# In Credit

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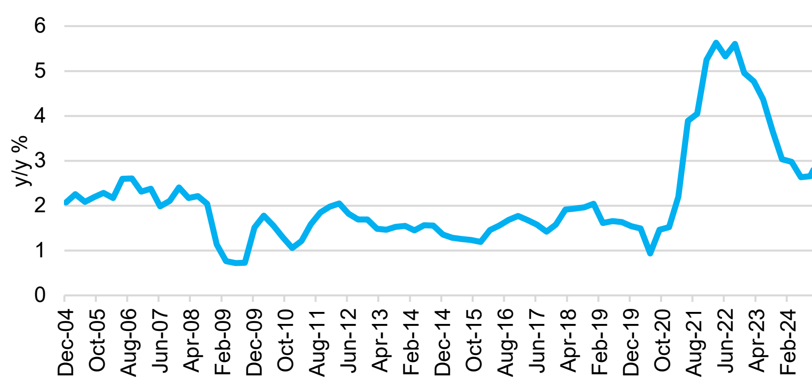
# Thanks given

## Markets at a glance

| | Price / Yield / Spread | Change 1 week | Index QTD return* | Index YTD return |
|---|---|---|---|---|
| US Treasury 10 year | 4.21% | -19 bps | -1.7% | 2.2% |
| German Bund 10 year | 2.06% | -18 bps | 1.0% | 2.1% |
| UK Gilt 10 year | 4.25% | -14 bps | -1.1% | -1.6% |
| Japan 10 year | 1.08% | -1 bps | -1.2% | -3.1% |
| Global Investment Grade | 90 bps | 2 bps | -0.3% | 4.8% |
| Euro Investment Grade | 107 bps | 2 bps | 1.2% | 5.1% |
| US Investment Grade | 83 bps | 3 bps | -1.1% | 4.6% |
| UK Investment Grade | 88 bps | 1 bps | 0.1% | 2.3% |
| Asia Investment Grade | 120 bps | -4 bps | -0.4% | 6.2% |
| Euro High Yield | 344 bps | -5 bps | 1.1% | 8.0% |
| US High Yield | 274 bps | 13 bps | 0.6% | 8.6% |
| Asia High Yield | 519 bps | 11 bps | -0.1% | 14.3% |
| EM Sovereign | 303 bps | 7 bps | -0.6% | 7.3% |
| EM Local | 6.3% | -1 bps | -5.2% | -0.5% |
| EM Corporate | 250 bps | 9 bps | -0.3% | 8.2% |
| Bloomberg Barclays US Munis | 3.4% | -12 bps | 0.2% | 2.5% |
| Taxable Munis | 4.9% | -21 bps | -1.3% | 3.4% |
| Bloomberg Barclays US MBS | 41 bps | 2 bps | -1.5% | 2.9% |
| Bloomberg Commodity Index | 234.23 | -0.8% | -1.5% | 4.3% |
| EUR | 1.0522 | 1.5% | -5.0% | -4.2% |
| JPY | 150.30 | 3.3% | -4.1% | -5.8% |
| GBP | 1.2707 | 1.6% | -4.8% | 0.0% |

Source: Bloomberg, ICE Indices, as of 29 November 2024. *QTD denotes returns from 30 September 2024

## Chart of the week – US Core PCE




Source: Bloomberg, as of 2 December 2024

## Macro / government bonds

Last week saw a modest bull flattening of curves across core markets, led by price action in the US Treasury market. There were various reasons for this. First, the growing perception that yields had gone a long way in a relatively short time – the so called "Trump trade" as investors had positioned for a more inflationary environment. Aside from give back, there was also the short covering of positions ahead of the Thanksgiving holiday, while at the margin index extensions in the US also provided a reason to buy fixed income.

Neel Kashkari, President of the Minneapolis Fed, also delivered a supportive tone to markets. He sent a message that a December rate cut remained on the cards, despite market concerns that the uncertainty surrounding the Trump policy agenda might cause Federal Reserve policymakers to pursue a more gradualist monetary easing approach. Economic data covering growth and inflation came in largely in line with expectations: Q3 GDP at 2.8% (annualised) underlined the resilience of the US economy, while Core PCE – one of the Fed's favoured inflation measures – came in at 0.3%, translating into an annualised figure of 2.8% (**see Chart of the Week**). The bid for fixed income instruments, alongside the perception that bond yields had overshot to the upside, led traders to reprice the probability of a December quarter point rate cut from 36% to 65%.

Price action in the eurozone bond market largely mirrored that of the US. The broad market move, however, helped mask emerging idiosyncratic risk in France amid politicking around a politically contentious budget. Michel Barnier, French prime minister, has been trying to push through a budget for next year, with the objective of trying to bring the deficit under control (expected to be circa 6% this year) through a mix of spending cuts and tax rises that would amount to €60 billion. In a legislature roughly evenly split between the centre, the right and the left, the far right National Rally party flexed its muscle, threatening to topple the government if it did not rein back its fiscal plans. National Rally achieved some success last week in getting the government to abandon taxes on electricity consumption, but was unsuccessful in demanding that the government abandon plans to curb the indexing of pensions to inflation.

Barnier used a constitutional mechanism to pass the budget, triggering calls for a no-confidence vote from both the left and the far right. If the government were to be voted down, the president, Emmanuel Macron, would have to appoint a new prime minister, but any appointment would likely meet pushback from the left and an emboldened far right. While Macron could dissolve parliament, this cannot take place until July 2025 at the earliest, creating scope for heightened political volatility.

Political uncertainty was crystallised through a widening in the yield spread over German sovereign bonds to 88bps. Spain and Portugal are now trading through France on spread terms relative to Germany, while the spread on French sovereign bonds is on a par with that of Greece, which only 10 years ago had been at the heart of a eurozone debt crisis. Alongside government bonds, valuations of French corporate bonds and equity weakened underperforming equivalent instruments in other eurozone markets, while the euro also gave ground against the US Dollar.

## Investment grade credit

In a holiday-truncated week, credit markets were very quiet. There has been a gradual drift wider these past couple of weeks in terms of spreads, taking the global IG index spread to 90bps from a recent tight of around 84bps, according to data from ICE Indices.

There was little specific of note in the past few trading sessions. There was some weakness in French bank bonds given the uncertain political backdrop in the country. Due to it being Thanksgiving week in the US there was little if any new issuance activity to report.

## High yield credit & leveraged loans

US high yield bond valuations remained stable amid light trading volumes during a holiday-shortened week.

The ICE BofA US HY CP Constrained Index returned 0.41%, while spreads were 10bps wider ending at +297bps. The index yield-to-worst declined slightly to 7.14%. According to Lipper, US high yield bond retail funds saw a $116 million outflow for the week, bringing year-to-date inflows to $19.5 billion. In leveraged loans, the average price of the Credit Suisse Leveraged Loan Index was stable around $96.4, a three-month high, as the asset class saw continued inflows. Retail loan funds saw another large inflow with $1 billion contributed for a tenth consecutive week, increasing year-to-date net inflows to $17.8 billion.

European HY had a solid week, returning 0.14%, and a solid month overall in November, returning 0.45%. This brought year-to-date returns to 7.9%. Both spread and yield fell across the week, respectively -5 bps to 344 bps and -12 bps to 6.18%. Inflows into the asset class continued through the week though were modest at €87 million, all due to managed accounts as ETFs experienced outflows. This brings the year-to-date net inflow for EHY to €12.4 billion. The primary market was busy, with about €4.2 billion in corporate bonds, largely for refinancings, but also included some hybrids and a new issuer. Interestingly, this week also saw a good portion done as FRNs (floating rate notes), one of which at €1.15 billion is the largest floating rate bond since 2018.

In credit rating news, the leisure facilities group Merlin was downgraded by S&P to B-. This was driven by weaker than expected performance due to competitive pressures and macro headwinds.

In M&A news, ABC technologies announced that they have agreed to buy Canadian auto parts company, TI Fluid, for £1 billion in cash.

In sector news,there was some positive news for autos. Aston Martin announced they would received a £100 million equity injection, which was well received by the market, while Antolin bonds fared well when earnings results turned out to not be as bad as originally feared.

## Structured credit

The US Agency mortgage-backed securities (MBS) sector had a strong week, up 1.3%, alongside lower interest rates and volatility. Longer maturities and lower coupons did best given their higher durations. Spreads tightened across the stack but still remain wide of their three-year and 10-year averages. November prepay speeds are expected to drop as much as 20% on fewer business days, seasonals and higher rates throughout much of the month. This is also a positive technical support of the sector.

Spreads in non-agency MBS were mostly unchanged. Recently released remittance reports show a continued rise in 60+ day delinquencies, however the pace appears to be slowing with only a 14 bps increase – the lowest posted since May. Spreads in both Commercial mortgage-backed securities (CMBS) and asset-backed securities (ABS) tightened on the week by a few bps. New issuance was low given Thanksgiving.

## Asian credit

The JACI index delivered another week of flat returns, with little contribution for both Treasuries and spread movements. The attributable sales for the top 100 property developers in November declined again to CNY288 billion (down 16% month-on-month and 3% year-on-year) after posting a first positive month in October. This implies that the some of the property support measures will likely need more time to bear results. Various property measures have been announced recently: tax cuts to buy larger residential properties (in excess of 140sqm); lower

downpayment ratios and mortgage rates; easing HPRs (home purchase restrictions); and expanded funding for “white-list projects”. The next immediate event is the annual Central Work Conference (CEWC) at which the focus will be on any indications of fiscal support and the broad policy direction for the year ahead.

Various Adani entities saw negative ratings action following the disclosure of the Department of Justice’s indictment. Fitch lowered the outlook of the Restricted Groups of Adani Green Energy Ltd from stable to negative. It also reduced the outlook of Adani Ports & SEZ (APSEZ) to “watch negative” due to what it views as the potential spillover effects from the corporate governance risks on APSEZ’s funding access. Moody’s also lowered its ratings outlook, albeit only to negative, which is less harsh than Fitch’s view on APSEZ.

## Emerging markets

It was a quiet week in EM as the US market slowed down for Thanksgiving. EM bond spreads ended the week 7bps wider, while EM local markets enjoyed a stronger week up 70bps as EMFX rebounded during the week. EMFX will remain challenged as investors worry about FX volatility during the second Trump administration.

The positive trajectory continued for Sri Lanka, which has been placed on review for credit upgrade by Moody's as it is set to complete its debt restructuring of dollar bonds. India's sovereign bonds rallied after a weak GDP growth report, and yields declined to an almost two-year low ahead of the central bank’s final monetary policy meeting of the year later this week.

Various Adani enterprises continued to grapple with the recent bribery charges against CEO Gautam Adani. French oil major TotalEnergies suspended fresh investments in Adani joint ventures. Fitch and Moody’s placed several Adani entities on negative outlook because of the allegations.

As a long year of elections continues, Romanian bonds had a rollercoaster week after an unexpected election result where the pro-Putin candidate performed well, amplifying investor concerns over budget policies. The parliamentary elections over the weekend appear to signal a more positive outcome with the ruling Social Democrat party securing around 23% of the vote. Focus will turn to the potential formation of a coalition government and the second round of the presidential vote scheduled for 8 December.

## Responsible investments

Despite the quietness of last week, the environmental, social and governance (ESG) bond market surpassed the $1 trillion mark in new issuance year-to-date. This will be the third year on record the market has reached the trillion dollar milestone after falling short last year (2023 saw $983 billion in issuance, according to Bloomberg). The 2024 figure was helped by more than $30 billion coming to market last week in a variety of green, social and sustainability bonds.

# Fixed Income Asset Allocation Views

25th November 2024

| Strategy and positioning (relative to risk free rate) | | Views | Risks to our views |
|---|---|---|---|
| **Overall Fixed Income Spread Risk** | Under-weight -2 -1 0 +1 +2 Over-weight | ▪ Post-election enthusiasm has moved spreads to generational tights. Volatility has decreased since October and fundamentals remain stable.<br>▪ **The group remains negative on credit risk overall and downgraded High Yield Corporates to the most negative outlook due to rich valuations.**<br>▪ The Federal Reserve has decreased to policy rate by 75bps since September. The CTI Global Rates base case view is that the pace and magnitude of additional cuts is uncertain and dependant on inflation and labor market conditions.<br>▪ The group is monitoring Donald Trump's fiscal policy proposals and personnel appointments to anticipate 2025 policy rate path and industry differentiation. | ▪ Upside risks: the Fed achieves a soft landing with no labour softening; lower quality credit outlook improves as refinancing concerns ease; consumer retains strength; end to Global wars<br>▪ Downside risks: Fed is not done hiking and unemployment rises, or the Fed pivots too early and inflation spikes. Restrictive policy leads to European recession. China property meltdown leads to financial crisis. 2024 elections create significant market volatility. |
| **Duration (10-year)**<br>('P' = Periphery) | ¥ £ $<br>Short -2 -1 0 +1 +2 Long<br>P € | ▪ Longer yields to be captured by long-run structural downtrends in real yields<br>▪ Inflation likely to normalize over medium term, although some areas will see persistent pricing pressures | ▪ Inflationary dynamics become structurally persistent<br>▪ Labour supply shortage persists; wage pressure becomes broad and sustained<br>▪ Fiscal expansion requires wider term premium<br>▪ Long run trend in safe asset demand reverses |
| **Currency**<br>('E' = European Economic Area) | EM<br>A$<br>¥<br>Short -2 -1 0 +1 +2 Long<br>€ £<br>$ | ▪ Dollar has been supported by US growth exceptionalism and depricing of the Fed while the ECB looks set to embark on a cutting cycle.<br>▪ Dollar likely to continue to be supported into year end, where a Trump presidency looks most likely, and with it a return to tariffs and America First policy. | ▪ Central banks need to keep rates at terminal for much longer than market prices, to the detriment of risk and growth and to the benefit of the Dollar |
| **Emerging Markets Local (rates (R) and currency (C) )** | R<br>Under-weight -2 -1 0 +1 +2 Over-weight<br>C | ▪ Disinflation under threat but intact; EM central banks still in easing mode.<br>▪ Real yields remain high.<br>▪ Selected curves continue to hold attractive risk premium. | ▪ Global carry trade unwinds intensify, hurting EMFX performance.<br>▪ Stubborn services inflation aborts EM easing cycles.<br>▪ Uptick in volatility.<br>▪ Disorderly macro slowdown boosts USD on flight-to-safety fears |
| **Emerging Markets Sovereign Credit (USD denominated)** | Under-weight -2 -1 0 +1 +2 Over-weight | ▪ Index spreads rallied following the US election, despite Trump's protectionist platform.<br>▪ The Group remains conservatively positioned and disciplined regarding valuations, reducing exposure where risk premium has compressed materially.<br>▪ Tailwinds: China stimulus, stronger growth outlook, disinflation, IMF programs.<br>▪ Headwinds: US trade policy & USD strength, Middle East tensions, higher debt to GDP ratios, wider fiscal deficits, slow restructurings. | ▪ Global election calendar (US, LATAM)<br>▪ Weak action from Chinese govt, no additional support for property and commercial sectors<br>▪ China/US relations deteriorate.<br>▪ Spill over from Russian invasion and Israel-Hamas war: local inflation (esp. food & commodity), slow global growth.<br>▪ Potential for the start of a new war in the conflict between Israel and Iran. |
| **Investment Grade Credit** | Under-weight -2 -1 0 +1 +2 Over-weight | ▪ Spreads are at the tightest levels since 1998. Current valuations limit spread compression upside and provide little compensation for taking additional risk.<br>▪ The group is keeping an eye on post-election industry differentiation.<br>▪ 2024 earnings have been above expectations. Results and commentary from issuers do not indicate fundamental deterioration.<br>▪ IG analysts expect strong fundamentals and decade-low leverage for 2024 / 2025. | ▪ Tighter financial conditions lead to European slowdown, corporate impact.<br>▪ Lending standards continue tightening, even after Fed pauses hiking cycle.<br>▪ Rate environment remains volatile.<br>▪ Consumer profile deteriorates.<br>▪ Geopolitical conflicts worsen operating environment globally. |
| **High Yield Bonds and Bank Loans** | Under-weight -2 -1 0 +1 +2 Over-weight | ▪ The group has downgraded High Yield because the extremely rich valuations are misaligned with a cautious fundamental outlook.<br>▪ Earnings season performed within expectations; however, the group still has a cautious view of fundamentals given management guidance, CTI default forecasts, and the increase in lender-on-lender violence and liability management exercises.<br>▪ Weaker outlook for cyclical industrial and consumer sectors.<br>▪ The Group is conservatively positioned but remains open to attractive high quality relval opportunities. | ▪ Lending standards continue tightening, increasing the cost of funding.<br>▪ Default concerns are revised higher on greater demand destruction, margin pressure and macro risks<br>▪ Rally in distressed credits, leads to relative underperformance<br>▪ Volatility in the short end of the curve, eroding potential upside where we are positioned for carry. |
| **Agency MBS** | Under-weight -2 -1 0 +1 +2 Over-weight | ▪ Spreads have backed up following the election and November FOMC<br>▪ The Group remains positive on Agency MBS because the carry and convexity are still attractive, and prepayment risk is low because of elevated mortgage rates.<br>▪ Prefer call-protected Inverse IO CMOs, a large beneficiary of aggressive cutting cycle. Difficult to increase position sizing as few holders are willing to sell into the current rate environment. | ▪ Lending standards continue tightening even after Fed pauses hiking cycle.<br>▪ Fed fully liquidates position.<br>▪ Market volatility erodes value from carrying.<br>▪ More regional bank turmoil leads to lower coupons to underperform. |
| **Structured Credit Non-Agency MBS & CMBS** | Under-weight -2 -1 0 +1 +2 Over-weight | ▪ Neutral outlook because of decent fundamentals and relval in select high quality issues.<br>▪ RMBS: Spreads near YTD tights. Fundamental metrics, such as delinquencies, prepayments, and foreclosures remain solid overall. Pockets of weakness emerging.<br>▪ CMBS: We are in the early stages of the office deterioration story. Outside of office, floaters and near-term maturities, performance has remained healthy.<br>▪ CLOs: Demand remains high given relative spread to other asset classes; active new issue market. Defaults remain low, but CCC buckets are rising with lower recoveries.<br>▪ ABS: 60+ Day delinquencies are elevated, driven by inflation and credit score drift. Spreads tighter over the past month; the group prefers higher quality, liquid securities. | ▪ Weakness in labour market<br>▪ Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening. Consumer (retail/travel) behaviour fails to return to pre-covid levels<br>▪ Student loan repayments weaken consumer profile more than anticipated, affecting spreads on a secular level.<br>▪ High interest rates turn home prices negative, punishing housing market.<br>▪ Cross sector contagion from CRE weakness. |

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