In Credit

17 February 2025

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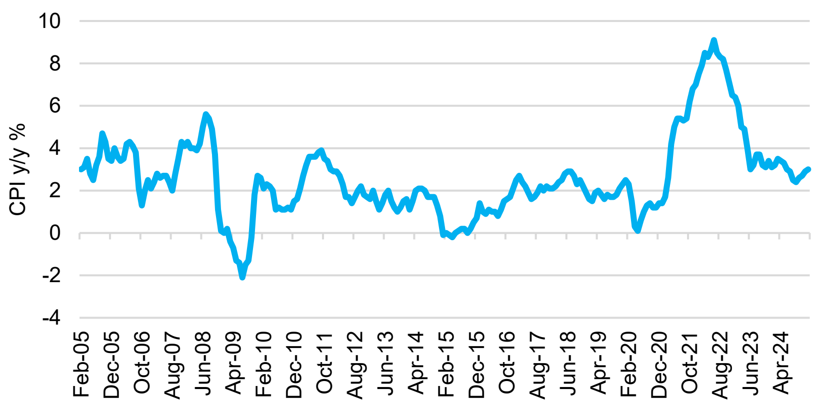
Cheaper by the dozen?

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.48%	-2 bps	1.1%	1.1%
German Bund 10 year	2.50%	12 bps	-0.1%	-0.1%
UK Gilt 10 year	4.56%	8 bps	1.4%	1.4%
Japan 10 year	1.40%	9 bps	-1.3%	-1.3%
Global Investment Grade	83 bps	-3 bps	1.1%	1.1%
Euro Investment Grade	88 bps	-3 bps	0.8%	0.8%
US Investment Grade	80 bps	-4 bps	1.3%	1.3%
UK Investment Grade	77 bps	1 bps	1.5%	1.5%
Asia Investment Grade	113 bps	1 bps	1.0%	1.0%
Euro High Yield	308 bps	-4 bps	1.4%	1.4%
US High Yield	262 bps	-5 bps	1.6%	1.6%
Asia High Yield	533 bps	-10 bps	0.8%	0.8%
EM Sovereign	286 bps	-2 bps	2.0%	2.0%
EM Local	6.3%	2 bps	3.5%	3.5%
EM Corporate	243 bps	-2 bps	1.5%	1.5%
Bloomberg Barclays US Munis	3.7%	5 bps	0.7%	0.7%
Taxable Munis	5.1%	0 bps	1.4%	1.4%
Bloomberg Barclays US MBS	34 bps	-1 bps	1.2%	1.2%
Bloomberg Commodity Index	257.18	1.7%	7.8%	7.8%
EUR	1.0476	1.6%	1.3%	1.3%
JPY	151.83	-0.6%	3.2%	3.2%
GBP	1.2592	1.5%	0.6%	0.6%

Source: Bloomberg, ICE Indices, as of 14 February 2025. *QTD denotes returns from 31 December 2024

Chart of the week: US Consumer Prices Index



Source: Bloomberg, as of 17 February 2025

Macro/government bonds

Price action last week was dominated by inflation data. US CPI rose 0.5% for January, which translated into an annualised figure of 3%. This was far higher than market expectations of 0.3%. The reasons behind the rise were an increase in shelter and food costs. One notable line item was the 15% rise in the price of a dozen eggs, as an Avian flu outbreak affected supplies. These types of price rises matter, as they are what ordinary Americans use to gauge whether their cost of living is rising or falling. The rise in consumer price inflation (see **Chart of the Week**) was the highest since August 2023 and underlined the current rude health of the US economy. The US Treasury market, and by implication global bond markets, reacted predictably with interest rates rising across the curve. Pricing in the swaps market indicates the probability of 1.5 quarter point interest rate cuts by the end of December, as sticky inflation forces the Federal Reserve to adopt a 'higher for longer' approach. In remarks to the House Financial Services Committee, Fed chair Jay Powell pointed to elevated levels of inflation. He also made the point that with the policy rate now significantly less restrictive than it had been, the Fed was not in a hurry to raise interest rates.

Alongside the consumer inflation print, we also had Producer Price Inflation data. PPI rose by 0.4% – again more than the market expected. The immediate market reaction was a bias to higher yields, but in an abrupt turn the market subsequently rallied. A kernel of market positive news could be found among stable price pressures in the healthcare and travel sectors, which suggested that inflation may be less severe than headline PPI predicted. Like the Grand Old Duke of York and his men marching up and down the hill, US Treasury yields that had shot up by circa 10bps on the CPI print, came back down by the same degree on the PPI news. US retail sales also came in lower than expected, exerting further downward pressure on yields.

While the market is more comfortable pricing economic data, it is in a quandary with regard to President Trump's trade policies. Announcements last week covered proposed tariffs on countries with VAT, and an expansion of tariffs on steel and aluminium products due to take effect from 12 March, whose greatest effect will be on China, Canada and Mexico. The question remains: will they be generally inflationary or do they simply represent a form of transactional politics designed to improve the hand of the US in bilateral trade negotiations? For the markets, any evidence of inflation persistence is likely to have three outcomes: first, a steeper yield curve; second, a higher-for-longer interest rate environment; and third, increased volatility in rates markets.

European bond markets took their cue from the US. In the UK, data continued to point to sluggish economic growth. Q4 GDP came in at 0.1%, translating into an annual growth figure of 1.4%. This reflected weak private demand with government the major driver of demand. A leaked forecast from the Office of Budget Responsibility pointed to lower growth for the UK economy. If it bears out it means Chancellor Rachel Reeves – in the absence of higher tax revenues – faces the uncomfortable political choice of either increasing borrowing or cutting wages. From the European Central Bank we heard the familiar themes of progress on inflation and the risk of trade friction.

Investment grade credit

Investment grade credit continued to grind tighter with euro-denominated spreads narrower in percentage terms than their US dollar or GBP counterparts this year.

While dispersion is a key theme globally, in terms of economic expansion and fiscal and monetary policy, corporate spreads are tight no matter which market you look at. Indeed, globally and in the US dollar IG market, valuations are at levels not seen since before the global financial crisis. With so little upside likely from spreads, it suggests caution is warranted and that a more conservative approach to taking credit risk is appropriate.

There are mitigating factors. Firstly, yields remain atttactive for investors seeking income with some degree of safety, so inflows continue to support markets on both sides of the Atlantic.

Likewise, and this is where it gets a bit more ‘geeky’, in Europe part of the reason spreads are so tight to similar maturity government bonds is that, with investors fearing rising deficits, those bonds (bunds and their cousins) have cheapened to swap rates (the market most new corporate issuance is priced over in euros). As such, spreads to swaps are less unattractive than to government bond yields. Lastly, the average duration of IG credit markets has fallen in recent years, in part because of rising bond yields and the convexity effect from 2022, and in part due to a shift in borrowing to shorter dates in 2024 as companies preferred to not ‘lock-in’ high all-in borrowing costs (the flip side of investor demand). This means the spread per unit duration is less unattractive than it might at first appear.

High yield credit & leveraged loans

European HY returned 0.35% last week. Spread tightening continued this week, contracting -4bps to 308bps while yields fell 7bps to 6%. Technicals remain strong given inflows and a still quite light primary market. CCCs were the outperformers returning 1.1% compared to BBs’ 0.21%, with the auto sector outperforming. Managed accounts continue to be the main driver of inflows (€186 million) as ETFs saw modest net outflows. The primary market was very quiet with only a small offering by Rekeep Spa, an Italian management services firm. This was B3/B rated, worth €360 million with a 9% coupon (inside of the 9.5% initial price talk.)

Meanwhile, earnings reporting last week showed companies generally meeting or beating expectations with only a few modest misses.

In ratings news, there is a new ‘fallen angel’ as US chemicals firm Celanese was downgraded by Moody’s to Ba1 from Baa3. This comes on the back of a Dupont acquisition some years ago, which resulted in Celanese having a much bigger auto industry exposure. Moody’s expressed concern given the slowdown in the auto sector and the company’s leverage numbers. Celanese is 5x leveraged (aiming for 3x).

In the telecom sector, United Group announced a sale of €1.5 billion of non-EU assets but suggested that only a small amount of the proceeds (€375 million) would be used to pay down debt with much of the rest used to make a big dividend payout.

European HY spreads are now showing one standard deviation inside the 10-year average, but on a yield basis are still one standard deviation cheap of the 10-year average.

A special note in the US HY space: an X (formerly Twitter) loan placement was well received by the market, with $4.74 billion offered and order books showing demand north of $15 billion. The debt was supported not only by Elon Musk’s ties to the Trump administration, but was also due to the company’s improving finances, including a 40% year-on-year increase in adjusted revenue to $312 million in December.

Asian credit

The JACI posted a small negative return of -2bps for the week, due to wider Treasuries offsetting tighter spread levels. Investment grade delivered negative returns of 14bps, but high yield performed better with a 71bps return underpinned by better spreads.

In China, JD.com announced its plans to enter a food delivery market dominated by Meituan and Ele.me (Alibaba). JD.com will offer a one-year zero commission rate for restaurants that participate before 1 May 2025, with food delivery fulfilled by Dada, which is 63%-owned by JD.com and runs its on-demand delivery business. The entry of JD.com will intensify the competitiveness in the food delivery business. Over the next few quarters, Meituan and Alibaba will likely counter with their respective offering of subsidies and incentives to defend their market shares.

In the China property sector, Vanke will reportedly receive a CNY50 billion funding package that includes a CNY20 billion special local government bond quota for the purchase of idle land and unsold homes, according to Bloomberg.

Axiata Group has launched a consent solicitation related to the proposed merger of Axiata XL (66% owned by Axiata Group) and PT Smartfren Telecom to create a new entity, XLSmart. Through the consent solicitation the company is seeking a waiver of the condition regarding the cessation of business by a principal subsidiary because PT Smartfren Telecom will be the new entity.

Emerging markets

Emerging markets remain steady as geopolitical events, inflation and tariff news continue to be in focus. Sovereign spreads ended the week almost 1bp tighter, returning 0.23% for the week in US dollar terms. EM Local returned 0.28% in US dollar terms, of which 0.77% came from FX. This offset the negative price action triggered by last week's US CPI data.

Other key news last week involved US president Trump and Russian president Vladimir Putin. According to one of Trump's posts on X, the two had a 'highly productive' phone conversation and decided to begin negotiations to 'immediately' end the war with Ukraine. US and Russian officials are due to hold talks this week in Saudi Arabia. On this news, Ukraine's 2034 dollar bonds jumped 4% to 62.5 – their highest value since they were issued in 2024. After pushing back on being omitted from discussions, Ukrainian president Volodymyr Zelenskyy is now set to join them.

Ecuador's dollar bonds slumped as first-round presidential elections produced a tighter-than-expected result. Investors had previously priced in a clear victory for market-friendly president Daniel Noboa. However, the emergence of populist challenger Luisa González meant Noboa led the vote by just 0.06%. The result sparked a slump in Ecuador's 2035 bonds, which fell 12.3% in price. Markets will remain cautious until April's run-off election.

Senegal's dollar bonds fell after the state auditor reported that the country's public debt and budget deficit were higher than previously reported. Instead of an originally reported 85%, central government debt-to-GDP was recalculated to 99.7%. Bonds maturing in 2048 fell 5.6% in value. The IMF is expected to move Senegal from moderate to high risk of distressed debt.

Last week was quiet for EM new issues, with only Albania and Israel coming to market. In the week ahead, central bank meetings will take place in Indonesia and Egypt.

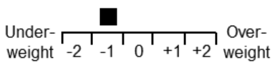
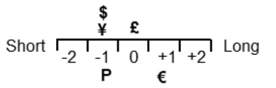
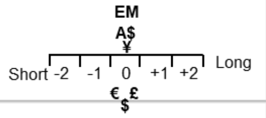
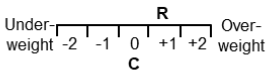
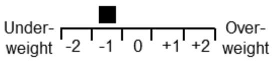
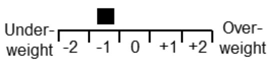
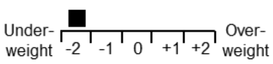
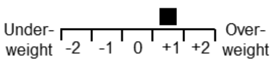
Responsible investments

Green bonds in Europe have had a face lift following the introduction of a new label by the EU in late 2023 called the ‘EU Green Bond Standard’. This voluntary label is currently the ultimate sticker for new green bonds and appears to be bringing forward some ‘greenium’ (a somewhat revived term for the lower borrowing costs on green bonds that the market hasn’t seen for quite a while). While EU green bonds issued so far this year have been immensively attractive, and oversubscribed, it does bear more complaince costs and reporting by the issuer. So if greenium really is making a comeback, issuers will have an incentive to put in the necessary work. There is demand from investors for this type of high quality green bond and an associated reduced risk of green washing.

Fixed Income Asset Allocation Views

17th February 2025

COLUMBIA THREADNEEDLE INVESTMENTS

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk		▪ Spreads remain near generational tights to start the year. Volatility remains below the early November peak 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 100bps since September. The CTI Global Rates base case view is that the pace and magnitude of additional cuts is uncertain and dependant on inflation data 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, and remain at those cycle tights. ▪ The Group remains conservatively positioned and disciplined regarding valuations, reducing exposure where risk premium has compressed materially. ▪ Tailwinds: Strong primary market and growth outlook, disinflation, IMF programs. ▪ Headwinds: US trade policy & USD strength, variation in monetary policy paths, Middle East tensions, higher debt to GDP ratios, wider fiscal deficits, slow restructurings.	▪ US trade policy aggression strengthens USD against EM currencies. ▪ EM policy makers constrained by currency pressure; rates remain tight. ▪ Fiscal concerns leak into local risk premia.
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. ▪ 2024 earnings and upgrades 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		▪ 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. Prefer loans due to cheaper relative valuations and strong market technicals.	▪ 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		▪ Agency MBS ended 2024 with positive excess return and spreads 11bps tighter YoY. ▪ 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		▪ Neutral outlook because of decent fundamentals and relval in select high quality issues. ▪ RMBS: Spreads near 2024 tights. Fundamental metrics, such as delinquencies, prepayments, and foreclosures remain solid overall. Pockets of weakness emerging. ▪ CMBS: Spreads tighter MoM. Stress continues, particularly in office, floaters, and near-term maturities. SASB delinquencies are rising and there are pockets of opportunity in SFR. ▪ CLOs: Demand remains high given relative spread to other asset classes; strong technicals. 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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