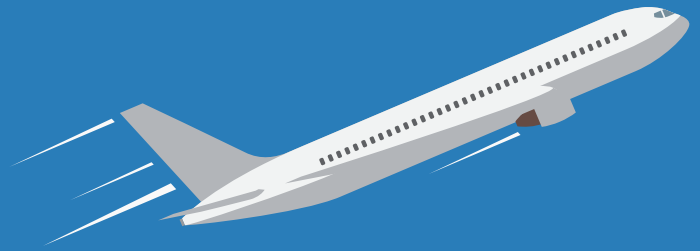




National
Australia
Bank



FLIGHT TO QUALITY

*Asia-based bond investors surveyed by
FinanceAsia and National Australia Bank
are seeking safety in higher-rated credits*

FinanceAsia

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FLIGHT TO QUALITY

Asia-based bond investors surveyed by FinanceAsia and National Australia Bank are seeking safety in higher-rated credits

By **Cherie Marriott and Bernice Cornforth**

Rising geopolitical risks and ultra-low global interest rates are prompting a flight to quality among bond buyers, according to a survey of Asia-based investors conducted by FinanceAsia and National Australia Bank (NAB) in August this year. Australia continues to provide a safe haven for fixed-income investors from the region — but the focus has shifted away from lower-rated corporates to government and supranational bonds.

In the latest survey of institutional investor appetite for Australian and New Zealand debt securities, Asian bond buyers were asked to provide information on their allocation strategies and indicate whether they planned to increase or decrease their exposures. Similar polls have been conducted by FinanceAsia and NAB every year since 2013.

Some 65 investors representing all types of firms participated in this year's survey, although a larger proportion of asset managers and pension funds took part and fewer hedge funds participated. Geographically, the respondents were spread more evenly between countries than in previous years, with 20% indicating they were based in Hong Kong, 26% in Singapore, 18% in Korea, 11% in the Philippines and 6.1% in Malaysia.

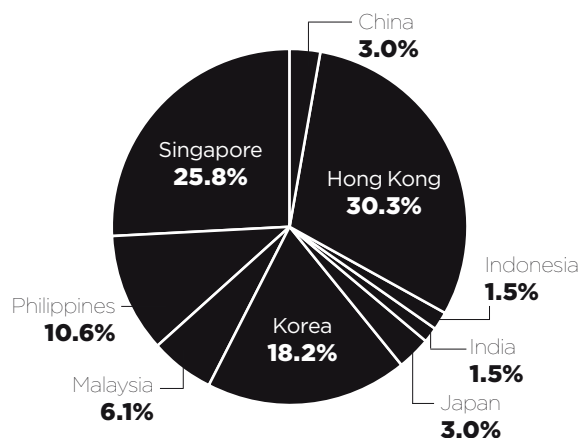
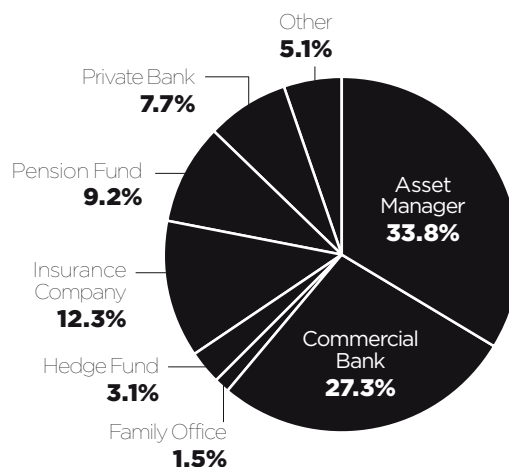
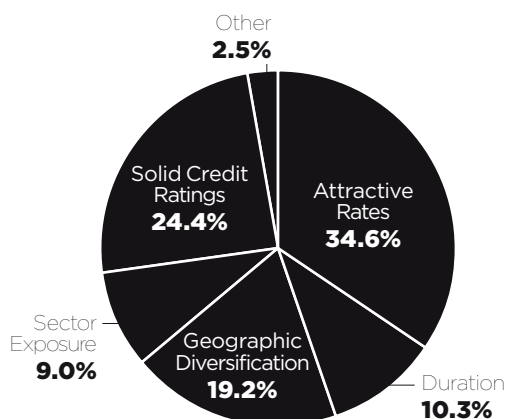
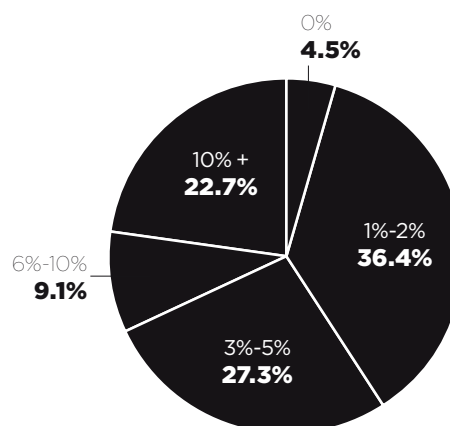
Connie Sokaris, General Manager, Investment Grade Originations at NAB, said the geographic spread of participants is indicative of the market's growing maturation.

"Investors from all over Asia, not just the financial hubs, now see Australian and New Zealand dollar debt securities as an essential component of their fixed-income portfolios," Sokaris said. "Asia is home to some of the largest pools of pension assets in the world and the need for these funds to look offshore for investments continues to grow."

The popularity of Australian and Kiwi dollar securities has been helped by a number of new issuers entering the Kangaroo and Kauri bond markets.

"Korea Development Bank and Korea Export Import Bank both issued their first Kauri bonds this year, and DBS tapped the Kangaroo market for the first time," Sokaris said. "When Asian names issue in new currencies they tend to bring a set of domestic bond buyers with them, some of whom may not have invested in the currency before."

The deepening of the market's appeal

WHICH COUNTRY ARE YOU BASED IN?**WHAT TYPE OF FIRM DO YOU WORK FOR?****WHAT ATTRACTS YOU TO AUSTRALIAN DOLLAR DEBT SECURITIES?****WHAT PERCENTAGE OF YOUR PORTFOLIO IS INVESTED IN AUSTRALIAN DOLLAR DEBT SECURITIES?**

was also evident in the number of investors who reported increasing their Australian dollar bond holdings over the past 12 months. A full 64% of those surveyed said they had increased allocations during the year, with 9% stating allocations were significantly higher.

More than 27% of respondents now have 3-5% of their portfolio dedicated to Australian dollar debt securities, compared to 23% in 2015 and 17% in 2014. Meanwhile, those with a 1-2% allocation now make up 36% of all investors polled compared to 27% in 2015 and 15% in 2014.

“The steady upward trend in allocations

is a real sign that the market is on a steady growth trajectory,” Sokaris said.

PRUDENT TIMES

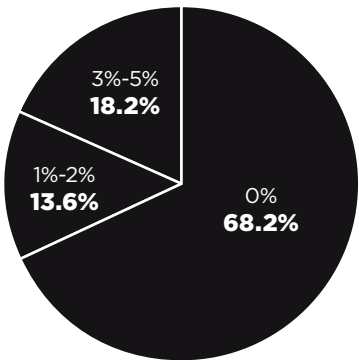
One of the most consistent trends the survey demonstrated was a preference for higher-rated credits.

“The survey results reflect what we hear from investors on the ground, and that is a general shift towards a more conservative approach,” said Jessica Tilton, Head of Markets, for NAB in Asia. “Investors are less sensitive to price and sector dynamics, and more focused on credit ratings. There is also a focus on

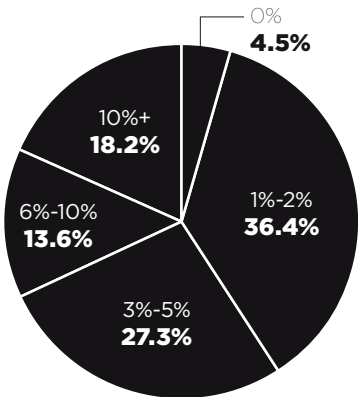
yield — which might sound counter-intuitive given the emphasis on higher ratings — but I think this just shows that Australia still offers the best yields in the developed world for a AAA-rated country.”

The flight to quality was clear in the survey. Last year investors said they were focused on yield and secondary liquidity, with 68% and 70% of respondents respectively saying these were essential factors when analysing a bond. Credit ratings were ranked as essential by only half of those polled in 2015. This year, however, 68% ranked credit ratings as essential,

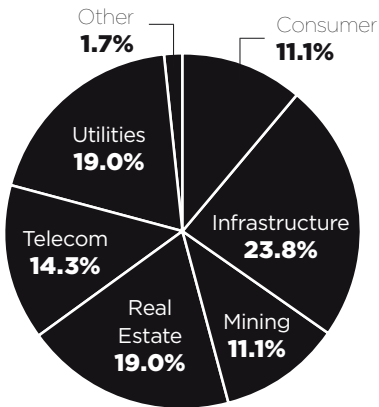
WHAT PERCENTAGE OF YOUR PORTFOLIO IS INVESTED IN NEW ZEALAND DOLLAR DEBT SECURITIES?



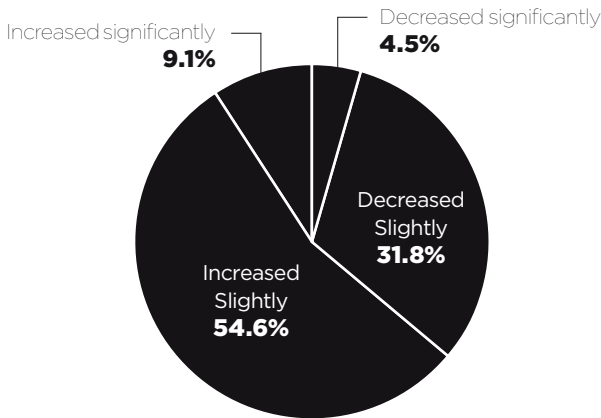
OVER THE NEXT 12 MONTHS, WHAT PERCENTAGE OF YOUR PORTFOLIO DO YOU PLAN TO INVEST IN AUSTRALIAN DOLLAR DEBT SECURITIES?



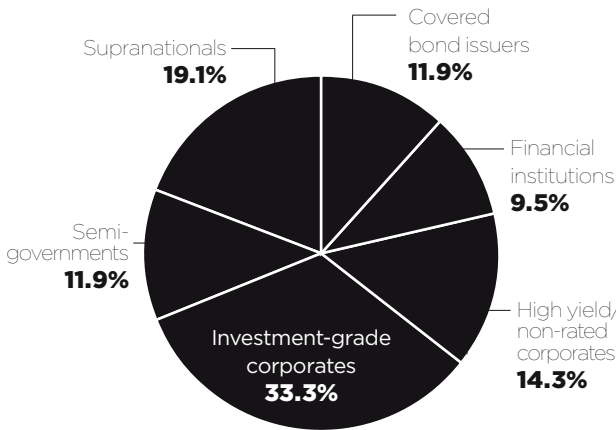
WHICH INDUSTRY TYPE ISSUERS WOULD YOU LIKE TO SEE MORE OF?



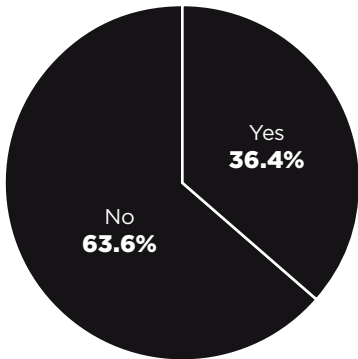
HAS YOUR EXPOSURE TO AUSTRALIAN DOLLAR DEBT INCREASED OR DECREASED IN THE PAST 12 MONTHS?



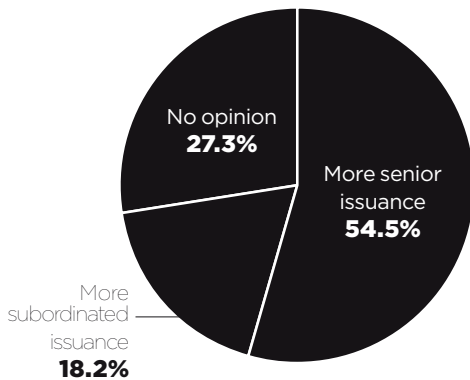
WHICH ISSUER TYPES WOULD YOU LIKE TO SEE MORE OF?



ARE YOU ABLE TO BUY TIER 2 STRUCTURES WHICH HAVE CONVERSION INTO ORDINARY EQUITY?



FOR FINANCIAL INSTITUTIONS, WOULD YOU PREFER TO SEE MORE SENIOR OR SUBORDINATED DEBT ISSUANCE?



HOW IMPORTANT ARE THE FOLLOWING FACTORS WHEN MAKING AN INVESTMENT DECISION?

	Tenor	Secondary liquidity	Credit rating	Yield	Industry / Sector
Essential	54.5%	50.0%	68.2%	77.3%	31.8%
Reasonably important	40.9%	45.5%	27.3%	18.2%	45.5%
Marginally important	4.6%	4.5%	4.5%	4.5%	18.2%
Not important	0.0%	0.0%	0.0%	0.0%	4.5%

and 77% said yield was central to their decision-making process.

“This switch in focus started to occur at the beginning of 2016 and gathered pace after the Brexit vote,” said Sokaris. “There is a general level of caution in the market due to the emergence of new geopolitical risks and concerns about the slow pace of economic growth around the globe. Everyone is looking for a safe haven where rates are still high enough to offer a reasonable return, and that’s why Australia consistently comes up as a good investment option.”

She said Australia has attracted even more attention as onshore rates in markets like Japan and Korea have fallen.

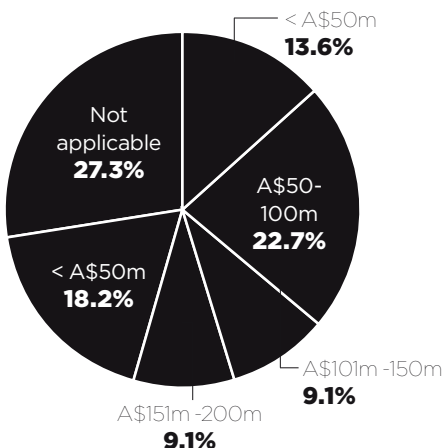
While previous surveys have charted a growing appetite for high-yielding non-rated or investment-grade corporate bonds, this year’s poll shows a preference for highly-rated government bonds. Asked which issuer type they would like to see come to market, investors pointed to supranationals (with 19% wanting more of these bonds this year compared to 10% last year), semi-governments (12% compared to 8%) and covered bond issuers (12% compared to 2%).

There was also a drop in appetite for financial institutions, indicating that investors may be reaching exposure limits on some of these credits. This year only

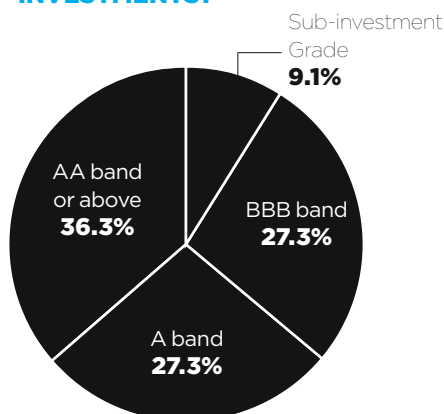
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IS THERE A MINIMUM TRANCHE SIZE YOU NEED BEFORE YOU CAN INVEST?

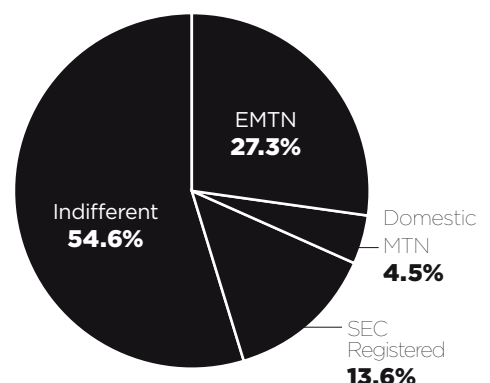
m = million



WHAT IS THE CREDIT RATING “SWEET-SPOT” FOR YOUR AUSTRALIAN DOLLAR INVESTMENTS?



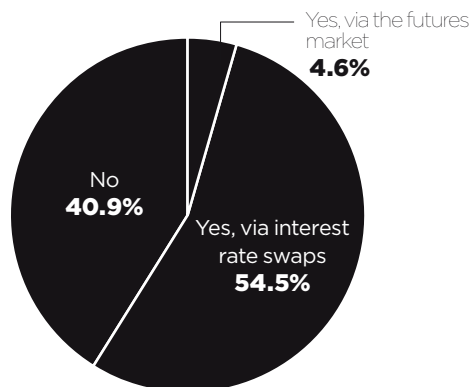
DO YOU PREFER TO BUY AUSTRALIAN DOLLAR DEBT ISSUED OFF EMTN, GLOBAL DOCS OR A DOMESTIC MTN PROGRAM?



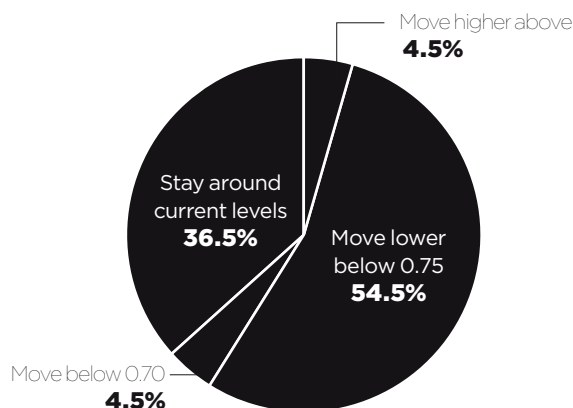
WOULD YOU LIKE TO SEE MORE AUSTRALIAN DOLLAR TLAC-ELIGIBLE ISSUANCE FROM THE FOLLOWING REGIONS?

	Yes	No
US	76.2%	23.8%
France	50.0%	50.0%
UK	66.7%	33.3%
Japan	70.6%	29.4%
China	44.4%	55.6%

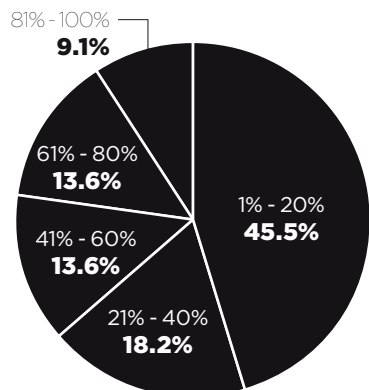
DO YOU HEDGE YOUR AUSTRALIAN DOLLAR EXPOSURE?



HOW DO YOU EXPECT THE AUD TO TRADE AGAINST THE USD IN THE NEXT 12 MONTHS?



WHAT PERCENTAGE OF YOUR TOTAL BOND VOLUMES ARE TRANSACTED ACROSS ELECTRONIC PLATFORMS?



9% of respondents said they would like to see more issuance from banks compared to 20% last year and 33% in 2014.

Furthermore, senior debt is preferred over subordinated issuance. "This is likely to be driven by a focus on credit quality but also points to the uncertain regulatory environment," said Sokaris, interpreting why only 18% of participants said they would like to see more subordinated debt from bank issuers. "The market is waiting on some clarity around how senior and subordinated debt will be treated under new banking rules. Investors are still evaluating the risks in the unsecured portion of their portfolios and the poll results show they aren't so focused on the sub-debt piece."

On the topic of industry preferences, survey participants listed infrastructure (24%) and utilities (19%) as favourites in this year's poll. "These sectors have always been popular and Australia has an enviable pipeline of new infrastructure projects ready to go," said Sokaris. "With a flight to quality under way, regulated assets with strong cash flows will become even more attractive."

ASIA BID STRENGTHENS

Investor preferences have had a marked impact on deal flow, said Sokaris, noting corporate bond volumes in Australian and Kiwi dollars have been on the low side this year. "By the same token there has been a real uptick in Australian dollar issuance by investment-grade

HOW IMPORTANT ARE THE FOLLOWING FACTORS WHEN CHOOSING A COUNTERPARTY BANK?

	Pricing	Credit rating	Relationship / Sales coverage	Research	E-platform	Execution & back office support
Essential	68.2%	50.0%	59.1%	54.5%	27.3%	45.5%
Reasonably important	27.3%	31.8%	36.4%	27.3%	40.9%	36.4%
Marginally important	4.5%	9.1%	4.5%	18.2%	18.2%	13.6%
Not important	0.0%	9.1%	0.0%	0.0%	13.6%	4.5%

institutions including Wells Fargo, Royal Bank of Canada, Credit Suisse, BTMU and ICBC.”

Sokaris said Australian dollar bonds sold by offshore issuers continue to be well supported by Asian bidders. “Asian investors like borrowers who are consistent issuers in the market and they generally make up about 35-40% of any book,” she said. “For some deals, Asian allocations can be even higher.”

When Wells Fargo launched its benchmark A\$1.65 billion deal in July this year it started with a five year tranche but quickly added a 10-year tranche in response to reverse enquiries from offshore accounts. “Wells Fargo generated extremely strong demand from Asia, especially from banks,” said Tilton. In the end, Asian investors took 42% of all orders.

One of the most successful corporate deals of the year was the A\$500 million fixed and floating note issued by the builders of the Westlink motorway in Sydney. “The funds are being used to expand an existing motorway that has an established track record as a well-performing asset for owners Transurban,” said Sokaris. “Investors are very hot on infrastructure and we saw significant interest in the 10-year tranche for Westlink as a result.”

Similarly, when Airservices sold a A\$400 million dual-tranche note in May, Asian accounts bought nearly 50% of the 10-year senior unsecured tranche following a roadshow though Hong Kong, Japan and Singapore. “Airservices is an air traffic control and aviation rescue company with strong links to the Australian government,” said Sokaris. “Investors were attracted to the relatively high yield for the AAA-rating”

PERFECT PARTNER

Commenting on other areas of the survey, Tilton said the flight to quality theme is reflected in the type of counterparty investors are choosing. Half of this year’s participants ranked a bank’s credit rating as an essential factor when deciding who to transact with. “This is a real jump from last year when only 36% of investors listed credit rating as a key consideration,” said Tilton. “It really shows that investors want to be sure they are dealing with a quality AA-rated counterparty like NAB.”

Research and execution also featured more highly on investors’ agendas. “Fixed-income funds in Japan, Taiwan and Korea are particularly focused on painless execution,” said Tilton, “and it’s great to see research gaining in importance as investors realise the value of analysis and want more insights into what’s driving the market.”

Access to an e-platform has also increased in importance with 37% of survey participants now transacting more than half of their trades across an e-platform, versus 20% who were doing so last year. By the same token, 27% of investors said the availability of an e-platform was essential when choosing a counterparty bank, compared to only 12% last year.

Tilton believes the use of e-platforms is streamlining the way bond buyers evaluate securities and is channelling interest towards Australian and New Zealand dollar debt. “The digitisation of the global bond market takes some of the emotion out of the investment equation and allows investors to run simple yield and credit rating analysis. In this way, Australia consistently rises to the top.” **FA**

FOR MORE INFORMATION**Connie Sokaris**

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