In Credit

9 December 2024

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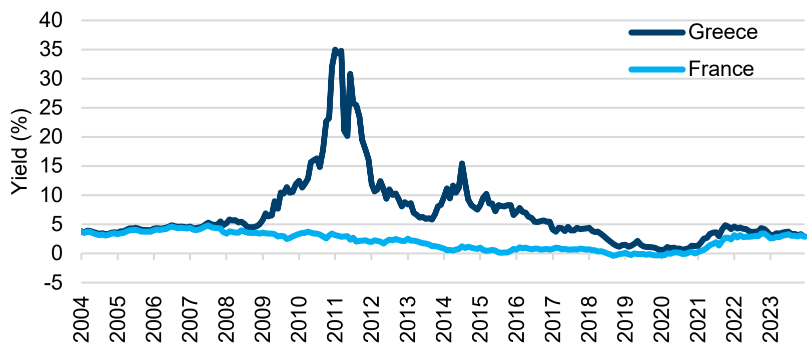
Égalité restored?

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.18%	1 bps	-1.3%	2.6%
German Bund 10 year	2.10%	1 bps	0.9%	2.0%
UK Gilt 10 year	4.25%	1 bps	-1.4%	-1.9%
Japan 10 year	1.05%	0 bps	-1.2%	-3.0%
Global Investment Grade	87 bps	-2 bps	0.1%	5.2%
Euro Investment Grade	99 bps	-7 bps	1.5%	5.4%
US Investment Grade	81 bps	-1 bps	-0.6%	5.1%
UK Investment Grade	84 bps	-3 bps	0.2%	2.4%
Asia Investment Grade	124 bps	4 bps	-0.3%	6.3%
Euro High Yield	320 bps	-36 bps	1.6%	8.6%
US High Yield	267 bps	-5 bps	1.0%	9.2%
Asia High Yield	520 bps	1 bps	0.2%	14.7%
EM Sovereign	300 bps	-4 bps	0.0%	8.1%
EM Local	6.3%	3 bps	-5.1%	-0.4%
EM Corporate	250 bps	0 bps	0.0%	8.6%
Bloomberg Barclays US Munis	3.4%	-5 bps	0.6%	2.9%
Taxable Munis	4.9%	-5 bps	-0.8%	3.9%
Bloomberg Barclays US MBS	39 bps	-2 bps	-1.0%	3.5%
Bloomberg Commodity Index	237.87	-0.6%	-2.0%	3.7%
EUR	1.0575	-0.1%	-5.1%	-4.3%
JPY	150.90	-0.1%	-4.2%	-6.0%
GBP	1.2783	0.1%	-4.7%	0.1%

Source: Bloomberg, ICE Indices, as of 6 December 2024. *QTD denotes returns from 30 September 2024.

Chart of the week: Greek versus France government bond yields, 2004-24



Source: Bloomberg, as at 9 December 2024.

Macro/government bonds

The weekend was full of news. Syrian president Bashar al-Assad's reign collapsed as rebel forces ousted him. With Russia and Iran (historic backers of the Assad government) distracted by other conflicts, the rebel forces seized their opportunity. The situation doesn't seem to be moving global bond yields at the moment (Crude oil prices rose by 0.4% overnight) but has longer-term implications for the geopolitical hotspots in the world.

In South Korea, opposition lawmakers indicated on Saturday that they would push for another impeachment vote on President Yoon after the first one failed.

The previous week ended with a mixed US jobs report for November. The headline gain for non-farm payrolls was +227,000 versus a 220,000 consensus expectation. However, the unemployment rate ticked up to 4.246% (versus an expected 4.1%). The probability of a December rate cut moved to 85% from 70% on Friday, which proved supportive for US Treasuries. The two-year Treasury yield fell by -4.7bps last week to 4.104%. Meanwhile, the 10-year yield fell by -1.6bps.

There was political turmoil in France as the government lost a vote of no confidence. However, while the France-Germany 10-year spread initially hit its widest since 2012 last Monday, it then continued to fall over the rest of the week to close at 77bps. Interestingly, French and Greek government bond yields are almost exactly the same now (see **Chart of the Week**).

In China, consumer price inflation cooled to +0.2% year-on-year in November (versus an expected +0.4%) – the lowest in five months and down from a +0.3% increase in October. The grind lower in prices continues to lead bond yields down in their wake.

Investment grade credit

Investment grade markets made advances in terms of spreads last week, as yield buyers and low levels of issuance supported the market into the year end.

The euro market outperformed last week (-7bps) led by gains from French issuers and the auto sector, which has been one of the weaker sectors year-to-date. Industrials also performed well, while healthcare and technology lagged the rally. Year-to-date, euro-denominated IG spreads are 27% tighter while US dollar bonds are trailing by 5% in terms of spread change. Shorter-dated bonds outperformed in spread terms in both markets as credit curves steepened. Globally, all industry sectors have seen spread tightening, with real estate and financials (banks and insurance) the clear winners.

Another notable feature of the market has been M&A activity and speculation. This included Credit Agricole increasing its stake in Italian bank Banco BPM. Meanwhile, there were press reports of a tie up between the world's third and fourth largest advertising businesses, Omnicom and Interpublic, which would create the largest agency globally. In the UK there were reports of bidding for troubled water company Thames, which saw bonds rally last week.

High yield credit & leveraged loans

US high yield bond valuations tightened amid lower US Treasury rates and Federal Reserve rhetoric indicating the Federal Open Market Committee is likely on track to deliver a 25bps cut at the upcoming meeting. The ICE BofA US HY CP Constrained Index returned 0.48%, while spreads were 4bps tighter ending at +289bps. The index yield to worst declined 0.15% to 6.99%. According to Lipper, US high yield bond retail funds saw a $429 million inflow for the week, bringing year-to-date inflows to $20.1 billion. In leveraged loans, the average price of the Credit Suisse Leveraged Loan Index increased slightly to $96.5, a three-month high, as the asset class saw continued inflows. Retail loan funds saw $776 billion contributed for an eleventh consecutive weekly inflow, increasing year-to-date net inflows to $18.4 billion.

European HY had a strong start to the last month of the year, as the week returned 0.51% with spreads contracting 22bps to 320bps, while yields fell 12bps to 6.06%. It was another week of strong inflows with €544 million coming into the sub asset class via both ETFs and managed accounts, though the latter outstripped the former by three times. The primary market was a little subdued but still solid with €1.9 billion of new corporate credit bonds, including a new issuer in the universe, Asmodee, the French board game company behind Exploding Kittens.

In credit rating news, Aramark was upgraded by Moodys to to Ba2 from Ba3 on credit metric improvements expectations.

In shedding assets news, ELO (Auchan) confirmed that local operatory Indotek is taking a 47% in Auchan Hungary. Similarly, there was action in telcos with Iliad announcing the sale of 50% of its stake in data center business OpCore to Infravia for €860 million. At the same time, the French wireless operatory announced plans to invest €2.5 billion over the next 10 years to expand the business in Europe via M&A.

In other M&A news, debt collector Arrow announced it would take over French debt collector iQera in a restructuring deal. In utilities, infrastructure investor Covalis submitted a bid of £5 billion for full Thames Water ownership. This would include £1 billion up front and raising the other £4 billion via asset sales, refinancing and the listing. Covalis also said that French water management company Suez would join as an operating partner.

Finally, in sector news there was a much improved general picture for real estate. There is a stronger tone across the sector, even in the case of universities. AI is supporting a strong demand for data centers with shopping malls also being viewed more positively.

Asian credit

The weekly outflow in emerging market bond funds eased to US$750 million, following a $2.7 billion outflow in the previous week, largely due to the slower outflow in hard currency funds.

The Central Work Economic Conference (CEWC) in China will be held on 11-12 December. The conference, which will be chaired by President Xi, is closely watched for broad policy guidance and economic priorities for the year ahead. However, the specific numerical targets will likely be disclosed only before the annual spring National People’s Congress (NPC) in March 2025.

The US has increased restrictions on China’s access to semiconductor manufacturing tools and AI memory chips, notably high-bandwidth memory chips (HBMs). The Bureau of Industry and Security (BIS) placed new controls on 24 types of semiconductor manufacturing equipment and three types of software tools. BIS also announced controls on HBMs and made 140 Entity List additions to restrict China’s ability in producing advanced semiconductors for military applications.

In South Korea, President Yoon Suk Yeol declared martial law, which caught the country by surprise. The declaration was criticised by the president’s own ruling party, the PPP or People Power Party. While the martial law was short lived, it triggered a period of elevated political uncertainty in the country. The opposition Democratic Party of Korea (DPK) brought an impeachment motion over the weekend, but the National Assembly was unable to gather enough votes due to the walkout by PPP legislators. PPP is not supportive of impeaching the president at the moment, but there is immense pressure within the party for the president to resign. If he steps down, a presidential election must be held within 60 days, during which the prime minister will assume the role of acting president.

Emerging markets

Emerging market spreads remained resilient this week, despite heavy news flow. EM bond spreads ended the week at 300bps over US Treasuries, 5bps tighter than the week prior, and returned 0.76% in USD. EM local returned 21bps, mostly from carry and duration.

The Reserve Bank of India held its final monetary policy meeting of the year and left benchmark interest rates unchanged. GDP growth expectations for FY25 were lowered to 6.6% from 7.2%, while inflation projections increased to 4.8% from 4.5%. This is on the back of a slowdown in India's real GDP growth and projections that food inflation in Q3 next year will be high.

In a period of just six hours, South Korean president, Yoon Suk Yeol, declared then revoked martial law on Tuesday night, igniting a political crisis and narrowly avoiding impeachment over the weekend. The Korean won was down 2% against the dollar, the worst performer in Asia last week. Heightened political tension compounded concerns about US-South Korea ties should US president-elect Trump turn his focus from China to Korea.

China's benchmark bonds have dipped below 2% – a 22-year low – on bets that the PBOC will ease monetary policy further. Following stimulus deployment in late September, China's recovery appears to be off to a slow start. Recent data on the property market showed that year-on-year sales growth is still negative. Investors are watching for annual targets from China's annual economic planning meeting, which will take place later this week.

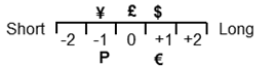
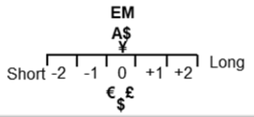
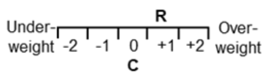
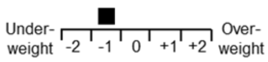
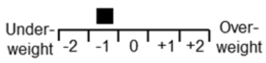
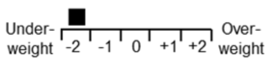
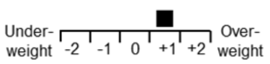
Colombian finance chief Ricardo Bonilla resigned on Wednesday amid corruption allegations at a critical stage for the government’s bid to raise taxes. Deputy finance minister, Diego Guevara, has been promoted in his place, causing the Colombian peso to swing between gains and losses as Guevara vowed to curb the fiscal deficit to improve macroeconomic stability.

The overthrowing of the Assad regime in Syria raises more uncertainty over the long-term stability of the Middle East, with oil prices rising 0.4% in response – although gains were capped due to a weak demand outlook. Saudi Aramco notified Asian customers that it was reducing prices for sales to the region to its lowest level since 2021 on Sunday evening.

Key new issues were Mexico, Poland and Sri Lanka. The trend of positive credit ratings for EM continues, with S&P affirming Estonia with an A rating.

Fixed Income Asset Allocation Views

9th December 2024

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk		▪ Post-election enthusiasm has moved spreads to generational tights. Volatility has decreased since October and fundamentals remain stable. ▪ **The group remains negative on credit risk overall and downgraded High Yield Corporates to the most negative outlook due to rich valuations.** ▪ 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)		▪ 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)		▪ 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))		▪ 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)		▪ Index spreads rallied following the US election, despite Trump's protectionist platform. ▪ The Group remains conservatively positioned and disciplined regarding valuations, reducing exposure where risk premium has compressed materially. ▪ 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		▪ Spreads are at the tightest levels since 1998. Current valuations limit spread compression upside and provide little compensation for taking additional risk. ▪ The group is keeping an eye on post-election industry differentiation. ▪ 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.	▪ 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		▪ The group has downgraded High Yield because the extremely 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.	▪ 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		▪ Spreads have backed up following the election and November FOMC ▪ 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. ▪ 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		▪ 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: We are in the early stages of the office deterioration story. Outside of office, floaters and near-term maturities, performance has remained healthy. ▪ 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.