

Investing in Asian Corporate Bonds

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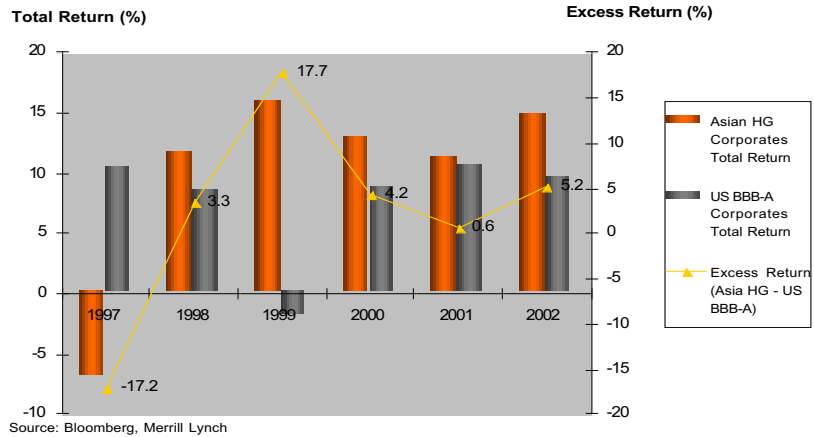


Why Asian High Grade USD Corporate Bonds?

- A good source of potential excess return and diversification benefit
- Stable and improving credit fundamentals
- Fabulous local liquidity supports a strong "Asian Bid"
- Greater international investor involvement

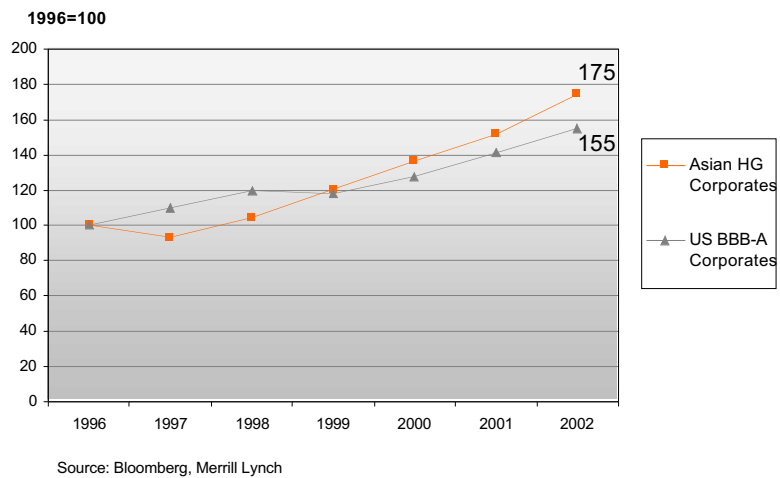


Annual Total Return Comparison



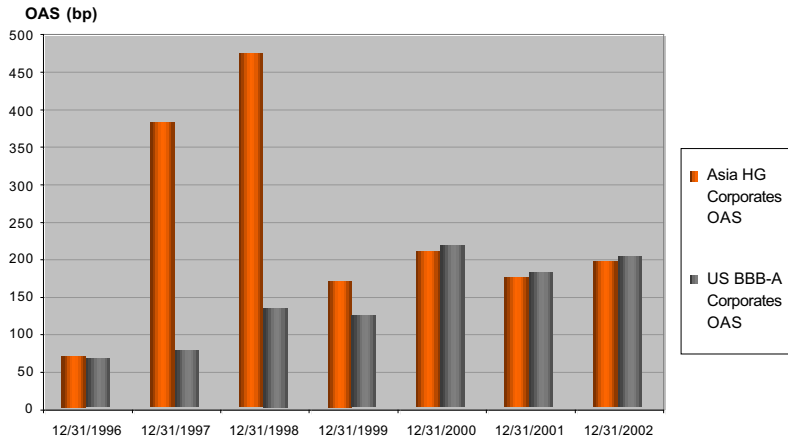
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Cumulative Total Return Comparison



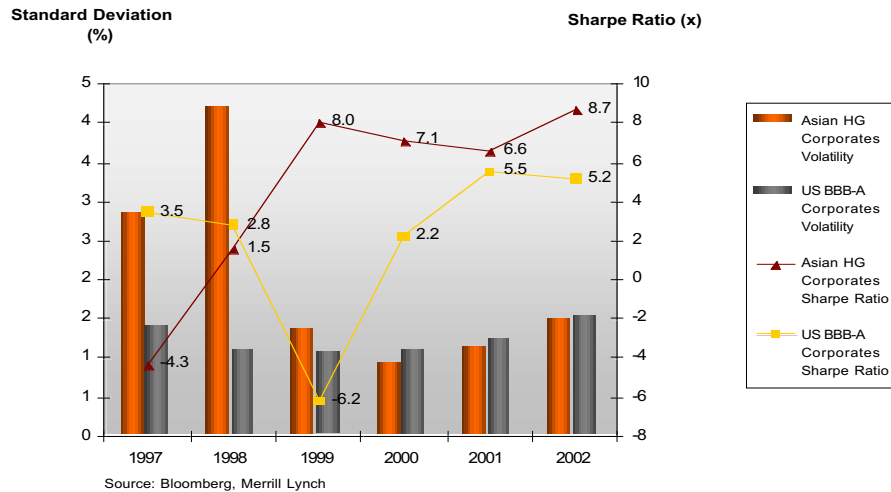
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Historical OAS Comparison



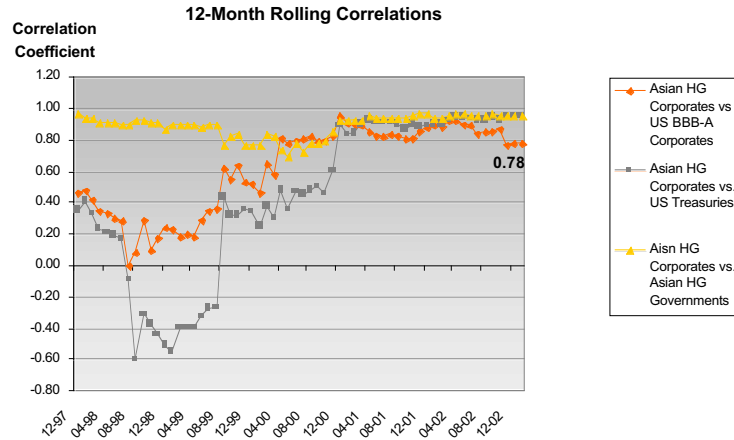
Source: Bloomberg, Merrill Lynch

Volatility and Sharpe Ratio Comparison



Source: Bloomberg, Merrill Lynch

Correlation Analysis



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Asia ex-Japan pre-crisis: what went wrong

- **Internal motivation** – to embrace the Japan model
- **External environment**
 - In the 1985-90 "Asian Boom", Asia ex-Japan/China was benefiting from :
 - rapid Western/Japan consumption growth
 - little competition in exports
 - little competition in attracting foreign direct investment (FDI)
 - In early 1990s, growth in Asia ex-Japan/China was under significant pressure because of :
 - the growing competition from other emerging economies (such as China, Mexico etc.) in exports and attracting FDI
 - Japan's recession
 - slowdown in Western consumption growth

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Aftermaths of the Asian financial crisis 1997-1998

- Overinvestment and overcapacity
- Large public and private debt loads
- Fragile banking system and mountains of NPLs
- Growing trade and current account deficits
- Badly inflated asset prices and widening wealth disparity
- Weak local capital markets
- Depressed domestic demand

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Asia ex-Japan post-crisis – restructuring and stimulating

- **South Korea**
 - Restructuring the chaebols
 - Financial sector reform: NPLs clean-up, liquidation, re-privatization and consolidation
 - Privatization and structural reform in the public sector
 - Opening up to foreign capital
- **Southeast Asian countries**
 - Improvement in balance of payment
 - Improvement in macro policy management
 - In different stage of banking restructuring country by country

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Credit fundamentals: the "+" s

- **Macro:**

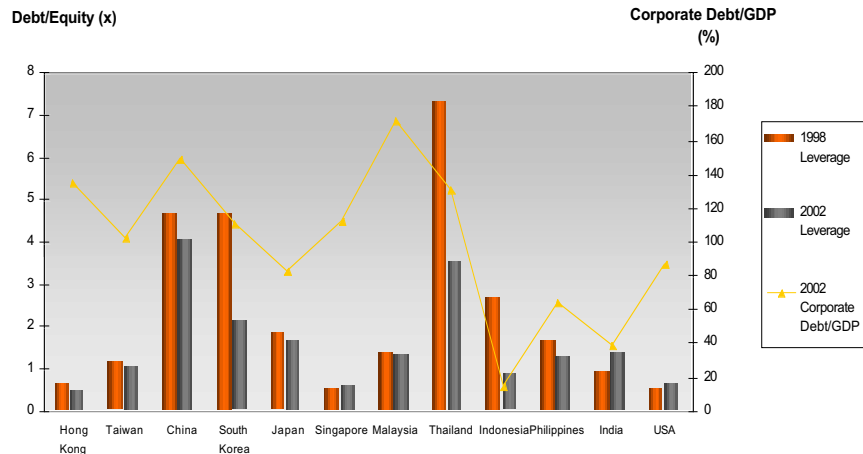
- Improving economic performance: domestic consumption is emerging as another source of growth in some countries
- Strong balance of payment positions
- Much lower foreign currency debt level
- Healthier financial sectors

- **Micro:**

- Stability: no default in Asian HG corporates in the past 3 years
- Main theme: de-leveraging
- Improving corporate restructuring
- Improving corporate governance from a low base

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Aggregate Corporate Leverage and Debt Levels



Source: DSG Asia

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Credit fundamentals – the " – "s and the "?"s

- **Short term:**
 - Oil, oil and oil
 - Geopolitical risks – North Korea and terrorism
- **Long term:**
 - Economies still compete on exports and FDI – the currency war and the "China Threat"
 - Mountains of NPLs are still limiting stimulus effects in some countries
 - Rising public debt and fiscal deficit in some countries
 - The urgent need to institutionalize bureaucracies
- **Key issue:** how to increase the efficiency and quality of growth

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Credit fundamentals – China and Hong Kong

- The "China Threat" and the "Collapse of China"
- Roots of economic and social problems – property rights and population
- Two key considerations in the government's decision-making process – foreign debt and inflation
- Hong Kong: structural weakness in the economy and relatively low-leveraged well-managed companies
- Benchmark credits:
 - China: CNOOC, China Mobile
 - Hong Kong: MTRC, KCRC, Hutchison, HK Land, Jardine, Wharf, Swire, PCCW-HKT, BNKEA, Dah Sing, CKWB

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Credit fundamentals – South Korea

- Significant progress in both old and new economies
- The double-engine growth strategy
- Drivers of credit improvement: solid economic growth, corporate restructuring and better ROE, strengthening external liquidity positions
- Key issues: internal and external
- Benchmark credits:
 - Utilities and Phones: Kepco, KHNP, Korea Telecom
 - Banks: Kookmin, Woori, Cho Hung, Hanvit, Hana, KEXIM, KEB, IBK
 - Industrials: Hyundai Motor, Kia Motors, Posco

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Credit fundamentals – Malaysia

- A "state-managed" economy highly-g geared to external growth especially global demand for electronic goods
- Drivers of credit improvement:
 - corporate restructuring, expected orderly political succession, economic recovery, improving balance of payment positions
- Key risks: short term and long term
- Competitive advantages and strategy
- Unique market dynamics: lack of "domestic bid"
- Benchmark credits: Petronas, Tenaga, Telecom Malaysia, Maybank

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