PIMCO GIS Asia High Yield Bond Fund Strategy Spotlight

1. WHAT IS THE PIMCO GIS ASIA HIGH YIELD BOND FUND AND WHY IS PIMCO LAUNCHING IT NOW?

The PIMCO GIS Asia High Yield Bond Fund is an actively managed portfolio that takes an opportunistic approach to investing in the dollar-denominated Asia high yield bond market. The Fund balances an emphasis on high conviction alpha opportunities with downside risk protection to meet its investment objective of generating strong total returns while delivering relatively high stable income to its investors. Our investment style combines top-down and bottom-up analysis, driven by cyclical as well as secular trends, and emphasizes diversification.

We decided to launch the Fund in response to emerging demand from global investors for dedicated access to the Asia high yield market, coupled with continued strong demand from local Asian investors for higher returning / income generating strategies. Additionally, expanding our offerings in Asia is a long-term strategic objective for PIMCO to meet the financial objectives of not only Asian investors, but global investors as well. As such, we intend to continue to invest in and build out our Asia platform.

2. PIMCO IS WIDELY KNOWN FOR YOUR ROBUST GLOBAL OFFERINGS. WHAT VALUE CAN PIMCO OFFER CLIENTS IN ASIA HIGH YIELD?

The PIMCO GIS Asia High Yield Bond Fund marks the next natural step in the seamless integration of two of PIMCO’s core competencies when it comes to fixed income investing – credit and emerging markets. The Fund focuses on adding value through a disciplined approach to credit selection, where our philosophy and approach to the Asia high yield market is consistent with our prudent, yet innovative approach toward global credit and emerging markets. This process employs a total return versus yield focus, where credit selection emphasizes strong fundamentals, adequate risk mitigation and capital structure analysis. Complementing PIMCO’s total return approach, is an intense focus on risk management that can allow the Fund to aim at less severe drawdowns than competitors and lower defaults than the market.

Underpinning this framework, PIMCO boasts one of the largest and most established Asia fixed income teams, which includes over 20 investment professionals spanning portfolio management and credit research across Hong Kong, Singapore, Tokyo and Sydney offices. The team is fully integrated into PIMCO’s global investment platform, enabling it to draw on macroeconomic expertise and combine with top-down and bottom-up input from the Asia region to implement investment views across capital structure, currency, and security type in the most attractive, efficient manner. Lastly, PIMCO’s forward looking fundamental credit and sovereign analysis and our internal ratings process that is completely independent from ratings agencies allows us to identify risk and capitalize on opportunities not fully priced into Asian markets.
3. WHAT EXAMPLES CAN YOU SHARE OF HOW PIMCO’S INVESTMENT PROCESS HAS BENEFITTED CLIENTS IN THE PAST?

PIMCO’s scale of resources dedicated to Asia credit markets also allows for greater coverage of the rapidly growing Asia high yield market. Additionally, it affords us better access to issuers and the opportunity to engage directly with many of the largest Asian companies and sovereigns that we lend to, enhancing our ability to influence attractive terms on behalf of our investors. When combined with other means of accessing liquidity premiums, including but not limited to 1) efficient execution, 2) cross-trading, and 3) derivative-cash basis, PIMCO possesses the requisite toolkit to unlock value in unique ways in Asia high yield markets.

Below are a few recent examples of PIMCO’s scale of resources benefitting our clients:

Example A  Independent Research

PIMCO’s independent ratings process can often result in identifying mispriced securities that straddle the investment grade / high yield universe.

Background

In November 2018, a quasi-sovereign issuer from a Southeast Asian country planned its inaugural bond issue to fund the acquisition of its stake in another large metals company. Initial market demand was weak given the expected large size of the deal, near-term cash flow issues stemming from high capex commitments, and a generally weak environment for commodities.

Investment Thesis

This resulted in pricing that was in line with high yield despite investment grade ratings by the ratings agencies. However, PIMCO’s bottom-up assessment on the company was constructive, and our view incorporated a stress test of the company’s balance sheet, assuming sharply lower commodity prices. We concluded that even in a worst case scenario, there was a low probability of the credit being downgraded to high yield.

Outcome

Given that valuations amid a weak market were attractive, PIMCO participated in the new issue and secured the largest allocation in the deal. We were able to harvest very attractive new issue concession, and since the transaction the bond has outperformed both the JACI Investment Grade and JACI Non-Investment Grade Indices.

Example B  Reverse Inquiry

PIMCO’s access to issuers often provides an information advantage when forming our forward looking independent views on a credit. This can directly benefit our clients through direct negotiation with issuers via reverse inquiries or bond putbacks.

Background

In July 2018, a large Indian public sector bank planned to issue a dual-tranche floating rate note in three- and five-year tenors. Based on weak initial market sentiment, the bank decided to pull back on the issue to wait for more attractive levels.

Investment Thesis

Given PIMCO’s constructive view on the credit, we engaged directly with the bank on a separate private placement at attractive levels, where we were able to influence terms with respect to tenor, structure and pricing. Additionally, we were able to negotiate an attractive premium on the issue over comparable secondary market levels.

Outcome

Given that PIMCO was able to fulfill the majority of demand on the private placement, the bank did not have to proceed with issuing its previously planned bond into the market at unattractive valuations. Thus, the bank delayed its offering and was able to access markets when the conditions were more favorable. PIMCO’s clients similarly benefitted, as the private placement has notably outperformed comparable off-the-run publicly issued bonds from the bank since the transaction.
Alongside rapid expansion in the Asia high yield market, which has seen its market capitalization grow by nearly five times since 2008, abundant opportunities are emerging for active management across industries, countries and issuers. PIMCO's scale of resources provides a distinct advantage in accessing these opportunities across a diverse and evolving range of unique Asian credit markets today.

**4. HOW ARE YOU POSITIONING THE FUND IN THE CURRENT MARKET ENVIRONMENT?**

The Asia high yield market endured a challenging year in 2018, as spreads were buffeted by myriad factors, including volatility stemming from trade war politics and a weak technical environment that saw local demand wane amid the China onshore deleveraging campaign, changes to onshore asset management rules and broader EM volatility.

The upshot to Asia high yield's underperformance in 2018 is that valuations look particularly attractive relative to U.S. high yield and similarly rated EM corporates today. Additionally, signs of reprieve from recent fundamental and technical pressures are beginning to materialize in the form of Chinese stimulus aimed at offsetting the deleveraging impact from last year, coupled with improvement in demand-side technicals as overall sentiment has recently turned more positive. As a result, we believe that Asia high yield is well-positioned for a rebound in 2019 – but there are key risks which bear monitoring. The foremost of which is stark differentiation in the quality of issuance, where weaker issues may continue to suffer from lack of credit in the event that government policy does not fix the transmission mechanism. This could lead to an increase in credit deterioration in onshore China and higher defaults, which could spill over into offshore markets if risks are not well-contained.

Balancing these risks and opportunities, we believe that the coming year should present exciting relative value opportunities for active managers that seek to deliver strong risk-adjusted returns, but vigilant risk management will be critical to identifying winners and losers. We remain focused on uncovering country-specific opportunities and carefully selecting credit positions based on our forward-looking, independent assessment of fundamentals and where we see value and remote default risk. We are finding these opportunities in sectors and countries that are generally supported by positive cyclical and secular growth prospects, strong asset coverage and financial flexibility to organically deleverage balance sheets. We favor leading China high yield property credits, as well as Asia issues in the oil and gas sector, transport and infrastructure, Indonesia quasi-sovereigns and Asia high yield sovereigns. Conversely, we are underweights to Asia banks, weaker China property issuers, China Local Government Financing Vehicles (LGFVs) due to opaque fundamentals and questionable liquidity backstops, and cyclical credits that remain exposed to weakening Chinese consumer sentiment.

5. **HOW CAN THE PIMCO GIS ASIA HIGH YIELD BOND FUND COMPLEMENT/BENEFIT A PORTFOLIO?**

The Fund can provide diversification from both core bonds and equities, along with a relatively high source of income. Additionally, it can offer compelling risk-adjusted return potential compared to other credit asset classes like broad emerging markets, global high yield or global investment grade credit. Investors seeking a credit allocation with lower sensitivity to interest rates than traditional corporate sectors, or those looking to lower the risk in their equity market exposure without sacrificing potential return may also want to consider the PIMCO GIS Asia High Yield Bond Fund.

Investors can use this Fund in several ways: as a substitute for global or U.S. high yield bonds, given relatively higher yields and low duration in the Asia high yield bonds targeted by the Fund; as a substitute for non-IG emerging markets bonds given lower volatility and higher average quality in the Asia high yield bonds targeted by the Fund; or as a diversifier to core bonds, as the correlation of Asia High Yield to U.S. Treasuries is relatively low.
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