Fund report, September 2021
Global Ethical High Yield
Fixed Income

Sparinvest

# DARK TIMES IN CHINA

### Supply and real estate crisis in China

**Markets.** Credit spreads widened by 6 bps in the High Yield (HY) market in September. The benchmark index gave a negative return of -0.50%, which brought the year-to-date return to 2.76%.

In many ways, it is a dark time in China at the moment. In September, households in large cities in China's northeastern provinces experienced blackouts due to electricity supply problems. Confidence in many property developers has disappeared, which is why bondholders and customers see their investments and pre-payments suffering losses. Those affected must look far for "common prosperity". Energy shortages are not an unknown phenomenon in China, but the current one exceeds previous periods and is occurring outside the energy-intensive peak seasons. Worse for the growth picture is that in recent weeks the Chinese authorities have selectively recommended energy-heavy companies, in steel, cement and chemicals, to reduce or stop production activity, which will hit the supply side in steel and cement. The introduced restrictions suggest some attention from the authorities to the supply shock that is currently hitting China. The situation has put the authorities in a painful dilemma. Extensive shutdowns of coal-fired power plants since 2016, without other energy sources having increased correspondingly, have exposed the vulnerability of securing supply during the transition period. The situation speaks in the short term for trying to increase access to coal – which is reflected in Chinese coal prices, that have risen by about 65% since mid-August. Problems in the Chinese real estate market escalated in September. The case of Evergrande, the largest issuer of HY bonds in China, continued and the company can no longer avoid bankruptcy without the help of the government. The company's sales of apartments fell more than 50% in September and at sharply reduced prices, putting pressure on a market with high prices as well as on competitors with similar high debt levels. The benchmark's negative return for the month can almost exclusively be attributed to the price decrease of bonds issued by Chinese real estate developers – several with a drop of more than 20%.

### Positive return, ahead of benchmark

**The Portfolio** had a positive return of 0.24% in September, which was 0.74 percentage points ahead of the benchmark. Year-to-date the return is 5.51%, which is 2.75 percentage points ahead of the benchmark.

Real Estate and Energy were the two sectors that generated the largest positive contribution to the portfolio relative to the benchmark, while Materials and Consumer Discretionary were the worst contributor. The largest positive contribution from Real Estate came from the large underweight in Chinese real estate developers. Within Energy, the positive contribution was broad based across several of the fund's positions. The negative contribution from Materials came from the fund's positions within mining companies. The reason was a minor correction in the bonds after a strong year, as commodity prices also corrected. In September, two bonds were called and three sold. In addition, some positions were reduced to accommodate seven new issues as well as increases in other positions. The changes increased the underweight in the U.S. and increased the fund's overall credit spread.

See performance and fund data Click here >

**Strategy**
Ethical High Yield Value Bonds invests in global corporate bonds, cf. the fund's prospectus. Bond selection is based on the value approach, meaning that the team focuses on bonds issued by companies with healthy long-term earnings power and strong balance sheets as well as an expected ability to service outstanding debt. The portfolio is diversified across sectors, regions and credit ratings. At least 2/3 of the portfolio are invested in High Yield bonds. Up to 15% may be invested in corporate bonds issued by companies operating in Emerging Markets.