Investment Outlook – Asia Fixed Income: High Yield

May 2025

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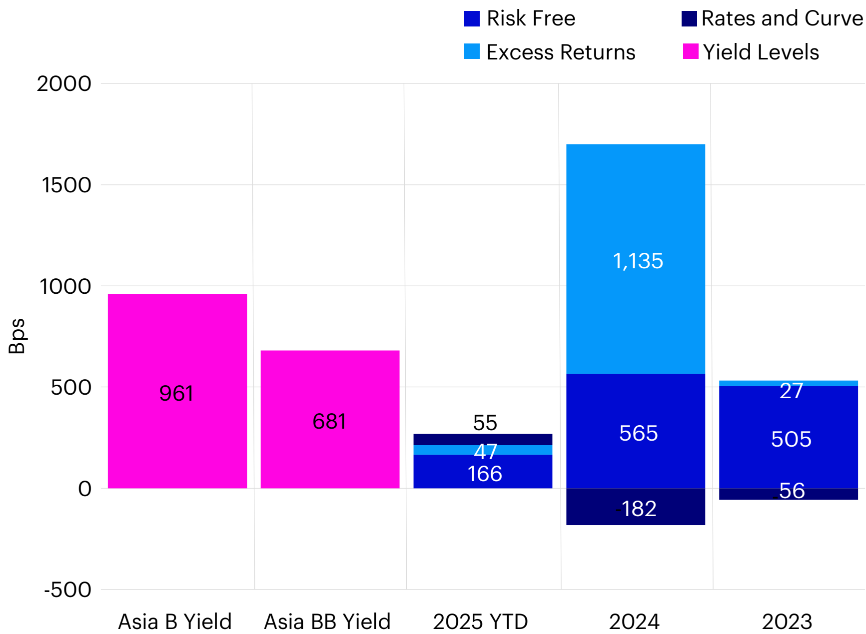
We saw a V-shaped recovery in Asia high yield (HY) markets between the start of April and May 2025, which also reflects the limited direct tariff impact for this asset class. Year-to-date excess returns for Asia HY are positive with total return at 2.7% (Figure 1).[1] Asia BB yields are currently higher than 2023 total returns. While returns were also very strong in 2024, we still expect income to be the core driver of returns going into 2H. We also highlight that select B-rated bonds can provide the incremental income that can possibly be an additive boost to overall portfolio yields, without taking excess credit default risks.

Figure 1: Drivers of Asia high yield historical returns versus outright yield levels (as of 19 May 2025)



Source: Invesco, Aladdin, data as of 19 May 2025.

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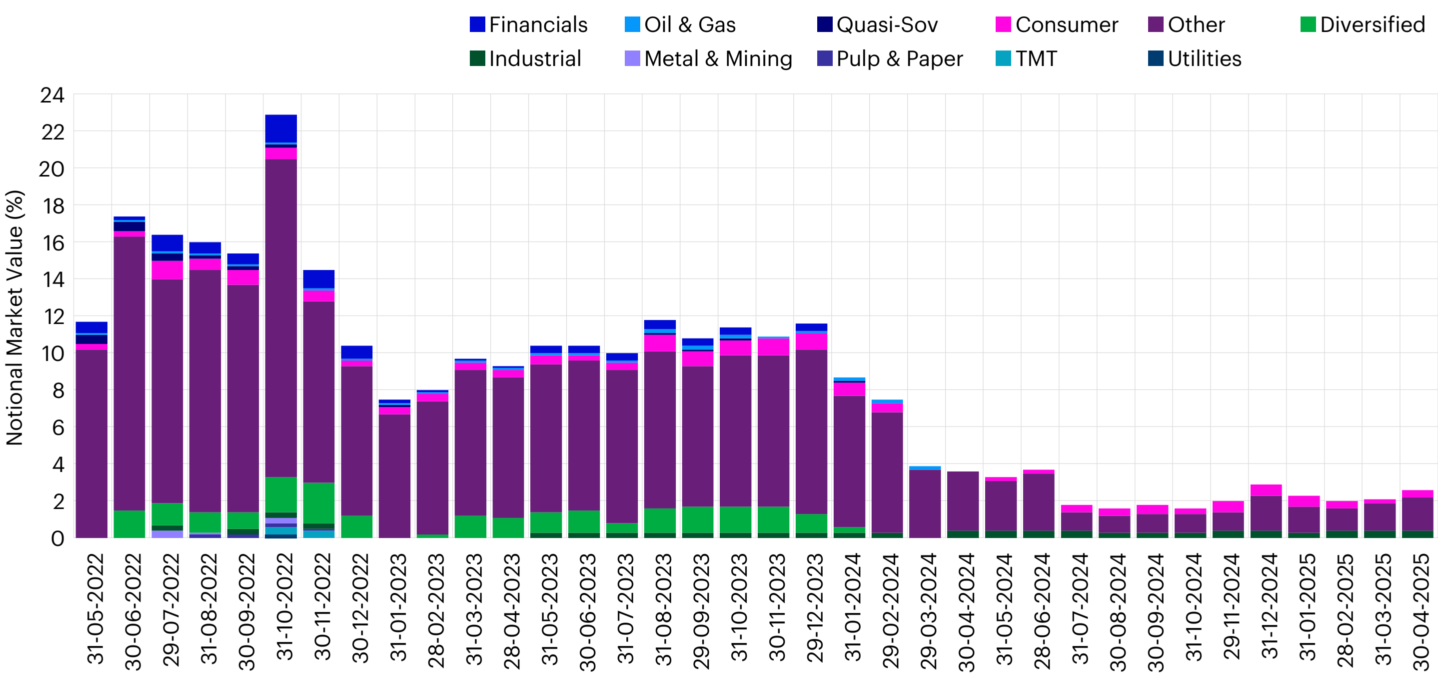
Heading into 2H 2025, we highlight the following topics that we think would be of interest to investors looking at the Asia HY asset class.

Default rate expected to remain low for Asia HY (excluding real estate)
At the end of April 2025, we witnessed the second default of a restructured China real estate developer and its subsequent departure from the J.P.Morgan Asia Credit Index (JACI) benchmark once again. It is evident that the debt burden remains too high for some of these China high yield real estate names that already undertook a first round of offshore debt restructuring. Another key takeaway is that the recovery value in such restructuring exercises is driven by the conversion price set within the convertible bonds which remains a key negotiation obstacle between the controlling shareholder and creditors. Lastly, we note that restructured bonds with an equity option embedded, be it in a convertible or mandatory convertible bond format, are not eligible to be part of the JACI index.

For 2025, we expect default rates in Asia HY (ex-real estate) to remain low, as evidenced by Figure 2 which shows a very small universe of bonds within the Asia HY index that trade at distressed levels of yields (which we define as having spreads of over 1000 basis points). From a sectoral perspective, Asia HY has limited exposure to oil and gas sectors and there are also several commodities issuers that are positioned at the lower end of the cost cash curve which are more resilient in times of lower commodities prices. In addition, we continue to see Asia HY bond issuers taking proactive early measures to refinance upcoming debt maturities or securing bank facilities to refinance them. As such, we remain constructive that default rates outside of the real estate sector will remain low for the rest of 2025.

Figure 2: Proportion of bonds (excluding real estate) that trade at a spread of over 1000 in JACI Asia High Yield Index



Source: Invesco, Aladdin, data as of 19 May 2025.

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Asia high yield continues to provide abundant income opportunities for fixed income investors in diverse sectors

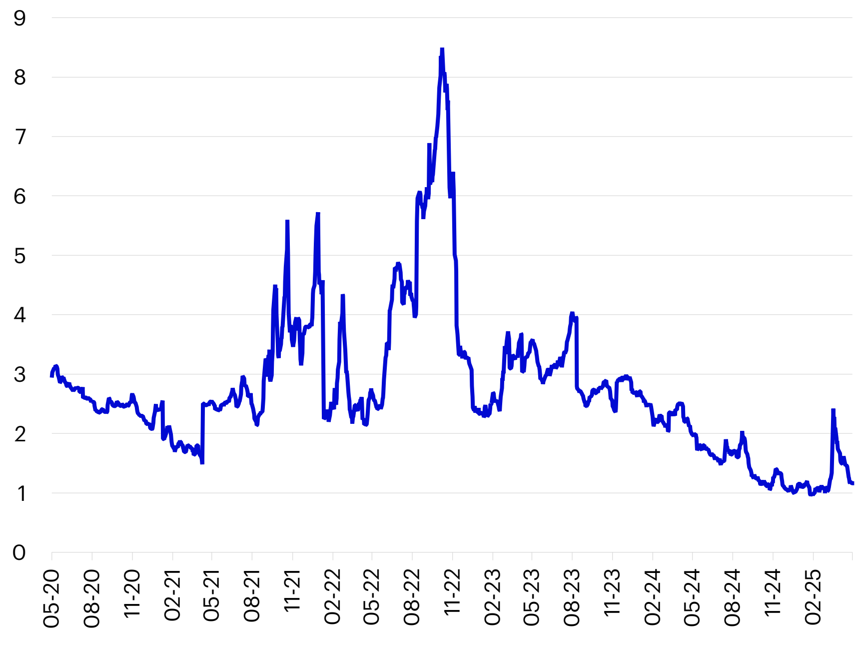
Within the Asia high yield asset class, we prefer bonds that yield between 8 to 10% as these provide good total return opportunities without the volatility of equities in terms of multiple risks including earnings revision risk. From a sectoral perspective, we continue to favour subordinated financials, secured first lien bonds with renewable or infrastructure assets, as well as the Macau gaming sector. These sectors are not directly impacted by tariffs and are instead more domestic focused and arguably have been battle tested during the Covid shutdown period. In addition, we believe emerging market (EM) frontier sovereigns do offer unique alpha opportunities in various macroeconomic scenarios, where continued progress on IMF[2] structural reforms on tax collection measures can pave the way for improved credit ratings.

Please also refer to our Q2 outlook where we highlighted the importance of coupons, which remains a core thematic.

Asia BB has limited yield pick-up versus BBB yields, hence it is important to focus on name selection rather than beta overweight as a strategy

Asia BB-rated bonds continue to provide a yield pick-up versus BBB, but this differential is around 120 basis points only which is at the lower bound of the 5-year average, while recovering from over 200 basis points at the peak of the April market sell-off (Figure 3). We still see all-in yields as attractive in the BB space but would advocate for very specific name selection in improving credit stories that have spread tightening potential, rather than an outright overweight on BB-rated names.

Figure 3: Yield differentials between Asia BB and BBB-rated bonds (May 2020 – May 2025)



Source: Invesco, Bloomberg, data as of 19 May 2025.

In this vein, we believe that an Asia bond strategy that can flexibly allocate between BBB and BB paper according to fundamental and valuation factors is best placed to harvest credit risk premium in Asia credit markets and generate resilient income.

2. IMF refers to International Monetary Fund

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