COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

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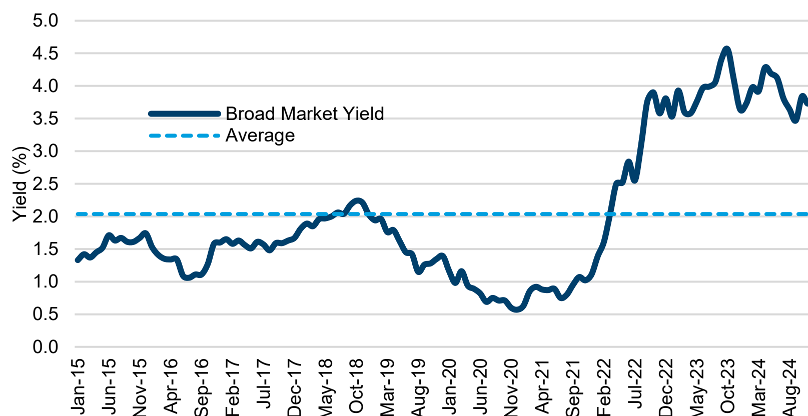
Exit music (for a year)

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.62%	0 bps	-0.1%	-0.1%
German Bund 10 year	2.45%	5 bps	-0.4%	-0.4%
UK Gilt 10 year	4.60%	-3 bps	-0.1%	-0.1%
Japan 10 year	1.14%	1 bps	0.0%	0.0%
Global Investment Grade	88 bps	2 bps	-0.1%	-0.1%
Euro Investment Grade	99 bps	0 bps	-0.2%	-0.2%
US Investment Grade	83 bps	2 bps	-0.1%	-0.1%
UK Investment Grade	80 bps	2 bps	0.0%	0.0%
Asia Investment Grade	118 bps	1 bps	0.0%	0.0%
Euro High Yield	318 bps	-2 bps	0.1%	0.1%
US High Yield	281 bps	-3 bps	0.3%	0.3%
Asia High Yield	524 bps	-1 bps	0.3%	0.3%
EM Sovereign	298 bps	1 bps	0.2%	0.2%
EM Local	6.4%	-7 bps	0.0%	0.0%
EM Corporate	239 bps	2 bps	0.1%	0.1%
Bloomberg Barclays US Munis	3.7%	-8 bps	0.3%	0.3%
Taxable Munis	5.2%	-2 bps	-0.2%	-0.2%
Bloomberg Barclays US MBS	43 bps	1 bps	-0.2%	-0.2%
Bloomberg Commodity Index	240.38	0.4%	-0.2%	-0.2%
EUR	1.0364	-1.1%	-0.4%	-0.4%
JPY	157.18	0.4%	0.0%	0.0%
GBP	1.2484	-1.2%	-0.7%	-0.7%

Source: Bloomberg, ICE Indices, as of 3 January 2024. *QTD denotes returns from 31 December 2024

Chart of the week: Broad market yield remains historically high



Source: Bloomberg, as of 6 January 2025

Macro/government bonds

December and Q4 2024 were negative periods for fixed income instruments with global government bonds returning -0.7% and -0.8% in US dollar hedged terms. In contrast, the return for 2024 as a whole for global government bonds was 2.98% in US dollar hedged terms.

Recent negative performance for global government bonds reflected a more uncertain outlook for fixed income instruments, as market focus increasingly turned from monetary policy to fiscal policy. The US Federal Reserve and the European Central Bank delivered quarter-point interest rate cuts during December. The message from the Fed was that they had entered a new monetary policy phase, which would see them adopt a more gradual pace of monetary easing. Economic projections from the Fed pointed to resilient growth and a slower disinflationary path. The market also wrestled with the uncertainty of President-elect Trump's proposed policies, which aim to increase tariffs and reduce illegal migration. The combination of a shallower interest rate path, potentially inflationary policies and rising term premia exerted greatest upward pressure on longer-dated bond yields, resulting in a steepening of the US yield curve. Price action in the US bond market set the template for bond markets globally.

The ECB, like the Fed, also delivered a less dovish message, as bank president, Christine Lagarde, pointed to elevated services inflation. The other factor influencing the direction of eurozone bond yields is political. Germany's coalition collapsed with elections scheduled for February, while French prime minister, Michel Barnier, lost his post over a contentious budget. The pricing in of greater risk premia to these markets led to the outperformance of peripheral eurozone markets, such as Spain and Italy.

Investment grade credit

As we start 2025 it looks like a year where the yield of the credit market will offer much more appeal than the spread to investors. Looking at the Global market, the index yield ended last week at 4.74%, which is 50bps higher than in September and comfortably above the long-term average of 4% (since 1996), according to data from ICE Indices. This has, of course, been led by higher underlying government bond yields.

The story for spreads is certainly less appealing. The Global Index ended 2024 with a spread of 88bps over government bond yields and was flat over the holiday period. The range last year was from 84bps-120bps with a long-run average of 127bps. Last year, spreads were significantly tighter in all major markets. Valuations tightened the most in euros and GBP (35bps versus 22bps for US dollar credit). On a percentage basis, GBP credit contracted by around 30% with euros 26% and the US dollar market 'only' 21% more expensive.

Industry sector-wise, real estate, banks and insurers outperformed with autos, media and healthcare lagging – albeit all sector spreads were tighter.

The focus this week will be the primary market where the first couple of weeks of the year tend to be some of the year's busiest. Our estimates are for similar net issuance to last year against a backdrop of ongoing strong investor demand.

High yield credit & leveraged loans

European high yield finished 2024 with a solid December performance, returning +0.6% and resulting in a Q4 performance of +1.7% and a year-to-date of +8.7%. This was the second-best quarter for the year. Credit spreads in December tightened around 19bps to 325bps, while the yield was unchanged at 6.18%. Single Bs were the outperformers for the month, returning 0.92% as spreads tightened 29 bps. The bifurcation between CCCs on one side and BB and Bs on the other side continued, with CCCs the only European HY rating bucket to experience not only a widening of credit spreads but also to have negative returns for the month (-0.55%) as well as the quarter (-0.9%). Despite this, for euro currency HY on a year-to-date basis CCCs returned 9.3%, outperforming BBs and Bs, which each returned 8.4% for 2024. The first couple

of days of 2025 showed further spread tightening of 7bps to 318bps, with yields also falling lower (-3bps to 6.15%).

Flows to the asset class turned negative in December after year-to-date net inflows peaked at €13.1 billion by the end of November. The December outflow of €166 million was specifically via ETFs with managed accounts still experiencing inflows into the year-end. This resulted in net inflows of €12.5 billion for 2024. The primary market petered out before the Christmas holidays, with December showing only €1.8 billion and resulting in a 2024 gross issuance of €118 billion and a net issuance of €28 billion. It was a very strong comeback after the poor numbers of 2022 and 2023 with a majority of months showing issuance greater than their five-year average.

In credit rating news, the S&P cut debt collector service Lowell (Garfunkelux) to a CC with a negative outlook. This came on the back of the company's proposal to exchange the existing senior secured notes for new bonds with a three-year maturity extension. There will also be a new issue that has a payment-in-kind (PIK) coupon. The rating agency said this would be considered tantamount to default once executed.

In the real estate sector, S&P downgraded the Heimstaden AB EUR perpetual hybrid securities to D from CC on the company’s announcement that they would defer interest payments on EUR perpetual hybrid securities until further notice in order to improve its credit profile. In telecoms, the beleaguered Eutelsat was downgraded by S&P to B- from B on concerns of an increasingly tougher market environment. On a brighter note, Italian payment services company Nexi became a rising star as it was upgraded to IG by Fitch (BBB-). S&P and Moody’s still have it rated as BB+ and Ba1 respectively.

Some M&A activity was still happening into the last days of the year as UK gaming company Allwyn Entertainment bought a 51% stake in sports betting company Logflex for €217 million with a promise of as much as €110 million in future performance-based payouts. In the real estate sector, Miller Home announced the acquisition of St Modwen Homes for £215 million.

Total returns in US high yield bonds were solid amid low volumes during the short holiday week. The ICE BofA US HY CP Constrained Index returned 0.44%, while spreads were 4bps tighter ending at 296bps. According to Lipper, US high yield bond retail funds saw a fourth consecutive weekly outflow, with $95 million withdrawn. Year-to-date retail fund inflows for the asset class totalled $16.4 billion. The US HY market returned 8.04% for 2024.

In leveraged loans, the average price of the S&P UBS Leveraged Loan Index was stable at $96.5 over the week. Retail loan funds saw $137 million contributed, reversing the prior week’s outflow. Year-to-date fund net inflows totalled $21.1 billion. US leveraged loans again outperformed other fixed income, returning 9.05% for 2024.

Structured credit

Overall it was a slow week in structured credit last week. There was very little activity and no new deals given the holiday schedule. The US Agency Mortgage-backed Securities sector posted a small positive return of 18bps. Spreads were relatively unchanged and remained wide of five- and 10-year averages. There were a few economic releases such as Pending Home Sales for November, which clocked in at its highest level since February 2023 at +2.2%. Home prices continued to rise with the Federal Housing Finance Agency reporting a 0.4% increase, or 4.5% year-on-year, as of October. The same trend was noted by S&P Core Logic with only two cities reporting declines: Tampa and Cleveland.

Asian credit

In December 2024, the JACI delivered negative returns of -0.8% due to weakness in both IG (-0.84%) and HY (-0.58%). On a FY24 basis the index rose 5.7% with an outperformance in HY of 15.2% compared with 4.2% for IG.

In China, the attributable sales for the top 100 property developers in December rose to CNY367 billion (+27.3% month-on-month and +0.4% year-on-year), marking the second positive month in 2024. The SOEs (state-backed developers) continued to outperform the market in December sales, notably China Overseas Land (+76% year-on-year) and China Resources Land (+52% year-on-year). However, on a FY24 basis attributable sales for the top 100 property developers dropped 27% year-on-year to CNY3,082 billion, given poor sales performance during through the year before the property stimulus measures were announced.

On the monetary policy front, the statement from the People's Bank of China, following December's Monetary Policy Committee meeting, was consistent with recent comments about shifting towards a moderately accommodative monetary stance. The PBOC maintains its pledge to lower interest rates and reserve requirement ratios for banks at an appropriate time in order to support growth. The PBOC also called for the maintenance of ample liquidity in the financial system and the extension of credit.

In India, GMR Hyderabad initiated a consent solicitation process to amend some language on restricted payments for its 2026 and 2027 bonds. The company is looking to get some flexibility to optimise its cash usage, which could include dividend payments.

The primary market is becoming active with several issuers coming to the market this week: India EXIM, Korea KEXIM, CLP HK, China Hongqiao, and potentially Vinhomes, a debut issuer from Vietnam.

Emerging markets

Emerging markets spreads tightened 9bps over the week. In December, the EMBIG Div returned -1.40% in US dollar terms and spreads tightened by 11bps. EM local returned -1.93% in US dollars and spreads widened by 10bps due to an overall high yield environment and a stronger US dollar. Key new issues this week will come from India's Exim Bank and Saudi Arabia.

EM sovereign credits ended 2024 at multi-year tights, with EM hard currency sovereign spreads tightening by more than 50bps, from 384bps in 2023 to 325bps in 2024, during the year. Total returns were 6.54%. This was despite US Treasury rate volatility, EM growth concerns, high gross issuance, and geopolitical risk.

EM corporates delivered a solid performance in 2024 with CEMBI year-to-date returns of 7.63% being meaningfully above US IG credit (2.13%) with less volatility. EM corporate credit ratings turned net positive in 2024 and sovereign credit ratings continued their trend of upgrades with a positive ratio of upgrades to downgrades in 2024. The fall in energy prices was an important tailwind for China and India, the largest EM economies. China was also supported by government initiatives aimed at supporting the construction sector and wider domestic demand.

The progress made in controlling inflation should continue to improve EM credit quality for both sovereigns and corporates. However, the scope for EM central banks to cut rates will be limited if the US dollar continues to strengthen. The team expects EM growth to remain stable in 2025, but the market faces the challenge of navigating the politics and economics between China and the US. The policies of the incoming US administration could slow down global trade flows across EM, with China and Mexico particularly at risk if we see aggressive US tariffs.

Responsible investments

It was a solid year for the ESG bond market, with the second-largest level of new issuance in history at just over $1 trillion. Green bonds made up most of the total, although social and sustainability bonds made up a larger portion than they respectively did in prior years.

According to research from Barclays, bonds issued in euros increased the most versus other core markets within Corporate issuers. Barclays also noted an increase in the number of debut issuers in more mature regions of the market, such as European-based companies.

In other news, the UK took the top spot from Germany for most electric vehicle (EV) sales in Europe, according to data from the KBA regulator. This was primarily driven by the UK's EV sales mandate, whereby car makers can face a fine of up to £15,000 per vehicle for failing to meet set targets, and the removal in Germany of EV purchase incentives back in 2023 that has subsequently reduced demand.

Fixed Income Asset Allocation Views

6th January 2025

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 dramatically fallen since early November and fundamentals remain stable. ▪ **The group remains negative on credit risk overall, with no changes to underlying sector outlooks.** ▪ 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. ▪ 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 ▪ 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) ('P' = Periphery)	¥ £ $ Short -2 -1 0 +1 +2 Long P €	▪ Longer yields to be captured by long-run structural downtrends in real yields ▪ Inflation likely to normalize over medium term, although some areas will see persistent pricing pressures	▪ Inflationary dynamics become structurally persistent ▪ Labour supply shortage persists; wage pressure becomes broad and sustained ▪ Fiscal expansion requires wider term premium ▪ Long run trend in safe asset demand reverses
Currency ('E' = European Economic Area)	EM A$ ¥ Short -2 -1 0 +1 +2 Long € £ $	▪ Dollar has been supported by US growth exceptionalism and depricing of the Fed while the ECB looks set to embark on a cutting cycle. ▪ 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 Under-weight -2 -1 0 +1 +2 Over-weight C	▪ Disinflation under threat but intact; EM central banks still in easing mode. ▪ Real yields remain high. ▪ Selected curves continue to hold attractive risk premium.	▪ Global carry trade unwinds intensify, hurting EMFX performance. ▪ Stubborn services inflation aborts EM easing cycles. ▪ Uptick in volatility. ▪ 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. ▪ The Group remains conservatively positioned and disciplined regarding valuations. ▪ Tailwinds: China stimulus, stronger growth outlook, disinflation, IMF programs. ▪ Headwinds: US trade policy & USD strength, Middle East tensions, higher debt to GDP ratios, wider fiscal deficits, slow restructurings.	▪ Global election calendar (US, LATAM) ▪ Weak action from Chinese govt, no additional support for property and commercial sectors ▪ China/US relations deteriorate. ▪ Spill over from Russian invasion and Israel-Hamas war: local inflation (esp. food & commodity), slow global growth. ▪ 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. ▪ 2024 earnings have been above expectations. Results and commentary from issuers do not indicate fundamental deterioration. ▪ IG analysts expect strong fundamentals and decade-low leverage for 2024 / 2025. ▪ The Group is keeping an eye on post-election industry differentiation.	▪ Tighter financial conditions lead to European slowdown, corporate impact. ▪ Lending standards continue tightening, even after Fed pauses hiking cycle. ▪ Rate environment remains volatile. ▪ Consumer profile deteriorates. ▪ Geopolitical conflicts worsen operating environment globally.
High Yield Bonds and Bank Loans	Under-weight -2 -1 0 +1 +2 Over-weight	▪ The current rich valuations are misaligned with a cautious fundamental outlook. ▪ 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. ▪ Weaker outlook for cyclical industrial and consumer sectors. ▪ The Group is conservatively positioned but remains open to attractive high quality relval opportunities, particularly sectors experiencing near-term volatility.	▪ Lending standards continue tightening, increasing the cost of funding. ▪ Default concerns are revised higher on greater demand destruction, margin pressure and macro risks ▪ Rally in distressed credits, leads to relative underperformance ▪ 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	▪ Strong performance in November as volatility fell and broader risk assets rallied. ▪ 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. Valuations are still cheap relative to longer term averages. ▪ 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. ▪ Fed fully liquidates position. ▪ Market volatility erodes value from carrying. ▪ 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. ▪ RMBS: Spreads near YTD tights. Fundamental metrics, such as delinquencies, prepayments, and foreclosures remain solid overall. Pockets of weakness emerging. ▪ CMBS: Stress continues, particularly in office, floaters, and near-term maturities. SASB delinquencies are rising and there are pockets of opportunity in Single Family Rental. ▪ 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. ▪ 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 ▪ Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening. Consumer (retail/travel) behaviour fails to return to pre-covid levels ▪ Student loan repayments weaken consumer profile more than anticipated, affecting spreads on a secular level. ▪ High interest rates turn home prices negative, punishing housing market. ▪ Cross sector contagion from CRE weakness.

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