

In Credit

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Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	3.65%	-6 bps	5.5%	4.6%
German Bund 10 year	2.15%	-2 bps	3.0%	0.8%
UK Gilt 10 year	3.77%	-11 bps	4.4%	1.3%
Japan 10 year	0.85%	-1 bps	1.6%	-1.7%
Global Investment Grade	105 bps	0 bps	4.7%	5.0%
Euro Investment Grade	118 bps	2 bps	2.6%	3.2%
US Investment Grade	99 bps	0 bps	5.8%	5.9%
UK Investment Grade	101 bps	2 bps	3.2%	3.1%
Asia Investment Grade	160 bps	-1 bps	3.8%	6.4%
Euro High Yield	376 bps	0 bps	2.6%	5.9%
US High Yield	337 bps	-2 bps	4.3%	7.0%
Asia High Yield	573 bps	12 bps	1.8%	11.7%
EM Sovereign	344 bps	-4 bps	5.4%	7.3%
EM Local	6.1%	-5 bps	7.1%	3.1%
EM Corporate	285 bps	3 bps	3.8%	7.8%
Bloomberg Barclays US Munis	3.3%	-2 bps	2.4%	2.0%
Taxable Munis	4.5%	-5 bps	6.9%	5.6%
Bloomberg Barclays US MBS	38 bps	-3 bps	6.2%	5.2%
Bloomberg Commodity Index	229.72	2.7%	-3.7%	1.2%
EUR	1.1126	-0.1%	3.4%	0.3%
JPY	140.11	1.0%	14.2%	0.1%
GBP	1.3201	0.0%	3.8%	3.1%

Source: Bloomberg, ICE Indices, as of 13 September 2024. *QTD denotes returns from 30 June 2024.

Chart of the week – The decline of 10-year US real yields – LTM



Source: Bloomberg, as of 16 September 2024.

Macro / government bonds

The big debate in the US Treasury market last week was how great the magnitude of the first rate cut would be: 25bps or 50bps. Yields on 10-year US Treasuries drifted lower over the week; the US 10-year yield fell 6bps to 3.65%, while pricing in the swaps market reflected an increased probability of a 50bps cut at the September FOMC meeting, edging higher from 27% to 35%. There were no killer economic data points, however, which could provide a definitive answer to the question as to how much the US Fed might cut by.

Out of the US, we had consumer price and producer price data. While headline CPI for August came in line with market expectations at 0.2%, core CPI rose 0.3%. Driving the upside surprise in core CPI were higher shelter costs, which saw their biggest rise in the last seven months, as well as volatile hotel and airfare prices. A similar trend was seen in producer price data for the month of August. Producer price final demand data came in at 0.2%, while core PPI rose 0.3%, which could largely be explained by strength in the services sector. The previous month's core PPI data was revised down from zero to -0.2%. While CPI and PPI data are used to create the Core PCE data series, which is the Fed's favoured inflation gauge, it can be difficult to estimate with certainty what the final number will be. Currently, the market is currently coalescing around 0.2%. We also had initial and continuing claims data. Both data series fell in line with market expectations and did not move the dial in terms of market directionality.

We also heard from the European Central Bank (ECB), which drew no surprises when it cut the interest rate on its deposit facility from 3.75% to 3.5%. The ECB published new inflation and growth projections, as part of its quarterly macroeconomic projections. Real GDP growth outlook edged lower by 0.1% in the years from 2023 to 2026, while the ECB left its inflation outlook broadly unchanged over the same period. Christine Lagarde (ECB President) made the following points at the accompanying press conference. First, that interest rates were on a declining, but not a predetermined path. Second, that disinflation was providing scope to moderate monetary policy restriction, although lingering concerns remained about the elevated level of inflation in the services sector. Third, the ECB was in data dependent mode and not data point dependency mode. Finally, in terms of the balance of risks, growth remained tilted to the downside, and inflation tilted to the upside. The day after the rate decision, Lagarde admitted that there could be an interest rate cut in October if there was a significant downshift in economic activity in the eurozone. Pricing in the swaps market put the balance of odds on a quarter point rate cut for December. The September rate cut had little impact on eurozone bond pricing, rather it was the continuing tussle in the US Treasury market between adherents of the 25bps cut or the 50bps cut, which drove market price action.

In the UK, we had real GDP data for July, which showed no growth on the previous month. Services output grew by 0.1% in July, which was offset by a 0.1% fall in production. In addition, manufacturing production declined 0.1% in July. At the margin, this increased the probability of a quarter point rate cut in November, alongside a further quarter point rate cut in December. This helped the UK to outperform other core markets on the week, with the 10-year UK Gilt falling 12bps to 3.78%. Like the ECB, the Bank of England has been keen to promote a cautious approach to easing monetary policy, as it balances a slowing growth outlook with still observable pricing pressures in the services sector.

Investment grade credit

Credit spreads were little moved last week. Global IG spreads remain at 105bps according to data from ICE indices.

The market has had to digest a significant amount of issuance as companies seem keen to issue / refinance ahead of the US election.

Falling interest rates in Europe last week and expected falling rates in the US this week are supportive for the market – but already discounted.

The auto sector continues to struggle with BMW, for example, pointing to weaker demand from China as one reason to reduce its margin expectations. So while Global IG spreads are around 8% tighter in 2024, auto spreads are unchanged joining media and healthcare as underperformers. On the positive side, real estate, banking and insurance are the best performing sectors globally this year by some margin. Real estate as a sector traded with a spread of around 285bps in late 2022 before embarking on a significant tightening to a level of 126bps at the end of last week.

High yield credit & leveraged loans

US high yield bond total returns were again positive and primarily driven by lower interest rates with an assist from continued retail fund inflows. The primary market reopened in force with the largest week of new issuance since May with \$11.4bn issued. The ICE BofA US HY CP Constrained Index returned 0.42% and spreads were unchanged. The index yield-to-worst declined to 7.19%, remaining around levels not seen in more than two years. According to Lipper, US high yield bond retail funds saw a \$633m inflow for the week. In floating rates, the average price of the Credit Suisse Leveraged Loan Index increased slightly to \$95.7 in an environment of moderate outflows and a resurgence of new issuance. Retail loan funds saw a seventh consecutive, weekly outflow with a \$230m withdrawal over the week.

European high yield spreads finished unchanged last week (377bps) after a mid-week bout of volatility that resulted in a spread widening up to 390bps before falling back to the level from the start of the week. Yields fell, marginally (-3bps to 6.56%). This resulted in a steady performance of +17bps for the week with CCCs outperforming higher-rated credits. The expected primary market pick-up has started with six new offerings last week amounting to €3.6bn. All were broad BB rated and well received by the market. Flows into the asset class continues though have slowed down compared to previous weeks. This is largely due to ETF sales as managed accounts still are seeing strong inflows which have been only partially offset by the ETF sales.

In credit rating news, Evoke (formerly 888) was downgraded to B- from B by S&P. The rating agency said that a weak H1 had resulted in the corporation taking longer than expected to achieve credit metrics commensurate with a B rating. In other news, Fitch downgraded Canary Wharf Group Investment Holdings plc's (CWHARF) Long-Term Issuer Default Rating (IDR) to B from BB and reduced its senior secured rating to BB- from BB+. All ratings remain on Rating Watch Negative (RWN), which Fitch says reflects "the continuing short-term refinance risk of CWGIH's £350m bonds due April 2025 and prospective cash flow constraints."

In sector news, autos are looking quite weak. Profit warnings from OEMs (VW, BMW, Volvo cars) are contributing to a negative sentiment. The auto sector took a hit in the last couple of weeks on headline negative news (VW closing down a German factory and BMW announcing that earnings will be lower on the back of a slowdown in shipments due to brake issues, etc).

And finally, a resolution for Playtech as it agrees to new terms with Caliply, resolving a legal dispute. The resolution means Playtech will now receive 80% of fees due to the company as well as an agreed process going forward (including a board rep), which will be positive for the growth and liquidity of Playtech.

In M&A news, there were a number of stories in the gaming sector. IGT announced plans to sell its gaming business while retaining the lottery business. Flutterer (BBB-/Ba1) stated it is buying a Brazilian business (NSX Group). The plan is for 56% for \$350m in cash while also injecting funds into its existing Brazilian business. In the leisure sector, PureGym made a bid for US-based Blink Fitness (itself a chapter 11 story). If successful it would acquire 67 gyms of Blink Fitness around NYC and New Jersey for \$105m. PureGym has in the past spoken about potentially expanding into the US, running a couple of trial gyms there to get to know the market.

Asian credit

The August activity data in China reflects the challenges in the domestic demand environment. Retail sales remained below 3% for the third month and FAI spending was weaker than expected with a YTD low of 3.4% y/y. Industrial production in August decelerated to 4.5% y/y (July 2024: +5.1% y/y). Additionally, deflationary risks have increased with the decline in core CPI and PPI. The real estate sector remained depressed. New home sales by area declined 12.6% y/y in August (July: -12.3% y/y) and new home sales by value shrank 16.3% y/y (July: -15.7% y/y).

In Thailand, PTT Global Chemical is taking steps to address its loss-making entities. The company has announced the judicial reorganization of Vencorex France and Vencorex TDI, which will be completed within three-four months. Vencorex produces intermediate petrochemicals that are used for coating applications. In Malaysia, Petrolia Nasional Bhd (Petronas) is maintaining discussion with the Sarawak State Government about the rights to natural gas trading and distribution in Sarawak. The Sarawak State Government has been pushing Petronas to finalize an agreement that will cede control of the oil and gas trading activities to the state by 1 October.

Fixed Income Asset Allocation Views

16th September 2024



Strategy and positioning (relative to risk free rate)	Views	Risks to our views
Overall Fixed Income Spread Risk 	<ul style="list-style-type: none"> Spreads have widened in recent macro volatility but remain on the tighter side of history. Credit fundamentals have remained stable despite rising volatility and early signs of slowing in macro data and issuer expectations. The group remains negative on credit risk overall, despite an upgrade to High Yield Credit to -1. The CTI Global Rates base case view is that the hiking cycle is over, and the start of the cutting cycle is expected to be the next Fed meeting. Uncertainty about the pace remains elevated due to sensitive monetary and fiscal policy schedules and US elections looming closer. 	<ul style="list-style-type: none"> 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) 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> 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) 	<ul style="list-style-type: none"> Dollar has been supported by US growth exceptionalism and deprioring 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. 	<ul style="list-style-type: none"> 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)) 	<ul style="list-style-type: none"> Disinflation under threat but intact, EM central banks still in easing mode. Real yields remain high. Selected curves continue to hold attractive risk premium. 	<ul style="list-style-type: none"> 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) 	<ul style="list-style-type: none"> EMD spreads have also widened this month, following the escalation in potential risk. Especially given the ongoing geopolitical and economic uncertainties. Fundamentals have been downgraded after improvements in distressed areas. Investment Grade spreads are near historical tightness while High Yield still offers idiosyncratic value. Tailwinds: Stronger growth forecasts, Central bank easing, potential China stimulus, IMF program boost for distressed names. Headwinds: higher debt to GDP ratios, wider fiscal deficits, geopolitical and domestic political uncertainty, restructurings slow. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Spreads have widened, especially short and intermediate, but long IG spreads remain near record tight Due to the tight spreads across the board, the compensation for taking on additional risk, in seeking higher yields, seems unattractive. Global portfolios prefer EUR IG over USD on reval basis. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Spreads have widened but stabilised since last month. Spreads are still implying lower defaults than the Columbia Threadneedle research team. Anticipate credit selection will be the performance differentiator in 2024. Looking to avoid defaults/distress, focusing on credit recovery and deleveraging stories. Increased lender on lender violence and aggressive liability management exercises further increase the risk in the distressed and highly leveraged segment. We expect this to accelerate in the coming months. Default forecasts for lower rated issuers, particularly in Europe, is deteriorating with default rates projected to go up. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Spreads are still wide of historic long-term averages. The decline in interest rate volatility since Fed signalled a definite end to the hiking cycle has been a tailwind for MBS. Fed's position on cuts, in relation to the recent CPI prints, is expected to be cautious. Constructive view on fundamentals over longer time horizon. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Neutral outlook because of decent fundamentals and reval in select high quality Non-Agency RMBS, and ABS. RMBS: Spreads remain tight. Delinquency, prepayment, and foreclosure performance remains. CMBS: There is ongoing pressure even on AAA securities. Outside of office and multifamily housing, however, performance has remained healthy. CLOs: Despite heavy new issue, spreads remain tight. Defaults remain low but CCC bucket defaults are rising with lower recoveries. ABS: Spreads tighter MoM, prefer senior positions. Higher quality borrowers have deteriorated somewhat, while lower quality borrowers underperform. Federal student loan payments remain a key uncertainty with continued legal noise. 	<ul style="list-style-type: none"> 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.
Commodities 	<ul style="list-style-type: none"> o/w sugar o/w Zinc o/w Gasoline o/w Distillates o/w Cocoa u/w natural gas u/w corn o/w lead o/w silver o/w soybean meal 	<ul style="list-style-type: none"> Global Recession

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