

ASIAN WALL STREET JOURNAL

09 Jan 2013 16:28 CST **WSJ BLOG/MarketBeat: Asian Bonds Won't Run Out of Gas in 2013**

By Mark Cranfield

There is still a way to go for the Asian bond party even if returns this year don't match the double-digit numbers from 2012, according to Asia Credit Advisors, an advisory boutique that serves major fund managers.

In the months ahead, returns will be driven by the positive ratings momentum of the past three years, and by relative value. Asian bonds are cheap compared to U.S. corporate bonds, the global benchmark, and are below the historical peak for Asian bonds set six years ago.

Yet, in Asia, there are two key risks: less bond buying by individuals with high net worth, and weakness from some sectors, notably bonds issued by property developers.

Asian private wealth has become a significant force in and backbone for the new-issue market. Wealthy individuals have been steadily increasing their participation in bond issues to 16% last year, from about 3% in 2007, according to Asia Credit Advisors.

In the year ahead, these investors may begin to allocate more funds toward equities, which have lagged behind the stellar performance of bonds in the past two years. Yet these investors won't reduce bond holdings to the low levels of 2007, as they want a "leg in each boat," said Dilip Parameswaran, founder of Asia Credit Advisors and a former head of credit strategy at Macquarie in Hong Kong.

Careful selection of Asian bonds will be important in the months ahead, as some sectors may face balance-sheet pressure. Specifically, property developers will warrant caution.

There are also external risks, including a European recession, the U.S. debt ceiling and tensions in the Middle East.

On the ratings front, Indonesia and the Philippines stand out as good prospects for sovereign-credit upgrades. India is the only country in Asia facing a downgrade threat in 2013, Mr. Parameswaran says.

He adds that Asian spreads may tighten by a further 50 basis points, even if U.S. treasury yields start a rising trend. The average spread for Asian investment-grade bonds is now at 220 basis points, up from just 95 basis points at their tightest in 2007.

Still, the Asian bond market has become an asset class in its own right, with a market capitalization that has swelled to \$400 billion as of last year from \$170 billion six years ago. For now, there seems to be enough juice left in the punch bowl to keep the party rolling for a bit longer.

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