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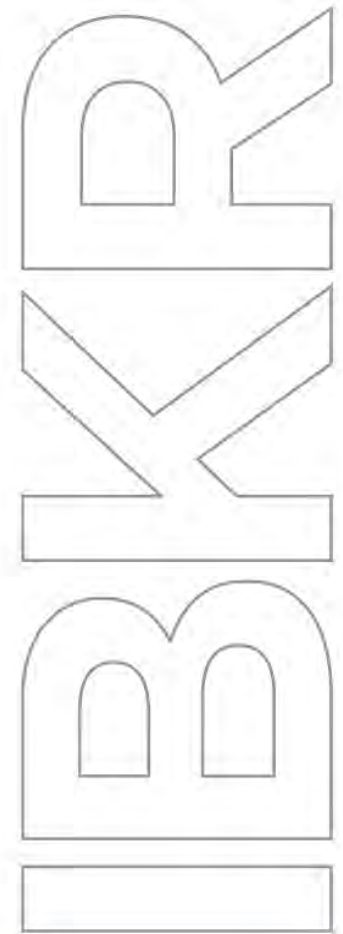
present:

Why Invest in Bonds in a Low Interest Rate Environment?

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Calvin Neo, Nikko Asset Management

Kang Wei Chin, SGX



February 2, 2021

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Why invest in bonds in low interest rate environment?

Sean Wan SGX Academy
2 Feb 2021





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Sean Wan - SGX Academy

Sean graduated from NUS and Warwick University in Accountancy and Business Administration. He is also a Fellow Chartered Accountant of Singapore.

His experience includes working in the Private Equity portfolio companies and managed Investors Relations for a listed bond offering.

Join my Telegram channel for regular updates:
t.me/WelInvest21





Kang Wei Chin

ETF product manager
SGX Limited

**Panelists
Q&A end
of session**



Calvin Neo

ETF Business Development
Specialist
Nikko AM Asia Limited



Learning objectives

1. What are the roles bond perform in portfolio assets allocation decision?
2. What are the concerns investing in bond in the current environment? If yes, how do we mitigate these concerns?



Topics to be covered

1. Bonds market overview
2. What is a Bond?
3. Why invest in Bond?
4. How is bond valued?
5. What are some of the risks when investing in Bond?
6. Is Bond ETF/Unit Trusts preferred?
7. How to evaluate Bond ETF/Unit Trusts?
8. What are the top 3 Bond ETFs +1 newly listed on SGX?
9. How did Bond perform during 2020 crisis?

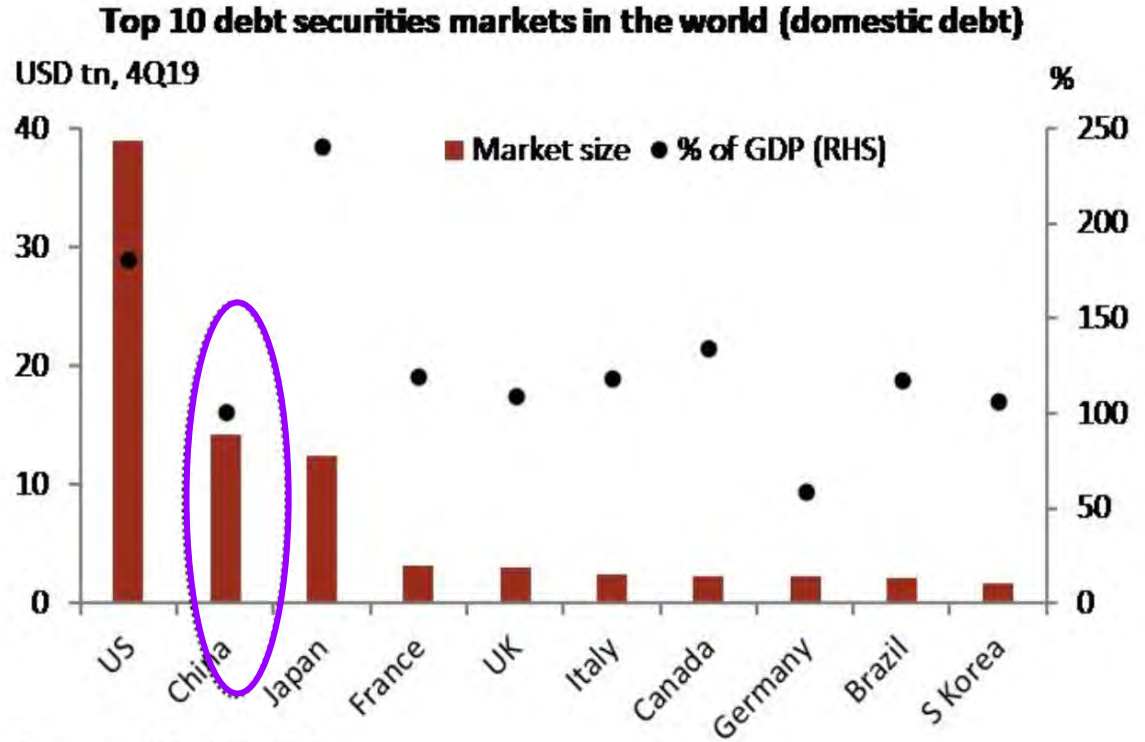


1. Bonds market overview

Size + concerns + mitigations



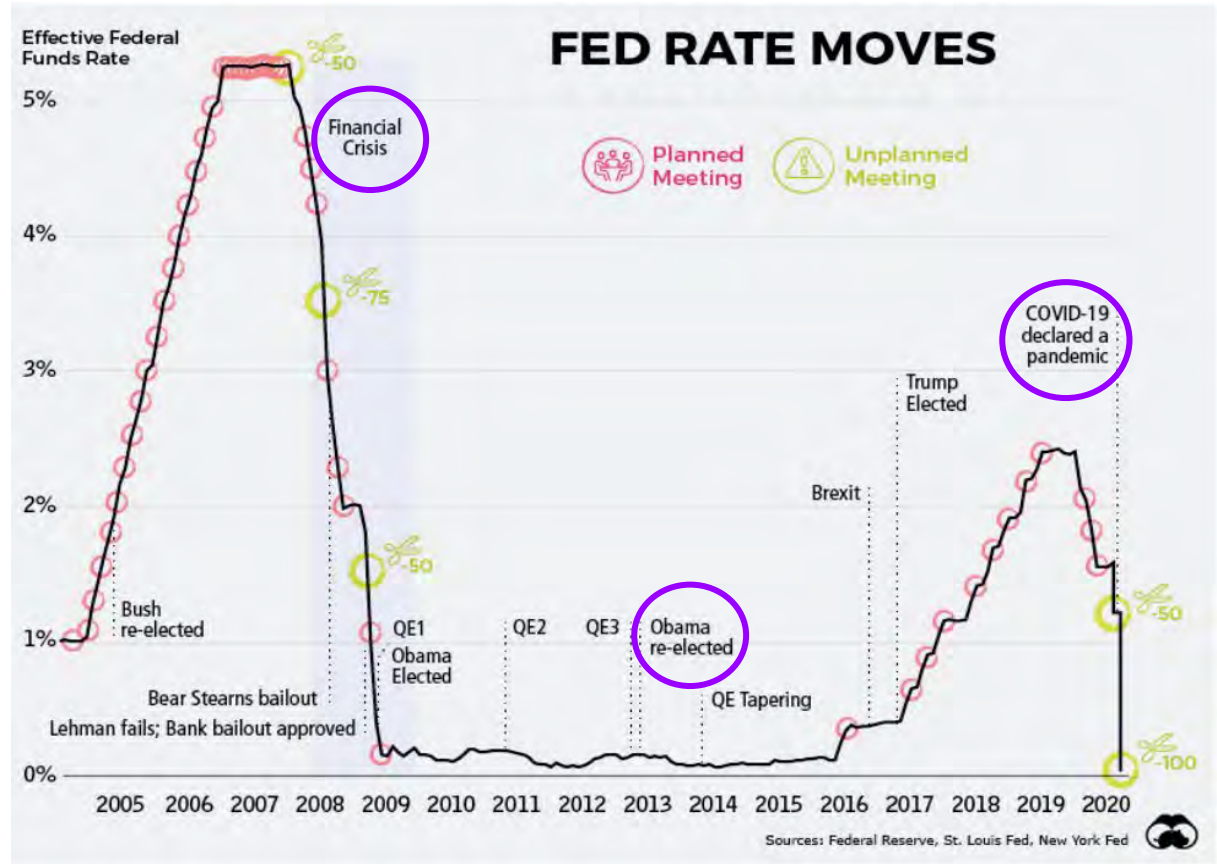
**Global bond market
> 60T USD is larger
the equity market
Not to be ignored**



Sources: BIS, IMF, DBS

Fed rate expected to remain low till 2022

Assets repricing should interest rate increase

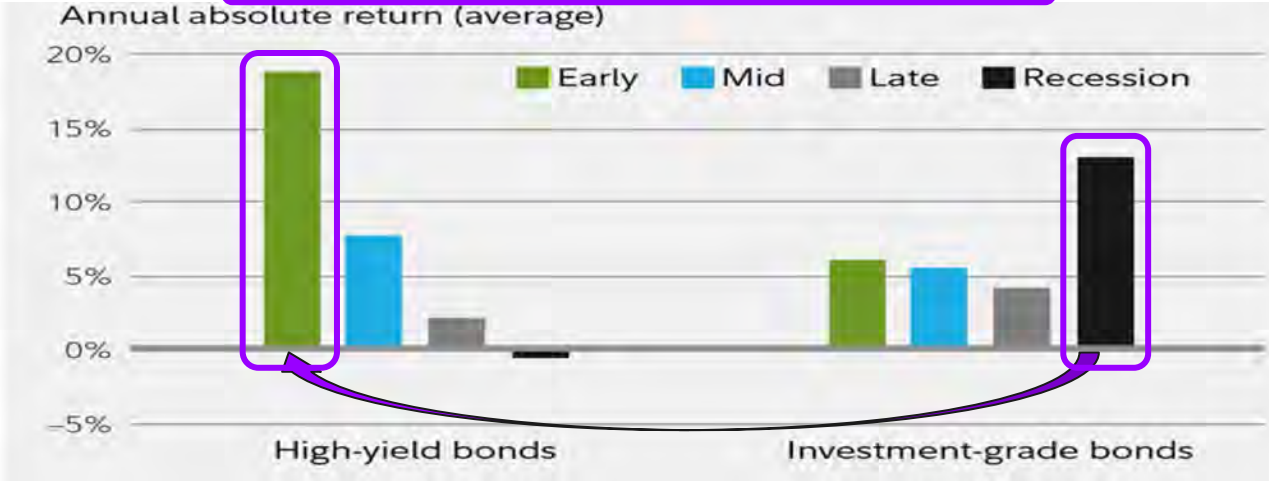


Not all bonds are the same....

High yield typically outperform investment grade bonds during early - mid phase of economic recovery may help cushion interest rate risk

Cycle Phases	EARLY	MID	LATE	RECESSION
	<ul style="list-style-type: none"> • Activity rebounds (GDP, IP, employment, incomes) • Credit begins to grow • Profits grow rapidly • Policy still stimulative • Inventories low; sales improve 	<ul style="list-style-type: none"> • Growth peaking • Credit growth strong • Profit growth peaks • Policy neutral • Inventories, sales grow; equilibrium reached 	<ul style="list-style-type: none"> • Growth moderating • Credit tightens • Earnings under pressure • Policy contractionary • Inventories grow; sales growth falls 	<ul style="list-style-type: none"> • Falling activity • Credit dries up • Profits decline • Policy eases • Inventories, sales fall

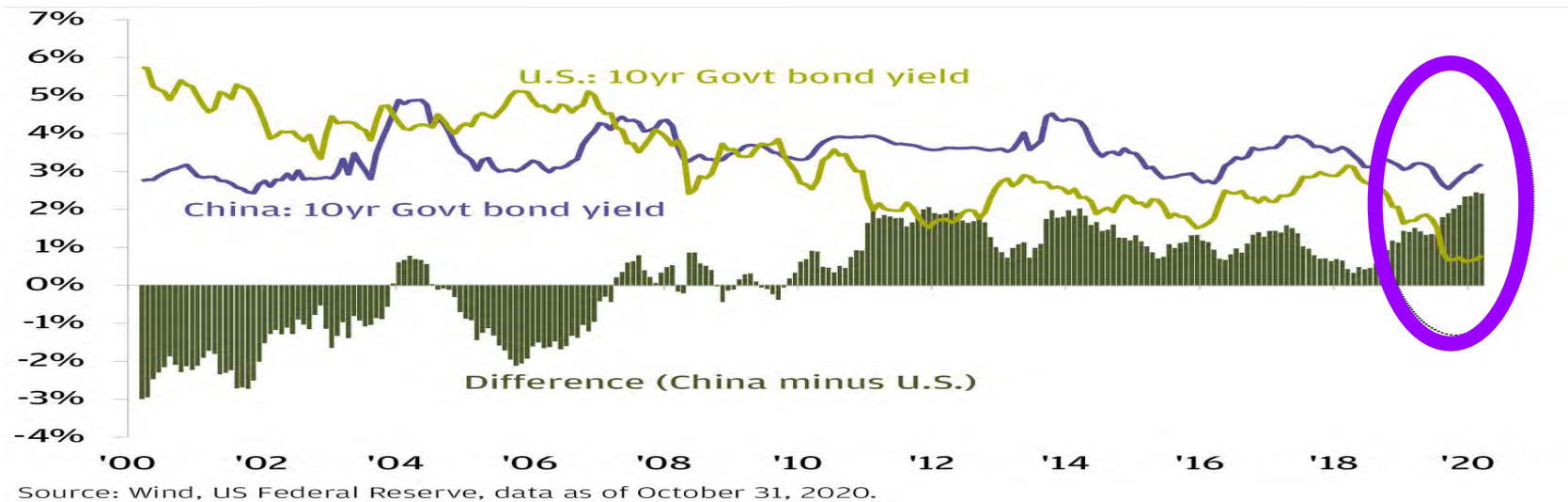
Bond performance across business cycle phases 1950-2010



Past performance is no guarantee of future results. Asset class total returns are represented by indexes from the following sources: Fidelity Investments, Bank of America Merrill Lynch, Ibbotson Associates, Barclays, as of July 31, 2014. Source: Fidelity Investments proprietary analysis of historical asset class performance, which is not indicative of future performance.

Not all bonds are the same.... US vs China Govt Bonds

Higher yield and strength of RMB increase attractiveness for China RMB Bond to cushion against interest rate risk and bearish USD





Varieties of bond offerings cater to diverse needs



**Short
Duration**



**Inflation
Indexed**



**Investment
Grade**



**Floating
Rate**



High Yield



Convertible



2. What is a bond?

3 major differences compared to equity



1. Bondholder is a creditor not a shareholder/business owner. Upon maturity the par value or the principle sum invested is returned.
2. Bond is issued with par value, coupon rate and maturity date. Regular bond interest is paid providing stable source of income especially for retirees and insurance industry.
3. In the event of liquidation bondholders get paid before shareholders. REITS, on the other hand is equity and highly leveraged. It is also obligated to dividend at least 90% of income resulting in regular rights issue/placement to refinance for expansion.



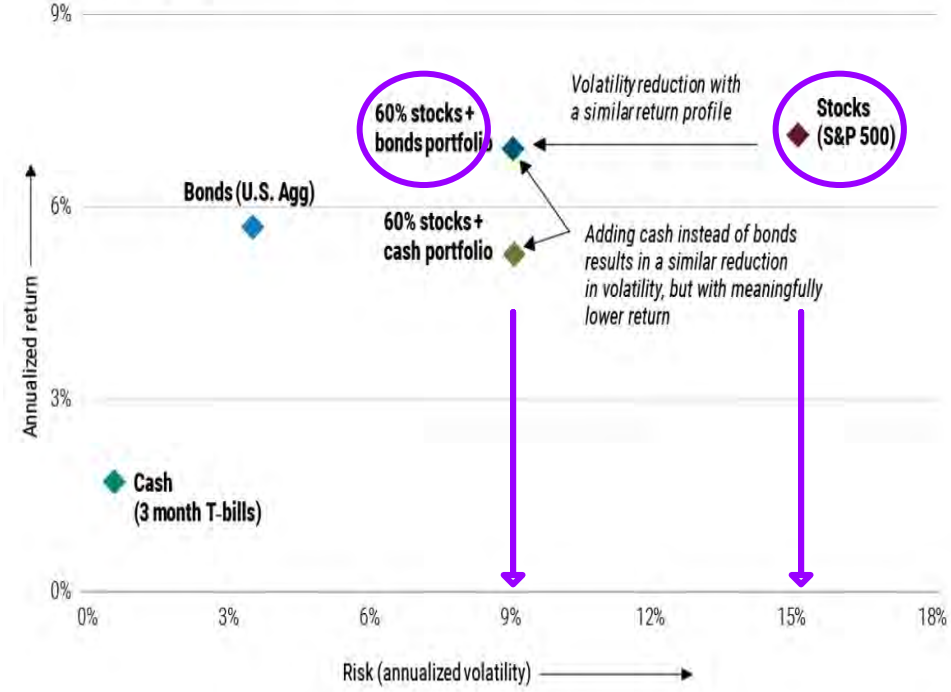


3. Why invest in bond?

Portfolio stability + diversification + income



Diversification Benefits: Adding Bonds Has Meaningfully Lowered Volatility With Similar Returns
(Data over past 20 years)



Portfolio stability + diversification

Bond allocation provides the needed diversification and stability. 60/40 portfolio on the efficient frontier provides stability with minimal impact on portfolio returns based on last 20 years data. Current low interest environment over bond weightage.

Source: Bloomberg, PIMCO as of 31 August 2020. **Past performance is not a guarantee or a reliable indicator of future results.** Bonds are represented by the Bloomberg Barclays U.S. Aggregate Index, Cash represented by the FTSE US 3-Month Treasury Bill Index and stocks represented by the S&P 500 Index. It is not possible to invest directly in an unmanaged index.



Equity for
Growth

Bond for
Income

Barbell Portfolio Strategy

To achieve the twin objectives of capital appreciation and income. Capital preservation, specific cash flow requirement and investment horizon drive the need for bond allocation but may underweight in current context.



4. How it bond valued?

Bond valuation is impacted by 3 key factors



Bond pricing formula

$$P = \left(\frac{C}{1+i} + \frac{C}{(1+i)^2} + \dots + \frac{C}{(1+i)^N} \right) + \frac{M}{(1+i)^N}$$
$$= \left(\sum_{n=1}^N \frac{C}{(1+i)^n} \right) + \frac{M \text{ Par value @ maturity}}{(1+i)^N}$$

Interest Rate

I

Lower the interest rate higher the bond price as they are inversely related

Coupon Rate

C

Larger coupon payment higher the bond price. Rating determines coupon rate

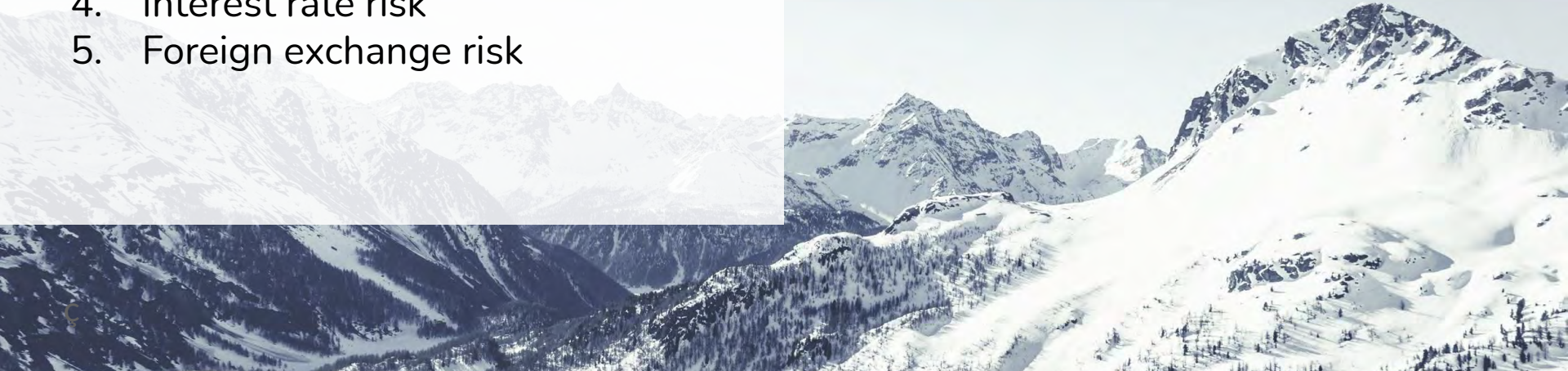
Number of payment

N

Larger the N lower the bond price due to PV discounting or "duration" effect

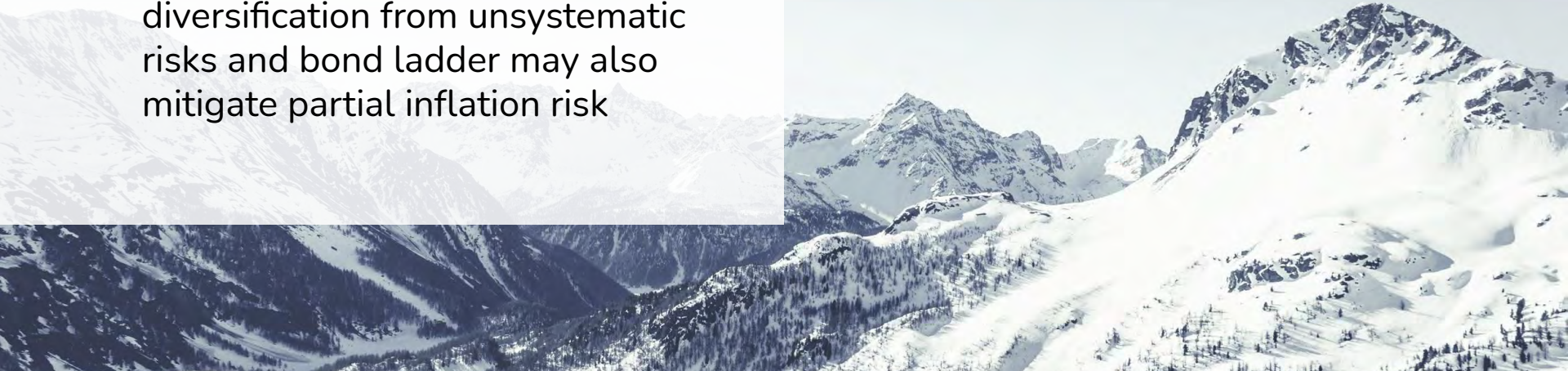
5. What are some of risks?

1. Default risk
2. Credit risk
3. Turnover risk
4. Interest rate risk
5. Foreign exchange risk



6. Bond ETF/UT preferred

1. Investing in individual bond carry higher concentration risk
2. Bond ETF/Unit trusts provides diversification from unsystematic risks and bond ladder may also mitigate partial inflation risk



7. How to evaluate bond ETF/UT?



Credit Rating



Current Yield



Effective Duration

Current Yield=Annual Interest/Current Bond Price

YTM = compounded ROI holding the bond till maturity. "1" in the valuation formula

Effective duration - sensitivity of bond price to change in interest rate

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Moody's	Standard & Poor's	Fitch Ratings	Kroll	Description
Aaa	AAA	AAA	AAA	Best Quality
Aa1	AA+	AA+	AA+	High Quality
Aa2	AA	AA	AA	
Aa3	AA-	AA-	AA-	
A1	A+	A+	A+	Upper Medium Grade
A2	A	A	A	
A3	A-	A-	A-	
Baa1	BBB+	BBB+	BBB+	Investment Grade
Baa2	BBB	BBB	BBB	
Baa3	BBB-	BBB-	BBB-	
Ba	BB	BB	BB	Speculative
B	B	B	B	
Caa	CCC	CCC	CCC	
Ca	CC	CC	CC	
C	C	C	C	
			D (default)	

Credit rating determines the coupon rate

Lower credit rating higher coupon rate

8. What are the top 3 bond ETFs by trading volume and a newly launched bond ETF on SGX?

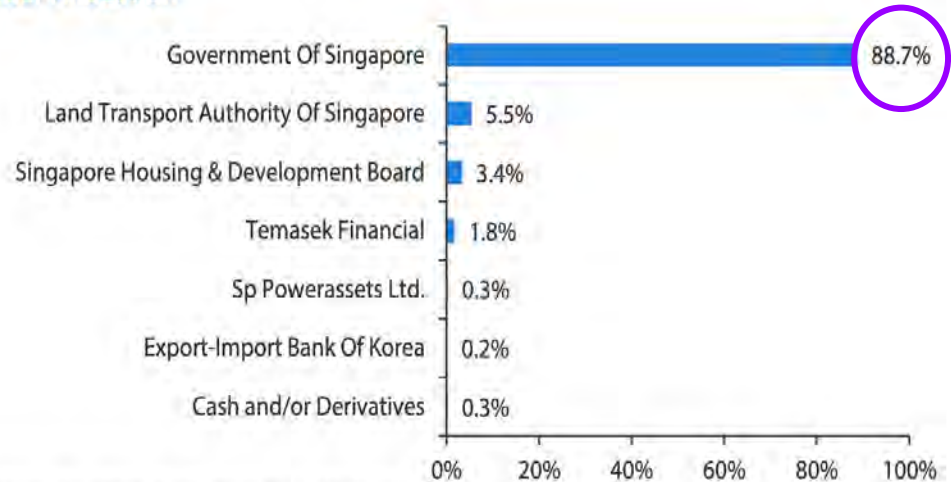




ABF SG Bond Index ETF

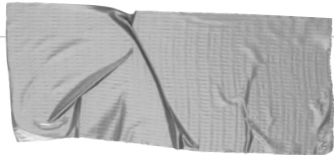
The ETF tracks the iBoxx ABF Singapore Bond Index, which contains high-quality bonds issued by the Singapore government and government-linked bodies such as the [Housing & Development Board \(HDB\)](#) and the Land Transport Authority (LTA).

Issuer Allocation



Fund Characteristics

	3-Years Annualised Tracking Error	Weighted Average Yield to Maturity ² (%)	Weighted Average Duration ³ (years)	Average Credit Rating ⁴
Fund	0.29%	1.15	8.90	AAA
Benchmark	-	1.18	8.91	-

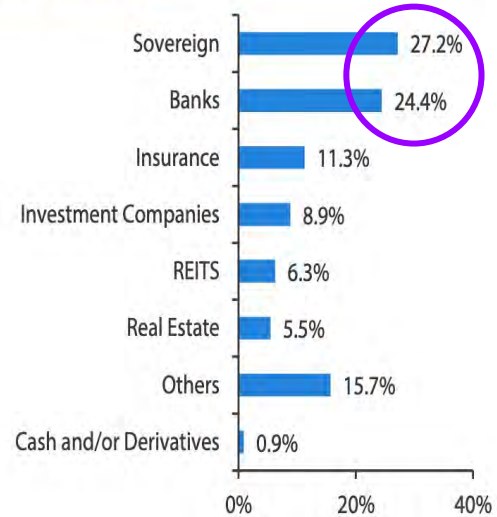


Nikko AM Investment Grade Corporate Bond Index ETF

It gives investors exposure to a diversified portfolio of quasi-sovereign, Singapore and foreign corporate bonds.

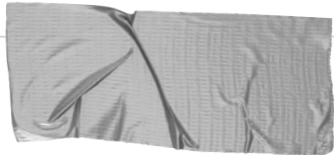
The ETF aims to replicate the performance of the iBoxx SGD Non-Sovereigns Large Cap Investment Grade Index.

Sector Allocation



Fund Characteristics

	1-Year Annualised Tracking Error	Weighted Average Yield to Maturity ² (%)	Weighted Average Duration ³ (years)	Average Credit Rating ⁴
Fund	0.40%	2.07	5.84	A
Benchmark	-	2.15	5.83	-



iShares High Yield Bond Index ETF

The iShares Barclays USD Asia High Yield Bond Index ETF seeks to track the investment results of an index composed of USD-denominated high yield bonds issued by Asian governments and Asian-domiciled corporations.

GEOGRAPHIC BREAKDOWN (%)	
	Fund
China	53.61%
India	11.15%
Hong Kong	7.78%
Macau	5.88%
Philippines	5.04%
Indonesia	4.02%
Sri Lanka	3.91%
Pakistan	2.10%
Mongolia	2.00%
Thailand	1.92%
Other	2.58%

PORTFOLIO CHARACTERISTICS	
Weighted Average Maturity	3.43 yrs
Weighted Average Yield To Maturity	7.33%
Effective Duration	2.83 yrs

MATURITY BREAKDOWN (%)	
	Fund
Cash and/or Derivatives	0.50%
0 - 1 Years	6.15%
1 - 2 Years	26.93%
2 - 3 Years	19.72%
3 - 5 Years	31.19%
5 - 7 Years	8.18%
7 - 10 Years	6.36%
20+ Years	0.98%

CREDIT RATINGS (%)	
	Fund
Cash and/or Derivatives	0.50%
BB Rated	35.01%
B Rated	38.86%
CCC Rated	4.21%
C Rated	0.17%
Not Rated	21.25%




9. How did bond perform during 2020 crisis?

Bond initial sell off raised the question if bond still plays a stabilization role in the portfolio.

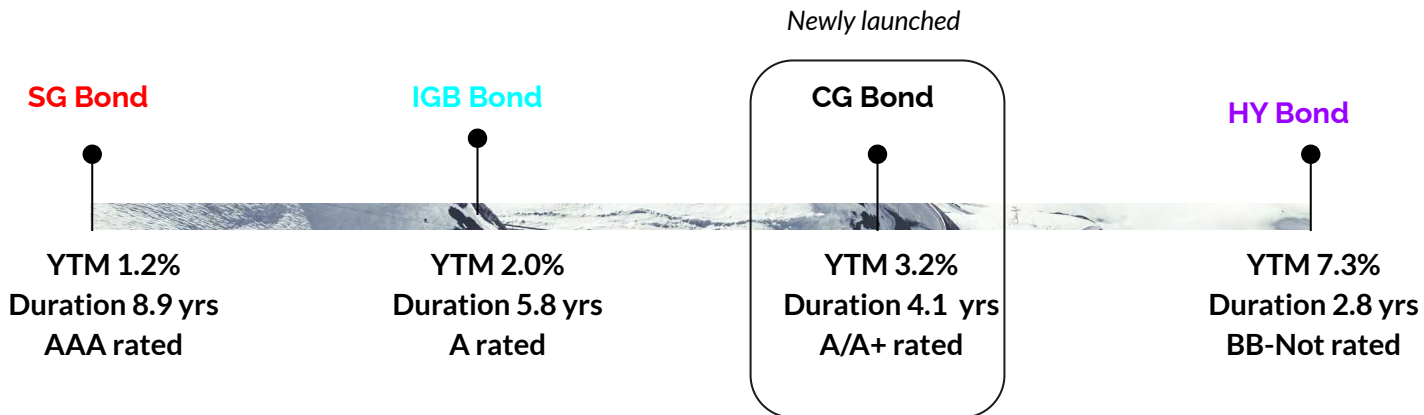
SG bond held steady while both IGB and HYB plunged
IGB outperformed HYB post crisis



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Bond ETFs on SGX - top volume + 1 new



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Newly
Launched

Nikko AM China Bond Index ETF

The investment objective of the Fund is to achieve long term capital growth by replicating the returns of the ChinaBond ICBC 1-10 Year Treasury and Policy Bank Bond Index (the "Index").

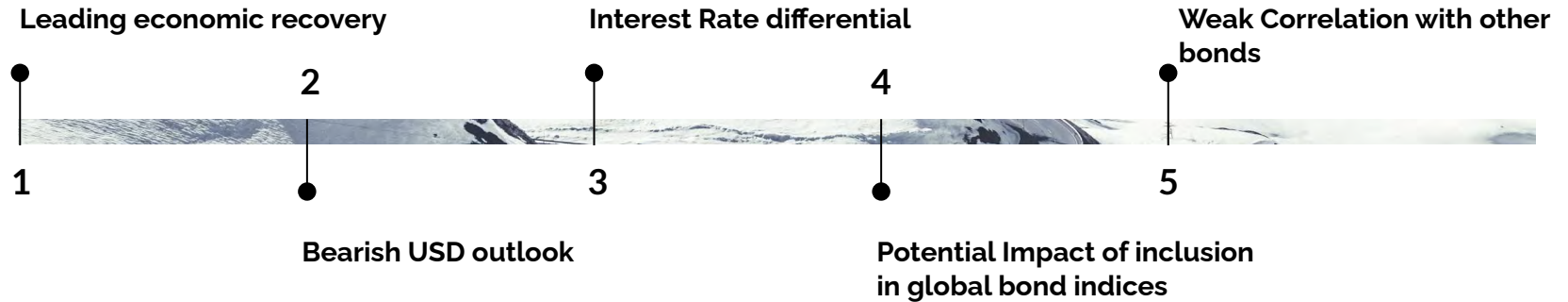
Index Characteristics:

- The Index consists of 216 bonds with 4 issuers
- Minimum outstanding: RMB 24.0 trillion
- Average credit rating: Moody's (A1); Standard & Poor's and Fitch Ratings (A+)
- Yield to maturity: 3.23% p.a.
- Duration: 4.10 years

Source: Nikko Asset Management Asia, China Bond Pricing Center, as of 30 September 2020

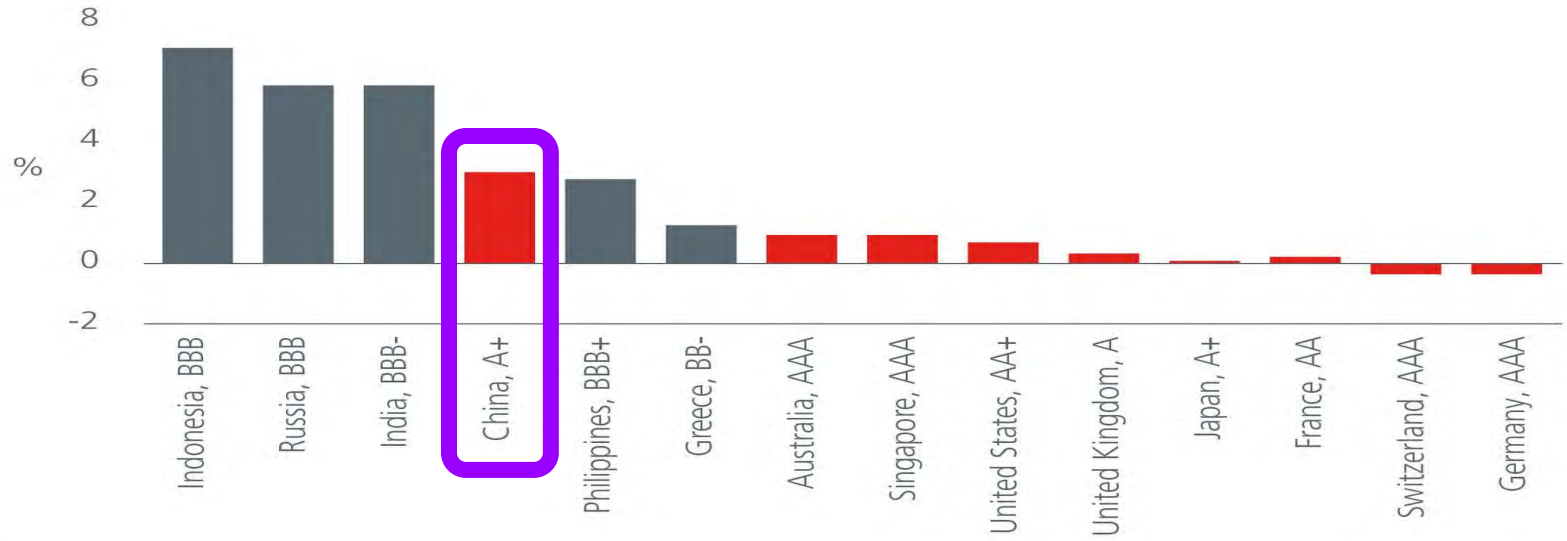


Tailwind expected for RMB + RMB assets



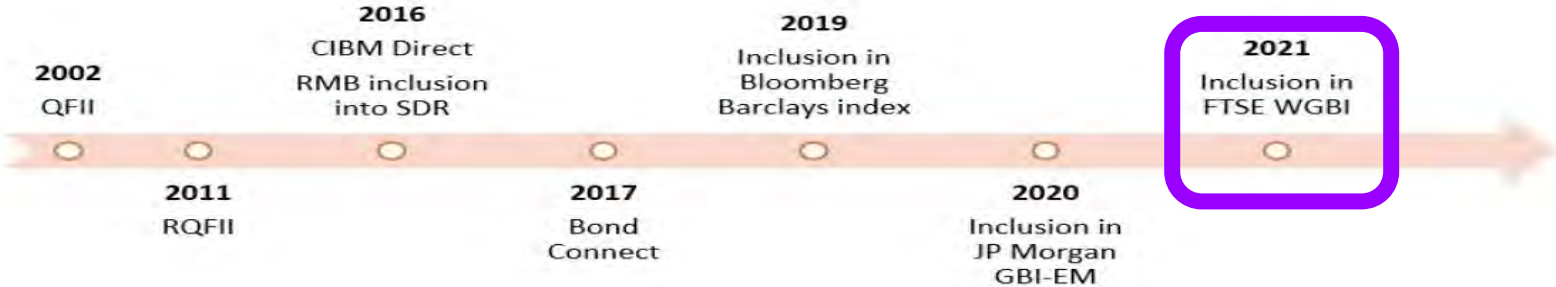
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3. Comparison of 10y Govt bonds yield



Source: Bloomberg as at June 2020. Country ratings refer to the long-term local currency ratings by Standard & Poor's

4.1 Potential impact of bond indices inclusion



Potential impact of index inclusion

	Bloomberg Barclays Global Aggregate Index	FTSE WGBI	JP Morgan GBI-EM
AUM	USD2.5tn	> USD2tn	USD200bn
China's weight	6%	5%	10%
Fund inflows (estimate)	USD150bn	> USD100bn	USD20bn

Sources: Reuters, Bloomberg, DBS

4.2 Potential impact of bond indices inclusion





5. China govt bonds relatively weak correlation

China's bond market correlations with other major bond markets, May 2020

	China	US	UK	Japan	Germany
China	1				
US	0.14	1			
UK	0.12	0.71	1		
Japan	0.18	0.55	0.51	1	
Germany	0.17	0.65	0.66	0.58	1

Source: BlackRock, May 2020. Correlations shown reflect 3-year weekly correlations of 5-year government bonds across the world's top five bond markets.

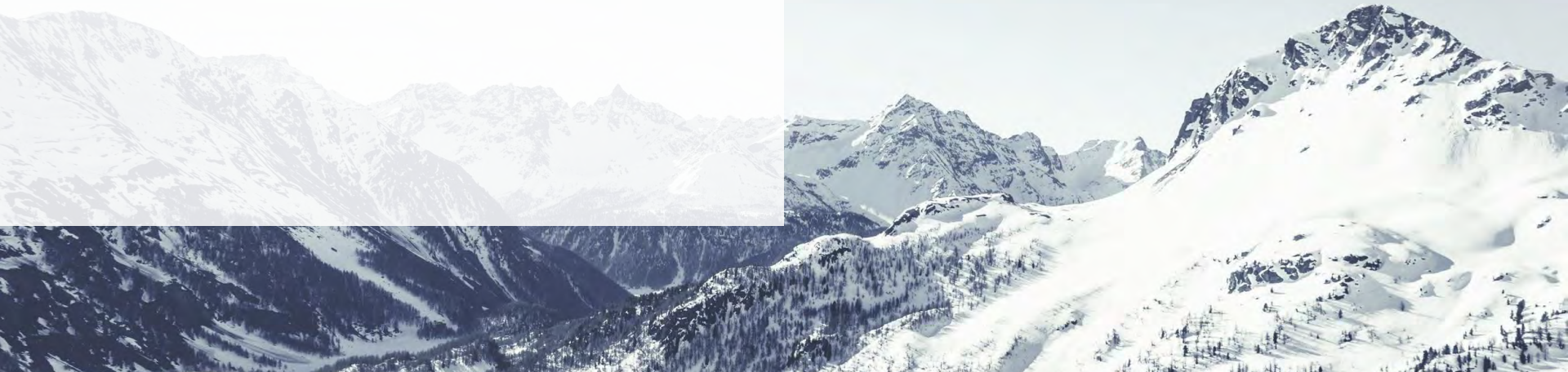
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Learning objectives

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2. What are the concerns investing in bond in the current environment? If yes, how do we mitigate these concerns?

Panelists Q&A



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