Assessing risk and reward in corporate bond market

Key Takeaways

- Corporate bond tend to outperform government bond throughout 2022. Besides giving higher year to date total return, corporate bond credit spread with government bond also declined
- We tried to understand the key driver of the recent market movement by assessing supply and liquidity risk, as well as market characteristics
- Supply risk : in response to Covid-19 crisis, government decided to widen its budget deficit since FY20 bringing gross and net securities issuance to jump, while corporate bond issuance was experiencing a decline reducing the market share of corporate bond
- However, compared to government bond, corporate bond is still significantly lower in terms of liquidity that may not fully reflect real market condition
- Worth noting that domestic corporate bond market was dominated by sectors like bank & financial institution, AAA-rated and SOEs which should also support the idea of lower credit risk
- Diversification to corporate bond may bring some benefits as it offer shorter average duration albeit the weight is small
- In order to optimize risk adjusted return, we recommend bond investor to consider AAA to A rated corporate bond with the maturity ≤5 years

Tirta Widi Gilang Citradi
Economist & Fixed Income Analyst
tirta.citradi@mncgroup.com

Corporate bond outperformed government bond

It is interesting to note that corporate bond performance is more stable than government bond this year even with higher credit risk. INDOBeX corp TR has yielded +3.08% YtD/+8.88% YoY, whereas INDOBeX govt TR lagged behind -1.16% YtD/+2.63% YoY. Note that in a clean price basis corporate bond still outperformed so far (Exhibit 1). Along with the outperformance, the credit spread matrix of investment grade corporate bond also lowered by -63 bps and -87 bps ytd for 3 & 5 year tenure respectively (Exhibit 2). Given such circumstances, we tried to understand the key driver and assessed the investment/diversification opportunity in corporate bond based on risk and reward it offers.

The supply side risk

Due to Covid-19, government has increased its securities issuance to finance the state budget since FY20. Government securities gross issuance rose by +21% CAGR FY17-FY21, while taking account the burden sharing scheme with BI, gross issuance increased by +10% CAGR FY17-FY21. During the same period, corporate bond issuance has lowered by -10% CAGR FY17-FY21 (Exhibit 3) bringing the outstanding of corporate bonds only accounted <10% from the total value of domestic bonds last year (vs ~16% in FY17) (Exhibit 4). This may also imply a higher supply risk from government. Outlook for FY22F may slightly diverge, with the positive impact of higher commodity prices on government budget and commitment to prudently manage the debt, government securities issuance for FY22F is likely to be lower than FY21. In contrast, the needs for refinancing and working capital are expected to increase the corporate bond issuance, yet we think that in the market pool, the percentage of outstanding to remain relatively small (<12%).

The liquidity risk

Despite the outstanding of corporate bond is around 8.8% to the outstanding of domestic fixed income assets, the average trading value and frequency of corporate bond is still low compared to government bond. Note that in FY21, the average daily trading value (outright) of corporate bond is merely around 5% indicating lower liquidity that may not indicate real market conditions (Exhibit 5).

Market characteristics

Despite the significantly lower liquidity, corporate bond market characteristics have supported the idea of lower credit risk from historical perspective. As at the end of May-22, the corporate bond market was dominated by bank and financial institution which accounted for 48% of corporate bond outstanding. Given the improvement in banks financial performance : 1) lower CoF; 2) NPL deceleration; 3) higher credit growth; 4) fee-based income acceleration; 5) front loading provisioning as well as 6) ample liquidity should be reflected on its credit quality. In addition, energy and metal mining sector which are positively affected by recent commodity price rally also accounted for 12% corporate bond outstanding (Exhibit 6). In addition, domestic corporate bond market is also dominated by investment grade (AAA) bond as well as SOEs securities which are guaranteed by government.

Risk & reward assessment

We think that interest rates risk is rising with global central bank has started to tighten since 1Q22 to fight against the elevated inflation. Bond prices are likely to fall and expecting market to be more volatile with the Fed is expected to be aggressive in adjusting their monetary policy. Starting to diversify to corporate bond may give some benefits despite its lower liquidity. It is worth noting, albeit corporate bond only accounted for 6.5% weight of ICBI, yet the average coupon rate and YTM is still higher and the duration is significantly lower, which we believe to give higher total return going forward (Exhibit 7). In order to optimize risk adjusted return, bond investors need to consider AAA to A rated corporate bond with the maturity ≤5 years.

Exhibit 1. Corporate bond outperformed government bond

Indices	YtD	YoY
INDOBeX Govt TR	-1.16	2.63
INDOBeX Govt CP	-4.26	-4.23
INDOBeX Govt GP	-4.12	-4.13
INDOBeX Corp TR	3.08	8.88
INDOBeX Corp CP	-0.60	0.40
INDOBeX Corp GP	-0.58	0.30

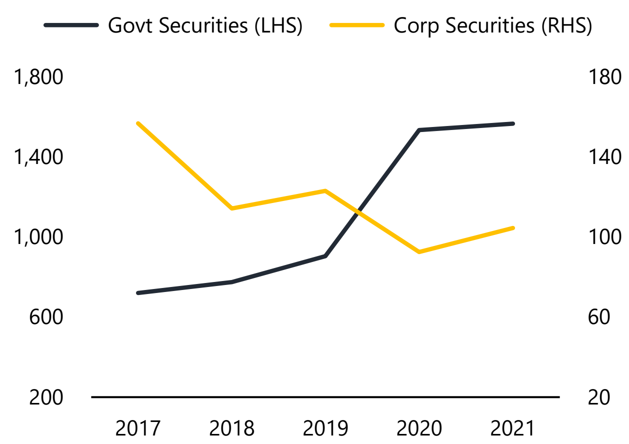
Sources : IBPA, MNCS Research

Exhibit 2. Credit spread of corporate bond declined

Maturity & Rating	YtD Credit Spread Change (bps)
5-Yr AAA	-63
3-Yr AAA	-87
3-Yr AA	-87
5-Yr AA	-88
5-Yr A	-156
3-Yr A	-170

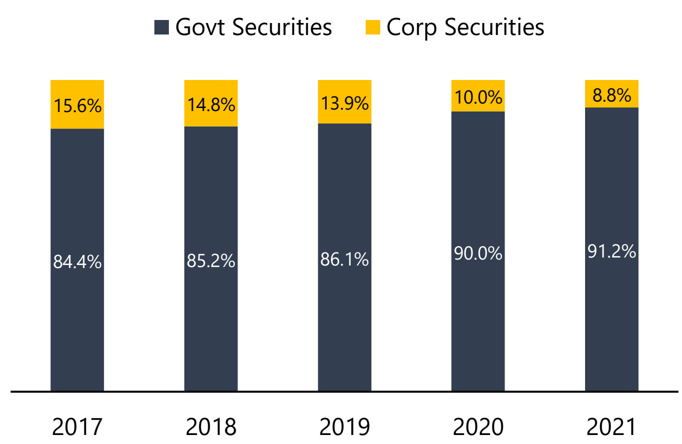
Sources : IBPA, MNCS Research

Exhibit 3. Govt securities vs corp. securities issuance trend (IDR tn)



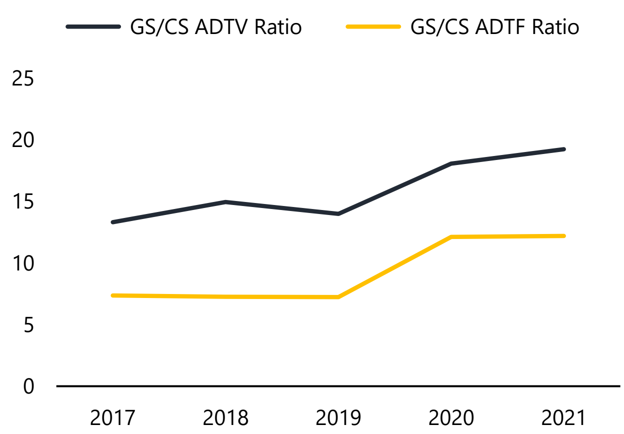
Sources : IDX, MNCS Research

Exhibit 4. Market share of govt & corp. securities



Sources : IDX, MNCS Research

Exhibit 5. Govt & corp. securities outright trading value & freq ratio



Sources : IDX, MNCS Research

Exhibit 6. Market share of corp. bond by sectors as of May-22

Sectors	Outstanding (IDR bn)	Share (%)
Bank & Financial Institutions	206,242	48%
Energy	30,282	7%
Pulp & Paper	24,493	6%
Building Construction	23,098	5%
Metal & Mineral Mining	20,739	5%
Telco	20,121	5%
Chemical	19,628	5%
Construction	17,300	4%
Toll Road, Airporta, Harbor etc	9,675	2%
Plantation	8,654	2%
Total	431,875	100%

Sources : IDX, KSEI, MNCS Research

Exhibit 7. ICBI index breakdown

Portfolio	No Bonds	Weight	Avg Coupon	Avg YTM	Average Duration
Composite	**555**	**100.0%**	**7.4%**	**6.5%**	**5.5**
Government	**83**	**93.5%**	**7.3%**	**6.5%**	**5.7**
Conventional	51	74.5%	7.4%	6.6%	5.8
Sukuk	32	19.0%	6.9%	5.9%	5.3
Corporate	**472**	**6.5%**	**8.5%**	**6.6%**	**2.9**
Conventional	420	6.2%	8.4%	6.6%	2.9
Sukuk	52	0.3%	9.2%	7.2%	3.6
By Rating					
AAA-rated	206	3.4%	8.0%	6.0%	3.2
AA-rated	54	0.6%	8.7%	6.6%	2.7
A-rated	44	0.5%	9.0%	7.8%	2.7
BBB-rated	9	0.1%	10.3%	9.2%	1.9
By Sector					
Banking	74	1.4%	8.9%	6.5%	2.5
Infra	72	0.9%	7.7%	5.9%	2.4
Finco	88	1.2%	8.5%	6.7%	4.5
Telco	28	0.3%	9.2%	6.7%	3.8
Others	208	2.7%	8.5%	6.9%	2.7

Sources : IBPA, MNCS Research

MNC Research Industry Ratings Guidance

OVERWEIGHT: Stock's total return is estimated to be above the average total return of our industry coverage universe over next 6-12 months

NEUTRAL: Stock's total return is estimated to be in line with the average total return of our industry coverage universe over next 6-12 months

UNDERWEIGHT: Stock's total return is estimated to be below the average total return of our industry coverage universe over next 6-12 months

MNC Research Investment Ratings Guidance

BUY : Share price may exceed 10% over the next 12 months

HOLD : Share price may fall within the range of +/- 10% of the next 12 months

SELL : Share price may fall by more than 10% over the next 12 months

Not Rated : Stock is not within regular research coverage

PT MNC SEKURITAS
MNC Financial Center Lt. 14 – 16
Jl. Kebon Sirih No. 21 - 27, Jakarta Pusat 10340
Telp : (021) 2980 3111
Fax : (021) 3983 6899
Call Center : 1500 899