India's Popularity Soars in Asian Bond Portfolios

Fueled by strong fundamentals, Indian bonds have become a market heavyweight.

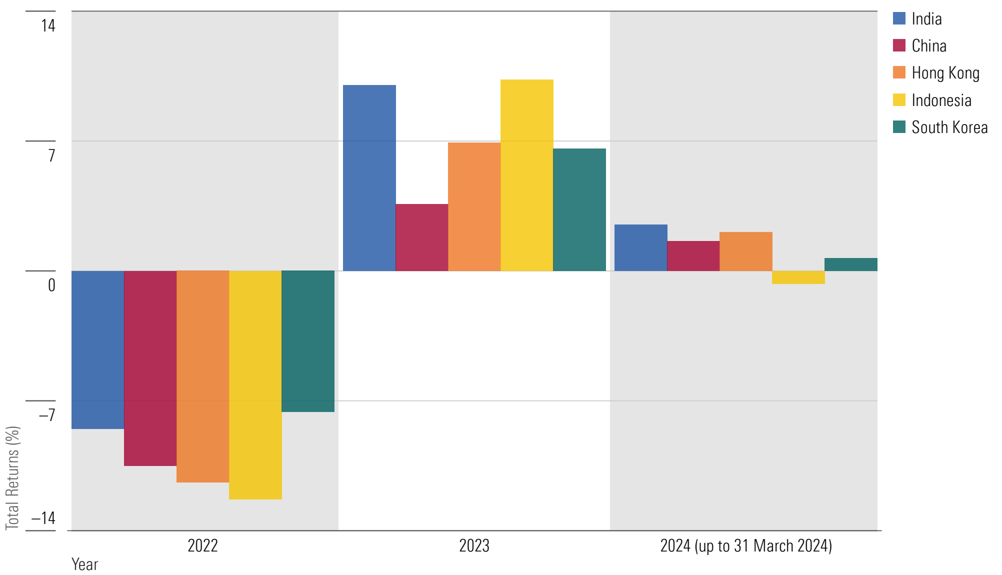
Morningstar Manager Research Services, Asia
May 7, 2024

Arvind Subramanian
Senior Analyst, Manager Research
+65 6340 1063
arvind.subramanian@morningstar.com

Introduction

India's strengthening macroeconomic outlook in recent years has not gone unnoticed by Asian fixed-income investors. The country's strong economic fundamentals—including robust growth, stable inflation, and extensive foreign exchange reserves—have bolstered confidence in the strength of its bond market. India's performance within the widely tracked JPMorgan Asia Credit Index, or JACI, has stood out over the years.

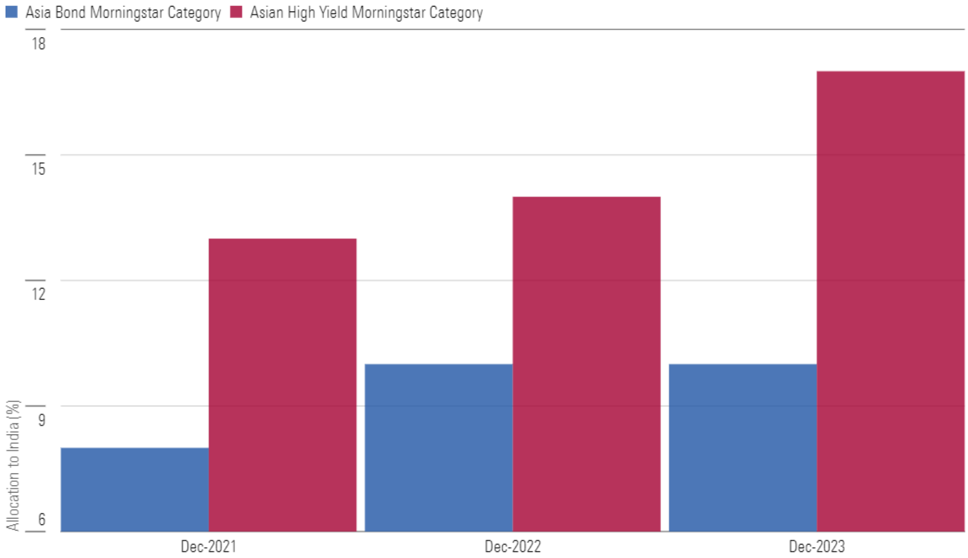
Exhibit 1 India Has Been a Strong Performer Within the JPMorgan Asia Credit Index



Source: J.P. Morgan. Data as of March 31, 2024.

The allocation to India by Asian fixed-income funds has increased markedly in recent years, as shown in Exhibit 2, even as India's weighting in prominent benchmark indexes has remained relatively stable, underscoring the favorable sentiment among fund managers toward the country. Over the past three years, India's weighting in JACI has consistently hovered between 6% and 7%, while the average India allocation for funds within the Asian bond Morningstar Category has climbed to 10% in December 2023 from 8% in 2021. Similarly, within the Asian high-yield bond category, the average India weighting surged to 17% from 13% over the same period, while the weighting in the JPMorgan Asia Credit Index Non-Investment Grade Corporate Index has remained broadly stable between 16% and 17%.

Exhibit 2 India's Growing Exposure Across Asian Bond and Asian High-Yield Funds



Source: Morningstar Direct. Data as of March 31, 2024.

This recent shift sharply contrasts with India's historically smaller presence within the Asian fixed-income market, primarily stemming from the limited supply of US-dollar-denominated bonds originating from the country. Unlike many Asian counterparts such as Indonesia and the Philippines, the Indian government does not issue hard-currency sovereign debt, meaning that investors seeking to access Indian bonds denominated in US dollars must do so via India's corporate bond market. Nevertheless, despite the lower supply, Asian fixed-income funds have steadily pursued Indian bonds as they sought diversification within the Asian region.

India Is Now One of the Largest Allocations for Many Asian High-Yield Funds

The investing landscape within the Asian high-yield market has evolved in recent years. While China originally dominated the market, a recent string of defaults in its real estate sector and increasing pressure on its credit market have lowered its appeal. Conversely, markets such as India, Macau, Hong Kong, and the Philippines have gained in prominence, resulting in a significantly more balanced universe.

The allocation to India among Morningstar's analyst-rated Asian high-yield bond funds has notably risen over the past year, as shown in Exhibit 3. India's weighting often ranks among the top one or two markets by allocation within the funds.

Exhibit 3 Exposure of Analyst-Rated Asian High-Yield Funds to Indian Bonds

Name	Morningstar Medalist Rating	India (%) - February 2024	Increase in India holding- past 12 months (percentage point)	Positioning relative to its Benchmark*(percentage point)
BGF Asian High Yield Bond D2 USD	Neutral	20	2	+4
PIMCO GIS Asia HY Bd Instl USD Acc	Gold	20	5	+3
HIFT - HSBC Asian High Yield Bd AC HKD	Neutral	19	2	+5
UBS (Lux) BS Asian HY $ Q-acc	Neutral	17	4	0
Fidelity Asian High Yield Y-Acc-USD	Neutral	17	6	0

Source: Morningstar Research. Data as of March 31, 2024.
*Benchmark is the JP Morgan Asia Credit Index Non-Investment Grade Corporate Index. Except for BGF Asian High Yield Bond (iBoxx ChinaBond Asian High Yield USD Hedged Index) and HSBC Asian High Yield (10% JACI Quasi-Sovereign + 20% JACI Sovereign + 70% JACI Corp Non-Investment Grade)

Pimco Asian High Yield, one of the largest funds in this category with USD 2.4 billion in assets under management as of February 2024, exemplifies the evolving dynamics of the Asian high-yield market. The fund's India exposure increased to 20% of assets in February 2024 from 15% in February 2023, constituting its highest country allocation within the portfolio and an approximately 4-percentage-point overweighting relative to its benchmark. The fund has benefited from an overweight position in the Indian renewable energy sector since the middle of 2019. The strategy’s managers, led by Stephen Chang, highlighted the robust fundamentals of the sector and supportive government policies as key drivers behind this positioning. Furthermore, they emphasized the environmental, social, and governance appeal of the sector, along with its cost-competitiveness, and the stability provided by long-term fixed-price contracts.

Similarly, **BGF Asian High Yield**, another large fund in this category with approximately USD 1.5 billion in assets under management, allocated roughly 20% of its assets to Indian bonds at the end of February 2024, representing a 4-percentage-point overweighting relative to its benchmark. The strategy’s managers noted that India is experiencing robust economic growth while facing relatively limited geopolitical and domestic political risks. The team favored renewable energy companies, steel companies (citing their strong cash flow generation), infrastructure credits such as airports (which stand to benefit as travel gradually resumes), and nonbank financing companies (citing their strengthened balance-sheet buffers). At **HSBC Asian High Yield**, India constituted the fund’s largest active overweight position (5 percentage points higher than its prospectus benchmark) as the managers preferred the region’s commodity and renewable energy sector names.

Asian Bond Funds Have Boosted India Allocations Despite Limited Investment-Grade Options
Funds in the Asian bond category primarily invest in investment-grade bonds, and India's sovereign rating of BBB- positions it at the lowest end of the investment-grade spectrum. Consequently, the pool of investment-grade Indian issuers is relatively limited and mainly consists of quasi-sovereigns, major Indian banks, and large conglomerates. India's weighting in the JACI stood at 6% as of February 2024, notably lower than the 17% allocation within its high-yield counterpart, the JACI Non-Investment Grade Index.

Exhibit 4 Exposure of Analyst-Rated Asian Bond Funds to Indian Bonds

Name	Morningstar Medalist Rating	India (%) - February 2024	Increase in India holding- past 12 months (percentage point)	Positioning relative to the JACI Benchmark*(percentage point)
BGF Asian Tiger Bond I2 USD	Bronze	15	8	+9
PIMCO GIS Asia StratIntsBd Ins USD Acc	Bronze	15	4	+8
JPMorgan Asian Tot Ret Bd (mth) - USD	Neutral	12	3	+6
Fullerton Lux Asian Bonds I USD Inc	Neutral	12	4	+5
HSBC GIF Asia Bond XC	Neutral	8	2	+2
Schroder Asian Invmt Grd Crdt SGD A Dis	Neutral	7	0	0
Manulife Asia Pacific Invmt Grd Bd A	Neutral	5	1	- 1
Fidelity Asian Bond Y-Acc-USD	Neutral	3	2	- 4

Source: Morningstar Research. Data as of March 31, 2024.
*The prospectus benchmark for the funds could vary, and not all funds utilize the JACI benchmark.

Nevertheless, like the trend observed within Asian high-yield funds, the majority of Morningstar's analyst-rated Asian bond funds also increased their exposure to India (Exhibit 4). Many of these funds had expanded their investments to include lower-rated high-yield bonds from India, utilizing the flexibility in their investment strategies to venture beyond their core mandates. Funds such as **DWS Invest Asian** and **LO Funds Asia Value Bond** have stood out in this category with 21% and 17% of their portfolios in Indian bonds as of February 2024, respectively. These allocations represented the largest market weightings for both funds.

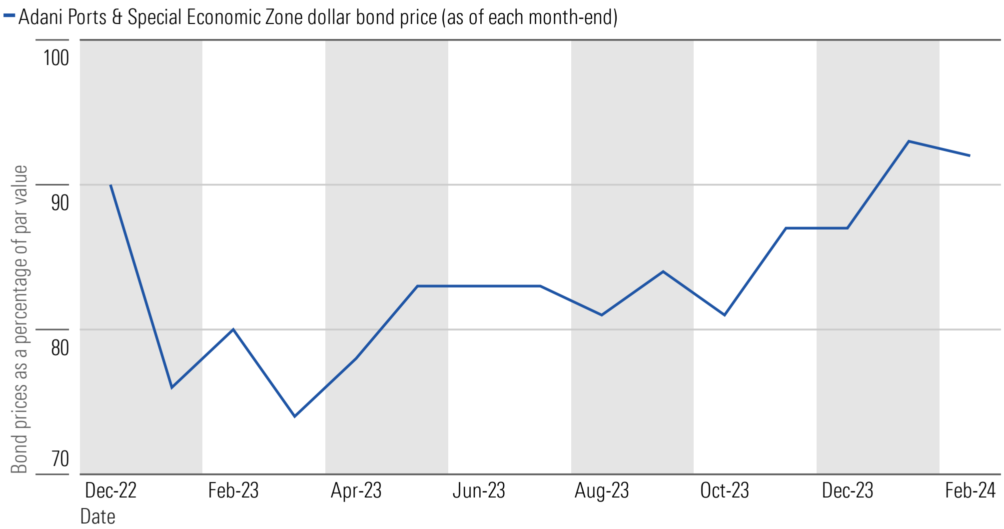
Is the India Trade Already Played Out?

While most asset managers are optimistic about India's macroeconomic outlook, some believe the valuations are unappealing, as much of the positive news may have been already factored into bond prices. For example, **Fidelity Asian Bond** held an approximately 2-percentage-point underweighting in India relative to its ICE BofA Asia Dollar Investment Grade Index in February 2024. The strategy's managers, led by Belinda Liao, acknowledge the region's sound fundamentals but argued that the credit spreads for Indian credits were too tight to leave scope for further gains.

Another concern shared by most asset managers is the muted bond supply from the country. This can be largely attributed to changing issuer preferences in favor of cheaper local-currency bonds or domestic bank loans compared with higher-cost offshore debt funding. The shift has been hastened by the series of rate hikes by the US Federal Reserve, which have increased the cost of funding for offshore US-dollar-denominated bonds. Indian corporations must issue their dollar-denominated bonds at a spread over US Treasuries to remain competitive; as US rates have risen, this has become increasingly costly. However, with central bank monetary tightening nearing an end, the supply of primary bonds could well pick up. Since the start of 2024, Indian corporates such as IRB Infra (high-yield infrastructure company) and Shriram Finance (nonbank finance company) have raised dollar bonds, while several other Indian issuers are in the pipeline to tap the offshore bond markets amid strong investor appetite.

Finally, despite the favorable backdrop, some Indian corporates have faced credit challenges, highlighting the risks associated with the market. For instance, Indian commodity giant Vedanta Resources, a prominent issuer in the high-yield market, saw its credit ratings plummet in recent months amid elevated debt levels and restructuring efforts. On the other hand, the Adani group, an Indian conglomerate that operates in various industries including infrastructure, energy, and logistics, saw its bond prices fall following a January 2023 negative report by US short-seller Hindenburg Research. Nevertheless, the group's bond prices have since staged a recovery, buoyed by a revival in investor sentiment (Exhibit 5). This was further underscored by the strong investor demand witnessed during Adani's recent dollar bond issuance in March 2024, signaling renewed confidence in the Adani group's prospects.

Exhibit 5 Adani Group's Bond Prices Have Recovered From the Lows in Early 2023



Source: Morningstar Direct. Data as of March 31, 2024. Security: USY00130VS35- Adani Ports and Special Economic Zone, USD, 4.2% 4aug2027

Upcoming Inclusion Into Global Emerging-Markets Indexes Could Further Boost Indian Sovereign Bonds

In September 2023, J.P. Morgan announced the inclusion of India's local-currency sovereign bonds into the GBI-EM Global Diversified Index, effective June 2024. The bond inclusion will be phased in gradually, reaching a weighting of 10% by March 2025. Meanwhile, iBoxx announced in October 2023 that it would gradually increase the India weighting in its Markit iBoxx ALBI local-currency Asian bond index, to roughly 12% from approximately 6% over the next three years. These developments are poised to enhance inflows into Indian sovereign bonds, potentially providing a tailwind for bond performance.

Several funds in the local-currency Asia Bond category have already begun positioning their portfolios to reflect these developments. For instance, as of February 2024, **Pictet Asian Local Currency**, which has a Morningstar Medalist Rating of Neutral on its cheapest share class, maintained a significant 21% stake in Indian bonds, making it the fund's largest market allocation and representing a hefty 11% overweighting relative to its JADE Broad Diversified benchmark. Similarly, **FTGF Western Asset Asian Opportunities**, rated Bronze on its cheapest share class, held India as its largest active overweight position, exceeding its Markit iBoxx ALBI benchmark's approximately 7% weighting by 5 percentage points. These funds also cited India's robust macroeconomic outlook, substantial foreign exchange reserves, and attractive bond yields as additional factors contributing to the appeal of this segment.

Morningstar Manager Research Services, Asia Report Disclosure

This Report is for informational purposes, intended for financial professionals and/or sophisticated investors ("Users") and should not be the sole piece of information used by such Users or their clients in making an investment decision.

The analysis within this report is prepared by the person(s) noted in their capacity as an analyst for Morningstar. The opinions expressed within the Report are given in good faith, are as of the date of the Report and are subject to change without notice. Neither the analyst nor Morningstar commits themselves in advance to whether and in which intervals updates to the Report are expected to be made. The written analysis and Morningstar Medalist Rating within this Report are statements of opinions; they are not statements of fact.

Morningstar believes its analysts make a reasonable effort to carefully research information contained in their analysis. The information on which the analysis is based has been obtained from sources which are believed to be reliable such as, for example, the fund's prospectus and shareholder reports (or their equivalents), fund company website, interviews with fund company personnel, and relevant and appropriate press sources as well as data, statistics and information within Morningstar's own database. Morningstar does not perform an audit or seek independent verification of any of the data, statistics, and information it receives.

Unless otherwise provided in a separate agreement, Users accessing this Report may only use it in the country in which the Morningstar distributor is based. Unless stated otherwise, the original distributor of the report is Morningstar Inc., a U.S.A. domiciled financial institution.

This Report is for informational purposes only and has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. This publication is intended to provide information to assist institutional investors in making their own investment decisions, not to provide investment advice to any specific investor. Therefore, investments discussed and recommendations made herein may not be suitable for all investors; Users and User clients must exercise their own independent judgment as to the suitability of such investments and recommendations in the light of their own investment objectives, experience, taxation status and financial position.

The information, data, analyses and opinions presented herein are not warranted to be accurate, correct, complete or timely. Unless otherwise provided in a separate agreement, Morningstar makes no representation that the Report contents meet all of the presentation and/or disclosure standards applicable in the jurisdiction the recipient is located.

Except as otherwise required by law or provided for in a separate agreement, the analyst, Morningstar and its officers, directors and employees will not be responsible or liable for any trading decisions, damages or other losses resulting from, or related to, the information, data, analyses or opinions within the report. Morningstar encourages Users and User clients to read all relevant issue documents (e.g., prospectus) pertaining to the security concerned, including without limitation, information relevant to its investment objectives, risks, and costs before making an investment decision and when deemed necessary, to seek the advice of a legal, tax, and/or accounting professional.

The Report and its contents are not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Morningstar or its affiliates to any registration or licensing requirements in such jurisdiction.

This Report may be distributed in certain localities, countries and/or jurisdictions ("Territories") by independent third parties or independent intermediaries ("Distributors"). Such Distributors are not acting as agents or representatives of the analyst or Morningstar. In Territories where a Distributor distributes our Report, the Distributor, and not the analyst or Morningstar, is solely responsible for complying with all applicable regulations, laws, rules, circulars, codes and guidelines established by local and/or regional regulatory bodies, including laws in connection with the distribution third-party research reports.

For a list of funds which Morningstar currently covers and provides written analysis on please contact your local Morningstar office. For information on the historical Morningstar Medalist Rating for any Fund Morningstar covers, please contact your local Morningstar office.

Please note that investments in securities (including mutual funds) are subject to market and other risks and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not be sustained in future and is no indication of future performance. A security investment return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost. A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's Risk, Return and Star Rating serves as useful data points with respect to evaluating a fund's risk profile.

A current yield percentage is not a reflection of the actual return an investor will receive in all cases as market prices for securities are constantly changing due to such things as market factors. Where a security is denominated in a different currency than the currency of the User or User's clients, changes in rates of exchange may have an adverse effect on the value, price or income of or from that investment.

Indexes noted within the report are unmanaged, their returns do not include payment of any sales charges or fees an investor would pay to purchase securities, and cannot be invested in directly.

In certain jurisdictions, the Report contents, except for the Morningstar Medalist Rating and key analysis/ opinions, may be shared with the fund company prior to publication. In the unlikely event that Morningstar would change their analyses/opinions and/or the Morningstar Medalist Rating based on feedback as result of such review, the Report would disclose such a fact.

Conflicts of Interest

- Analysts may own (actual or beneficial) interests in the financial products that are the subject of the Report. No material interests are held by Morningstar, the analyst or their immediate family in the financial products that are the subject of the Report. The Conflicts of Interest disclosure above also applies to relatives and associates of Manager Research analysts in India.

- Analysts' compensation is derived from Morningstar's overall earnings and consists of salary, bonus and in some cases restricted stock. Analysts' receive no compensation or material benefits from product issuers or third parties in connection with the Report. The Conflicts of Interest disclosure above also applies to associates of Manager Research analysts in India. The terms and conditions on which Morningstar Investment Adviser India Private Limited offers investment research to clients, varies from client to client, and are detailed in the respective client agreement.

- Morningstar does not receive commissions for providing research and does not charge financial product issuers to be rated.

- Analysts may not pursue business and employment opportunities outside Morningstar within the investment industry (including but not limited to, working as a financial planner, an investment adviser or investment adviser representative, a broker-dealer or broker-dealer agent, a financial writer, reporter, or analyst).

- Morningstar may provide the product issuer or its related entities with services or products for a fee and on an arms' length basis including software products and licenses, research and consulting services, data services, licenses to republish our ratings and research in their promotional material, event sponsorship and website advertising.

- Morningstar affiliates (i.e., its investment management group) may have arrangements with a fund company's affiliate to provide investment consulting advice some of which an analyst may issue an investment research reports on one or more of the fund company's funds. However, analysts do not have authority over Morningstar's investment management group's business arrangements nor allow employees from the investment management group to participate or influence the analysis or opinion prepared by them.

- Morningstar, Inc. is a publicly traded company (Ticker Symbol: MORN) and thus a fund which is the subject of this Report may own more than 5% of Morningstar, Inc.'s total outstanding shares. Please access Morningstar, Inc.'s proxy statement, "Security Ownership of Certain Beneficial Owners and Management" section http://investorrelations.morningstar.com/sec.cfm?doctype=Proxy&year=&x=12. A fund's holding of Morningstar stock has no bearing on and is not a requirement for funds Morningstar determines to cover.

Analysts do not have any other material conflicts of interest at the time of publication. Users wishing to obtain further information should contact their local Morningstar office or refer to https://corporate.morningstar.com/us/asp/subject.aspx?xmlfile=540.xml.

Morningstar Medalist Rating™

The Morningstar Medalist Rating is the summary expression of Morningstar's forward-looking analysis of investment strategies as offered via specific vehicles using a rating scale of Gold, Silver, Bronze, Neutral, and Negative. The Medalist Ratings indicate which investments Morningstar believes are likely to outperform a relevant index or peer group average on a risk-adjusted basis over time. Investment products are evaluated on three key pillars (People, Parent, and Process) which, when coupled with a fee assessment, forms the basis for Morningstar's conviction in those products' investment merits and determines the Medalist Rating they're assigned. Pillar ratings take the form of Low, Below Average, Average, Above Average, and High. Pillars may be evaluated via an analyst's qualitative assessment (either directly to a vehicle the analyst covers or indirectly when the pillar ratings of a covered vehicle are mapped to a related uncovered vehicle) or using algorithmic techniques. Vehicles are sorted by their expected performance into rating groups defined by their Morningstar Category and their active or passive status. When analysts directly cover a vehicle, they assign the three pillar ratings based on their qualitative assessment, subject to the oversight of the Analyst Rating Committee, and monitor and reevaluate them at least every 14 months. When the vehicles are covered either indirectly by analysts or by algorithm, the ratings are assigned monthly. For more detailed information about the Medalist Ratings, including their methodology, please go to

http://global.morningstar.com/managerdisclosures

The Morningstar Medalist Ratings are not statements of fact, nor are they credit or risk ratings. The Morningstar Medalist Rating (i) should not be used as the sole basis in evaluating an investment product, (ii) involves unknown risks and uncertainties which may cause expectations not to occur or to differ significantly from what was expected, (iii) are not guaranteed to be based on complete or accurate assumptions or models when determined algorithmically, (iv) involve the risk that the return target will not be met due to such things as unforeseen changes in changes in management, technology, economic development, interest rate development, operating and/or material costs, competitive pressure, supervisory law, exchange rate, tax rates, exchange rate changes, and/or changes in political and social conditions, and (v) should not be considered an offer or solicitation to buy or sell the investment product. A change in the fundamental factors underlying the Morningstar Medalist Rating can mean that the rating is subsequently no longer accurate.

Analysts do not have any other material conflicts of interest at the time of publication. Users wishing to obtain further information should contact their local Morningstar office or refer to the Analyst Conflicts of Interest and Other Disclosures for North America, EMEA, or APAC at:

http://global.morningstar.com/managerdisclosures

under Section “Methodology Documents and Disclosures”.

Morningstar Rating
The Morningstar Rating for funds is a proprietary data point that is quantitatively driven. Funds are rated from 1 to 5 stars based on how well the fund performed (after adjusting for risk and accounting for sales charges) in comparison to similar funds. Within each Morningstar Category, the top 10% of funds receive 5 stars and the bottom 10% receive 1 star. Funds are rated for up to three time periods—three, five, and 10 years—and these ratings are combined to produce an overall star rating, which is noted within the Report. Funds with less than three years of history are not rated. Morningstar Ratings are based entirely on a mathematical evaluation of past performance. Star ratings are in no way to be considered a buy or sell signal nor should be viewed as a statement of fact.

For Recipients in Australia: This Report has been issued and distributed in Australia by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544; ASFL: 240892). Morningstar Australasia Pty Ltd is the provider of the general advice (‘the Service’) and takes responsibility for the production of this report. The Service is provided through the research of investment products. To the extent the Report contains general advice it has been prepared without reference to an investor’s objectives, financial situation or needs. Investors should consider the advice in light of these matters and, if applicable, the relevant Product Disclosure Statement before making any decision to invest. Refer to our Financial Services Guide (FSG) for more information at www.morningstar.com.au/fsg.pdf.

For Recipients in Hong Kong: The Report is distributed by Morningstar Investment Management Asia Limited, which is regulated by the Hong Kong Securities and Futures Commission to provide services to professional investors only. Neither Morningstar Investment Management Asia Limited, nor its representatives, are acting or will be deemed to be acting as an investment advisor to any recipients of this information unless expressly agreed to by Morningstar Investment Management Asia Limited. For enquiries regarding this research, please contact a Morningstar Investment Management Asia Limited Licensed Representative at https://shareholders.morningstar.com.

For Recipients in India: This Investment Research is issued by Morningstar Investment Adviser India Private Limited. Morningstar Investment Adviser India Private Limited is registered with the Securities and Exchange Board of India (Registration number INA000001357) and provides investment advice and research. Morningstar Investment Adviser India Private Limited has not been the subject of any disciplinary action by SEBI or any other legal/regulatory body. Morningstar Investment Adviser India Private Limited is a wholly owned subsidiary of Morningstar Investment Management LLC. In India, Morningstar Investment Adviser India Private Limited has one associate, Morningstar India Private Limited, which provides data related services, financial data analysis and software development.

The Research Analyst has not served as an officer, director or employee of the fund company within the last 12 months, nor has it or its associates engaged in market making activity for the fund company.

For Recipients in Japan: The Report is distributed by Ibbotson Associates Japan, Inc., which is regulated by Financial Services Agency. Neither Ibbotson Associates Japan, Inc., nor its representatives, are acting or will be deemed to be acting as an investment advisor to any recipients of this information.

About Morningstar Manager Research

Morningstar Manager Research provides independent, fundamental analysis on managed investment strategies. Analyst views are expressed in the form of Morningstar Medalist Ratings, which are derived through research of three key pillars—People, Parent, and Process. A global research team issues Managed Investment Reports on strategies that span vehicle, asset class, and geography. Medalist Ratings are subjective in nature and should not be used as the sole basis for investment decisions. A Medalist Rating is an opinion, not a statement of fact, and is not intended to be nor is a guarantee of future performance.

About Morningstar Manager Research Services

Morningstar Manager Research Services combines the firm's fund research reports, ratings, software, tools, and proprietary data with access to Morningstar's manager research analysts. It complements internal due-diligence functions for institutions such as banks, wealth managers, insurers, sovereign wealth funds, pensions, endowments, and foundations. Morningstar's manager research analysts are employed by various wholly owned subsidiaries of Morningstar, Inc. including but not limited to Morningstar Research Services LLC (USA), Morningstar UK Ltd, and Morningstar Australasia Pty Ltd.

For More Information

Wing Chan
Head of Manager Research, Europe & Asia-Pacific
+852 2973-4623

MORNINGSTAR®

Unit 6807-09, Level 68,
The Center,
99 Queen's Road Central,
Hong Kong