

## Asian credit opportunity for hedge funds

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Following a very strong performance in 2009, the Asian credit market continues to offer significant opportunities for investors across the spectrum. In the liquid credit space, investors can profit from growing new issuance, strong credit fundamentals, healthy technicals, attractive valuations and spread dispersion. Meanwhile, in the less liquid spectrum, investors willing to roll up their sleeves can find opportunities in transactions being disposed of by players exiting the field or transactions that need to be worked out.

The Asian Credit Hedge Fund is focused on the liquid section of the market. There are a few main fundamental themes that spell positive news for this market, starting with stronger economic growth supporting corporate earnings and keeping a lid on bank non-performing loans.

Another positive factor is a healthy banking system, with strong capital ratios and a funding mix primarily geared to depositors rather than wholesale funding. Additionally, sub-prime related losses have also been manageable in Asia. Finally, corporate leverage levels are lower given less leveraged buy-out activity and real growth opportunities.

In general, credit expansion in Asia has been subdued compared with that in other markets. This is a positive for the banking system as debt levels are likely to be more sustainable. Consumer leverage is also generally low and saving rates are high.

In terms of current opportunity sets in the liquid credit space, we remain constructive on the market as a whole, given strong fundamentals and valuations that are cheap in relation to comparable US values.

With new issuance volumes expected to remain strong, selective participation in primary market transactions can be an important alpha generator if one correctly assesses the credit, valuation and technicals on individual deals. We also note that despite the compression in credit spreads in 2009, credit spread dispersion remains high, providing relative value trading opportunities for bottom-up credit pickers.

One important area for most Asian credit hedge funds, including the Asian Credit Hedge Fund, is the credit default swap market. We use CDS trades to reduce return volatility and hedge against event risks.

However we note that while liquidity in the Asian CDS market has improved, it has not returned to pre-crisis levels; trading volumes are lower and concentrated in indices. We expect the situation to improve over time, especially as CDS clearing is pushed onto exchanges – which will help address counterparty and notation concerns.

Given our positive view on the Asian credit market and the current opportunity set, the Asian Credit Hedge Fund is targeting returns upward of 12 per cent over a medium term horizon by investing in Asian bonds/credits with a value approach. The fund has a diversified approach on macro allocation, with each country accounting for up to 15 or 20 per cent of the portfolio.

Meanwhile, to participate in opportunities in the less liquid spectrum of the market, Income Partners recently launched the Asian Opportunities Fund. The fund is an initiative with Deutsche Bank to target event-driven opportunities, with a focus on special situation credit and related private equity investments in Asia.

**Suvir Mukhi is director of investments at Income Partners**

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