Credit funds come of age in Asia

The positive performance of Asian credit funds is leading many investors to view them as something of a safe haven from the volatility of the equities markets

Asian credit funds have gained significantly greater prominence post the global financial crisis, largely on the back of deepening credit markets in Asia. A move among investors towards taking a multi-strategy approach in Asia as well as rocky equities markets, which make credit funds seem a safe haven, has also given further impetus to demand for Asian credit funds.

Not only has the performance of credit funds been positive, but the capital inflows in them have also been significant. Samena Capital, for example, doubled its credit portfolio at the beginning of the year when it launched its Credit Opportunities Fund with assets of close to $50 million. Saka Capital, a long/short Asian credit fund focused on public securities in investment-grade and high-yield debt markets as well as in the CDS space, has also taken in a good amount of capital this year and recently exceeded $300 million in AUM.

"Launches this year that are more credit-focused have raised money and investors seem to be more willing to be locked in. There is certainly more optimism around credit funds or multi-strategy funds," says Melvyn Ford, head of prime services Asia Pacific at HSBC.

Complex landscape

Changes to Asia's credit market bring opportunity and at the same time, new challenges. Richard Yang, managing director at Samena Capital, feels that while the market historically was dominated by sovereign, quasi-sovereign and bank issues, corporate credit and high yield has really taken over as the engine of growth for Asian credit market. "For the Asian credit hedge fund manager, the challenge is in grappling with the lack of transparency and high level of event risk of Asian corporates that are often family-owned or government-controlled. I think here lies both the risk and opportunity especially when fund flows to the region are still dominated by large real-money investors from developed markets who tend to focus more on numbers and under-appreciate the nuances of the local context."

Nevertheless, Asian credit markets, though far smaller and less liquid than their counterparts in the US or Europe, offer unique opportunities for those in the know, particularly as European banks — which have been big lenders to Asian companies — battle with Basel III and other constraints on capital.

Fred Ingham, managing director and head of hedge fund investments in Asia at Neuberger Berman, notes that European banks have lent


Richard Yang

> *"Fund flows to the region are still dominated by large real-money investors from developed markets who tend to focus more on numbers and under-appreciate the nuances of the local context"*

roughly $1.5 trillion to Asian corporates. With all the new constraints on capital, "how much of that capital will be refinanced over the next five years? What does that mean for Asian credit?" he asks.

Asian credit fund managers agree that Europe's worries have actually been a boon to the region's credit markets. As European banks stop lending, Asian companies are being forced to issue debt in the public markets.

Indeed, Asian credit markets have seen an explosion of new issuances in the first half of 2012. This year, in the first quarter alone, there was $50 billion of issuances, almost equal to the annual figure last year. Total debt issuance in 2011 in the dollar Asian market was $60 billion while in 2010, it was $73 billion. Between 2000 and 2008, average issuance was about $30 billion per year.

The China and India factor

One of the more interesting shifts in the market has been the rise of Chinese debt issuances. Korea has traditionally been the largest debt market is Asia, but increasingly, credit funds are seeing the growth of Chinese companies issuing debt.

Yang certainly sees the birth of the CNH/CNY bond market as a potential game changer. "Even though the market is a long way from reaching the level of depth and sophistication of the G3 fixed-income markets, it has the potential to rival and even surpass all other bond markets in size when the country embarks on further liberalisation of the capital account and interest rates," he says, adding he believes that all managers will need to have a long-term strategy for this market.

The dim sum bond market was full of technical trades last year, but with the renminbi less 'hot' this year, the market certainly feels like it is on more of a sound footing.

India has been another area of interesting opportunities, Yang adds. "Many corporates are finding it difficult to raise capital and refinance maturities, especially in the convertible bond market. There are now many issuances that are trading at double-digit yields and many convertible bonds are 'busted' in the sense that the conversion price is far higher than the current share price."

Shifting capital

With more and more capital flowing into credit funds, Asian equity long/short funds have been on the losing side.

There has definitely been some kind of shift from equities to credit-focused funds, observes HSBC's Ford. But he is quick to emphasise that with the majority of funds in Asia still following equity long/short strategies, redemptions are not necessarily a reflection on the performance of the manager, but a result of investors exiting the market due to continuing uncertainty in Europe. Moreover, equities sometimes see higher redemptions because they are more liquid, making for a quicker exit. Credit funds, in particular distressed funds, generally have a one- to three-year lock-in period.

If the current environment stabilises, "then money will come back into equities, but the end result is that there will be more money in Asian credit strategies than there is currently", Ford adds.

Emerging players in the market

Though still few and far between, Asian credit funds are making a name for themselves.

Saka Capital focuses mostly on liquid credit and, market watchers say, has done a good job hedging during difficult periods. AUM is up this


Fred Ingham


Melvyn Ford


Lanny Lim

“Are you making a call on Asian credit spreads and aiming to be long Asian credit? Or are you making a call that there’s more alpha in Asian credit than in the west? Those are two quite different decisions”

“One advantage of Asian credit funds is that, for higher quality credits, there is usually underlying support from the high net-worth and retail markets when there is a sell-off in Asian markets”

year – both from fundraising and healthy returns. The fund delivered a 2% return last year and over 3% year-to-date by the end of May.

Another top credit fund in the region is run by Singapore-based Tahan Capital Management. The firm, run by chief investment officer Tse Ern Chia, formerly of GLG Partners and Jabre Capital, runs a credit fund with a mix of liquid and illiquid credits.

Orchard Capital Partners, which invests primarily in debt securities of issuers located in the Asia Pacific region, is yet another example of a well-regarded fund in credit space. The fund invests in public debt issuance, secondary market special situations as well as privately negotiated CBs and loans. As a secondary strategy, the fund also invests in special-situations equity. Orchard is run by Stuart Wilson and Teall Edds, two former principals at Stark Investments, who acquired Stark Hong Kong.

Samena Capital is a ‘value investor’ in the credit space and runs the Samena Asia Bond Fund and the Samena Credit Opportunities Fund. Samena invests in Asian and Middle Eastern credit markets, in rated or unrated corporate credits as well as sovereign or government-related entities.

The firm emphasises its local knowledge, playing up its relationships with prominent Asian and Middle Eastern families, giving investors exposure to attractive credit opportunities in the fixed-income space. The fund is up 6.1% through April and, since inception in February 2010, has an annualised return of 8.2% with a volatility of 5.4.

Yang explains that the Middle East has been a major source of non-correlated returns for Samena this year. The Middle East has been resilient to the woes in Europe, partly because of high oil prices, receding Iran risk and also strong liquidity flowing through to the GCC which is considered a safe haven in the region. Also, since the debt crisis in Dubai in 2009, the region has been on the path to recovery. “We are seeing very strong liquidity in the region which has underpinned GCC credits in particular,” he says.

Asian versus global funds

Asian credit funds have a unique niche among credit funds, but it can also be a challenge to stand out from global competitors.

“It depends on what you are trying to do: are you making a call on Asian credit spreads and aiming to be long Asian credit? Or are you making a call that there’s more alpha in Asian credit than in the west? Those are two quite different decisions,” says Ingham.

Some investors may allocate to Asian credit funds because they think that Asian credit spreads are attractive relative to the west. That might be a reason to allocate to Asian credit, but the opportunity set is cyclical, he adds.

Another shortcoming to Asian credit funds, Ingham says, has been that funds are too correlated, both to the markets and to each other. “The problem we always have when we come back to look at Asian credit is that most funds have a meaningful long bias, which means returns are correlated to the wider market.”

The universe of liquid credits for an Asian credit fund is narrower than a US or global fund. Inevitably, this means there tends to be crowding in certain names. There is still a relatively limited number of CDS contracts in Asia that are really liquid compared with the west, notes Ingham.

“Often funds sound different in terms of style or strategy, but when you look at the portfolios, you might see the same 10 names or themes,” he says.

Yet another risk to be aware of: Asian funds often have an unusual portfolio composition in that their long book is more high-yield-oriented whereas their short book has more investment-grade credits and indices, notes Lanny Lim, portfolio manager at SAIL Advisors, one of the leading fund of hedge fund managers in Hong Kong.

US credit managers can often have less “basis risk” between their long and short side because global credit markets are deeper, he says. “But one advantage of Asian credit funds is that, for higher-quality credits, there is usually underlying support from the high-net-worth and retail markets when there is a sell-off in Asian markets.”

For investors who want exposure specifically to Asia, global funds are insufficient. Many global credit hedge funds trade out of New York or London, which Asian managers say doesn’t give them a feel for what is going on in the region. Moreover, global credit funds don’t have a significant exposure in Asia.

And though global fund managers can theoretically allocate to Asia when it’s attractive and move out when it’s not, the reality is that a large global credit fund is unlikely to have a very large allocation to Asia due to liquidity and diversification issues, notes Ingham.

In a region still dominated by equity funds, credit is often overlooked, notes Lim. Asian credit has been a good absolute performer over the last decade and generally outperforms equities by a comfortable margin during times of market stress, particularly investment-grade credit, he concludes.