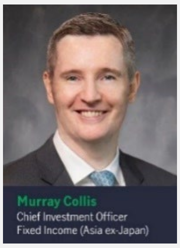
Manulife Investment Management

Investment Note

12 April 2023



On 16 March 2023, J.P. Morgan announced that it will be introducing the new JACI Asia Pacific Index into the J.P. Morgan Asia Credit (JACI) family of indices. In this investment note, Murray Collis, Chief Investment Officer, Fixed Income, Asia ex-Japan, discusses the implications for investors.

Asian credit's next evolution: introducing the JACI Asia Pacific Index

On 16 March 2023, J.P. Morgan announced that it will be introducing the new JACI Asia Pacific Index within the J.P. Morgan Asia Credit (JACI) family of indices. This move followed consultations with over 38 investment managers and asset owners domiciled in Asia, Europe, and the US, who collectively manage around US$115 billion of assets and over 90% of the assets benchmarked to the JACI Index series.

The JACI Asia Pacific Index, to be launched in the second quarter of 2023, expands the coverage of the existing JACI Index to include debt from Japan, Australia, New Zealand, and other Pacific countries. To be clear, the JACI Asia Pacific Index is a new index within the JACI family. It will not affect the existing flagship J.P. Morgan Asia Credit Index (JACI Index), which will continue to focus exclusively on Asia debt (excluding the debt of Japan, Australia, New Zealand and other Pacific countries).

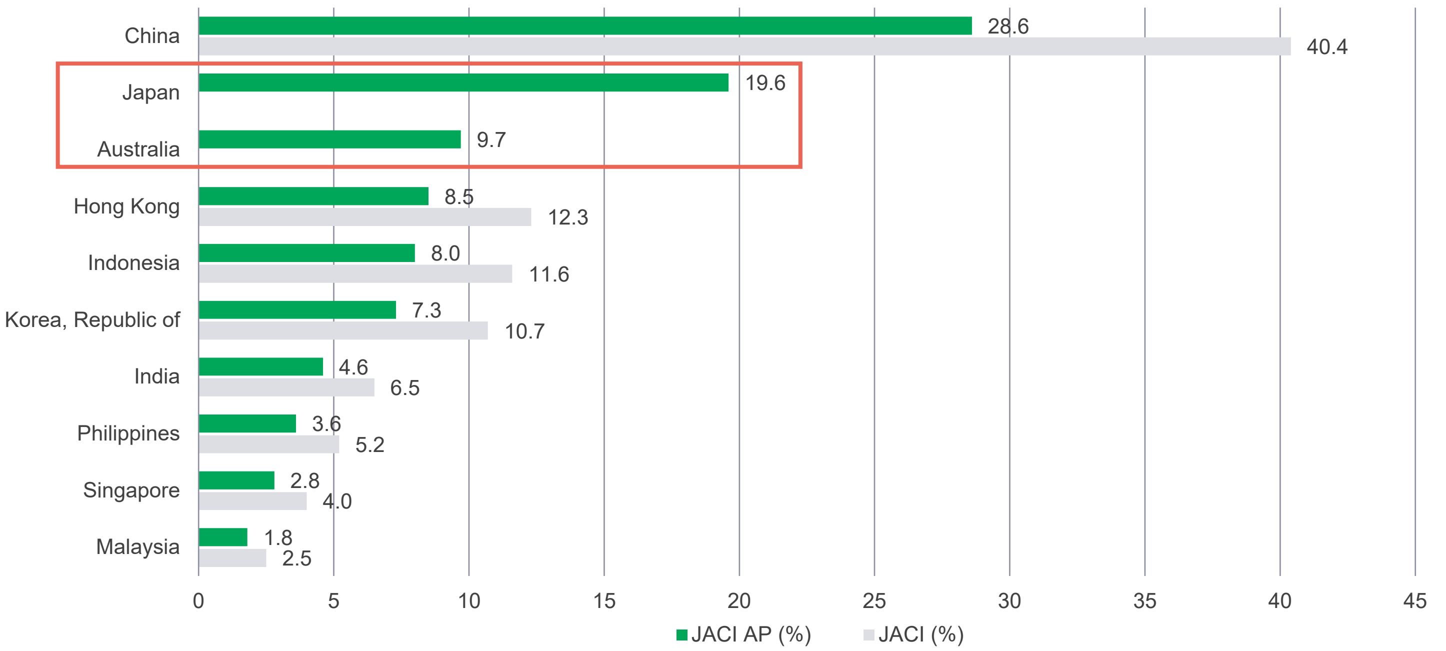
Main differences between the JACI Asia Pacific and JACI indices

The JACI Asia Pacific Index is expected to provide coverage of US$1,561.8 billion in corporate, quasi-sovereign and sovereign debt across 648 issuers in 21 markets. In comparison, the JACI Index covers US$1,089.9 billion in debt across 555 issuers in 17 markets[1]. The average credit rating for the JACI Asia Pacific Index is marginally higher at A3/A-/BBB+ from Baa1/A-/BBB+ (Moody's/S&P/Fitch) for the JACI Index[2]. JACI Asia Pacific Index's duration is marginally lower at 4.40 years compared with the JACI Index's duration of 4.51 years[3].

I. **Regional exposure:** one of the key differences is the inclusion of Japan (19.6%), Australia (9.7%) and New Zealand (0.9%) bonds into the JACI Asia Pacific Index. Accordingly, other Asia regional weights will be lower compared to their JACI Index weights, led by China (from 40.4% to 28.6%), Hong Kong (12.3% to 8.5%), and South Korea (10.7% to 7.3%).
II. **Sector exposure:** financials within JACI Asia Pacific Index will be higher at 37.9% compared with 26.8% of the JACI Index, given the dominance of high-quality banks and diversified financials among Japan and Australia issuers. Meanwhile, sovereigns and real-estate should see the largest corresponding declines based on estimates.
III. **Credit quality:** compared with the JACI Index, single-A rated issues within JACI Asia Pacific Index will be 7.3% higher at 39%, while exposure to BBB rated issues will be 6.5% lower at 34.9%. Most newly added issuers from Australia, New Zealand and Japan are single-A rated issuers. The decrease in BBB-rated issuers is predominately due to reduced exposure to Asian sovereign issuers such as Indonesia and the Philippines.

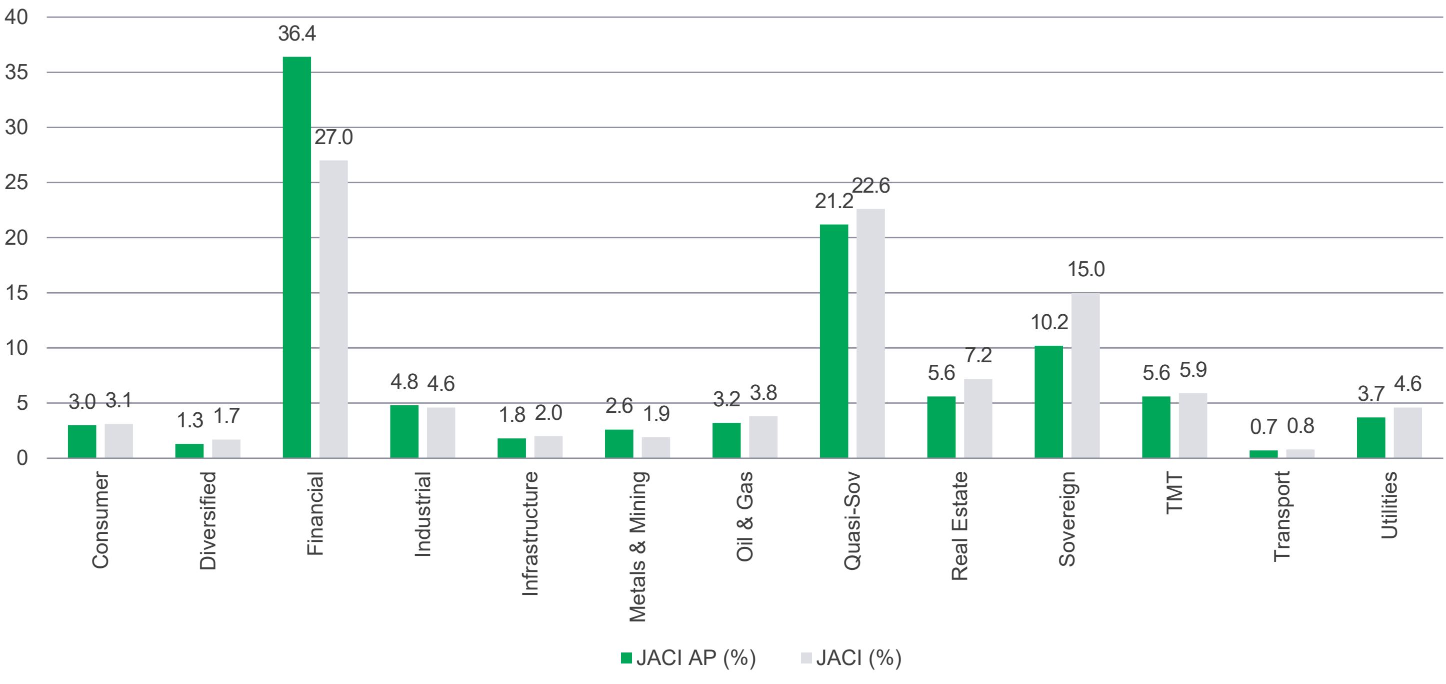
[1] J.P. Morgan, 16 March 2023.
[2] J.P. Morgan, as of 28 February 2023.
[3] J.P. Morgan, as of February 2023.

JACI Asia Pacific vs JACI Index - top 10 regional weights



Source: J.P. Morgan, as of 28 February 2023. JACI Asia Pacific Index regional/geographical weights are estimation from J.P. Morgan based on the new index.

JACI Asia Pacific vs JACI Index - sector weights



Source: J.P. Morgan, as of 28 February 2023. JACI Asia Pacific Index sector weights are estimation from J.P. Morgan based on the new index.

Implications for investors

Comparing the two indices, the JACI Index has a high single market exposure to China, while the JACI Asia Pacific Index sees this concentration diminished. Historically, China credit at times has exceeded 50% of the JACI Index weight due to the country's dominance of new-issuance trends and its importance as a growth engine for Asia. Hence, a possible downside of the JACI Index for some investors is that they face a high and potentially unwanted concentration in a single market versus the broader Asian credit universe. From this perspective, introducing the JACI Asia Pacific Index, which broadens exposure to include Japan and Asia-Pacific countries, helps reduce the overall concentration in single markets.

At the same time, the weighting to sovereign issues is lower at around 10.4% of the JACI Asia Pacific Index (from 15% of the JACI Index), while exposure to corporate (including quasi-sovereign) issues has increased from 85% to just under 90%. Given the above, adopting the JACI Asia Pacific Index may help improve regional and sector diversification and reduce overall concentration risks.

Based on back-tested results and analysis by the index provider, the JACI Asia Pacific Index has outperformed the JACI Index over the past six years, with cumulative returns of 8.96% versus 7.87% and lower volatility of 4.79% versus 5.34%. The JACI Asia Pacific Index also achieved a Sharpe ratio of 0.31 vs 0.25 for the JACI Index[4].

Concluding thoughts

As an Asian bond manager and asset owner, we have actively invested across the broader Asia-Pacific fixed-income universe, including Japanese and Australian issuers, for well over a decade. From our experience, we view such credits as typically well-supported by investors. The extension of the investment universe via the JACI Asia Pacific Index may prove attractive for some investors looking for broader exposure to the Asia-Pacific region, with the potential for an improved risk-return profile as well as lower volatility.

Given our extensive credit-research footprint with fixed-income teams based on the ground across Asia, including Japan, we already have strong coverage and existing relationships with many of the new Japan, Australia and New Zealand issuers that will form part of the JACI Asia Pacific Index. Accordingly, we believe we are in a prime position to help customers navigate through this exciting new phase of development in Asian credit.

[4] J.P. Morgan, as of 30 December 2022. JACI Asia Pacific Index performance are back-tested and hypothetical – this is provided for informational purposes only to indicate historical performance had the index been calculated over the relevant time periods. The back test is based on mapping the new JACI AP Index constituents and running historical return/risk time series analysis.

Important Note

Investing involves risks, including the potential loss of principal. Financial markets are volatile and can fluctuate significantly in response to company, industry, political, regulatory, market, or economic developments. These risks are magnified for investments made in emerging markets. Currency risk is the risk that fluctuations in exchange rates may adversely affect the value of a portfolio's investments.

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Manulife Investment Management

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