
Credit on the comeback trail in 2023

Fixed income | January 2023



David Oliphant
Executive Director, Fixed Income

- **Last year was tough for all investors, with credit offering little respite**
- **In a world without quantitative easing and artificially low rates, investors will have to seek higher credit quality**
- **We do this through intense ‘bottom-up’ fundamental credit analysis with a focus on issuer and security selection**

All global financial markets were rattled in 2022. We saw an aggressive policy pivot from multiple major central banks to address an inflationary environment that was much more persistent than hoped or expected. Assets sensitive to rising real and nominal rates, such as government bonds, performed woefully. In addition, the lower quality bonds of the high yield space also underperformed badly. As such, fixed income investors could have lost just as much money in treasuries as they did in high yield bonds.

There is agreement on what it will take to stop the carnage: clarity on an end to central bank rate rises. The US Federal Reserve recognises this, but chair Jay Powell has made it clear that the Fed wants to see “compelling evidence of inflation easing” before it shifts policy¹. The difficulty it and other central banks face is that monetary policy impacts the real economy with a lag: it can take around six months for changes in interest rates to be seen. As such it is hard to judge what effect policy makers are having. The risk is that, not seeing sufficient signs of inflation easing, they push rates too high; if they don’t go high enough inflation continues for longer. But it does appear the US is seeing evidence that its policy is starting to work.

Into 2023






As the year progresses we expect to see a dramatic slowing in economic growth. Although this won’t be comparable to the global financial crisis of 2008 or the effects of Covid-19, we expect recession in the UK and Europe, as well as in the US – although the slowdown in the latter should be less stark than on this side of the Atlantic.

¹ FT.com, Jay Powell faces test of Fed’s ‘unconditional’ resolve to tame inflation, 22 June 2022

This means that companies and consumers with too much leverage, and sovereigns not well positioned to deal with elevated levels of currency volatility, will come under increased pressure. We are also now in a world where policy-based shock absorbers such as quantitative easing or artificially low rates have gone. Instead investors will have to seek higher credit quality: companies with strong fundamentals, a healthy cash flow and lower leverage.

Here is how we're looking at the credit market for 2023:

Credit triggers – outlook for corporate credit spreads

Key Indicators	Current Flag	Notes
Policy conditions		Central banks took interest rates beyond neutral in 2022. Expectations are for them to remain in restrictive territory in the coming year(s).
Economic outlook		Economic growth to be around 0% in 2023 – weakest in the UK and strongest in the US. A modest rebound is expected in 2024.
Valuations/spreads		Spreads to be well above short-term averages and modestly higher than long-run averages. Europe/UK look cheapest, US more neutral.
Corporate health		From a strong starting point, we expect credit fundamentals to improve in the US, but modest deterioration in Europe. High-yield defaults will increase throughout the year but remain low.
Abnormally low but rising volatility		After increased volatility and challenging liquidity in Q2/Q3 2022, volatility has fallen and liquidity has improved

How we manage credit

At Columbia Threadneedle Investments we have always sought to deliver attractive relative and risk-adjusted relative returns through the cycle. And in what is an asymmetrical risk-return asset class – one which has most of the downside (when things go wrong) and not much of the upside (when things go well) – that has never been more important.

In order to find higher credit quality we have intense “bottom-up” fundamental credit analysis, with a focus on issuer and security selection. Downside risk management is embedded in portfolio construction and in our research, and the chief focus for our team of analysts is default and downgrade risk. Put simply, we want to find the best companies out there.

We believe this is not a time to stay on the side-lines. There are very compelling total return opportunities in high-quality assets. Yes, there are risks, but investors are being well-compensated, and a focus on quality and credit selection will be critical to setting the stage of successful fixed income investment outcomes.



Important Information

For use by professional clients and/or equivalent investor types in your jurisdiction (not to be used with or passed on to retail clients). For marketing purposes.

This document is intended for informational purposes only and should not be considered representative of any particular investment. This should not be considered an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services. Investing involves risk including the risk of loss of principal. Your capital is at risk. Market risk may affect a single issuer, sector of the economy, industry or the market as a whole. The value of investments is not guaranteed, and therefore an investor may not get back the amount invested. International investing involves certain risks and volatility due to potential political, economic or currency fluctuations and different financial and accounting standards. The securities included herein are for illustrative purposes only, subject to change and should not be construed as a recommendation to buy or sell. Securities discussed may or may not prove profitable. The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Threadneedle Investments (Columbia Threadneedle) associates or affiliates. Actual investments or investment decisions made by Columbia Threadneedle and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be suitable for all investors. Past performance does not guarantee future results, and no forecast should be considered a guarantee either. Information and opinions provided by third parties have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. This document and its contents have not been reviewed by any regulatory authority.

In the UK: Issued by Threadneedle Asset Management Limited, No. 573204 and/or Columbia Threadneedle Management Limited, No. 517895, both registered in England and Wales and authorised and regulated in the UK by the Financial Conduct Authority.

In the EEA: Issued by Threadneedle Management Luxembourg S.A., registered with the Registre de Commerce et des Sociétés (Luxembourg), No. B 110242 and/or Columbia Threadneedle Netherlands B.V., regulated by the Dutch Authority for the Financial Markets (AFM), registered No. 08068841.

In Switzerland: Issued by Threadneedle Portfolio Services AG, an unregulated Swiss firm or Columbia Threadneedle Management (Swiss) GmbH, acting as representative office of Columbia Threadneedle Management Limited, authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

In the Middle East: This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). For Distributors: This document is intended to provide distributors with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Market Counterparties and no other Person should act upon it.

Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies.