COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

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The times they are a-changin'

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.47%	16 bps	-3.2%	0.7%
German Bund 10 year	2.39%	3 bps	-0.8%	0.3%
UK Gilt 10 year	4.49%	5 bps	-2.9%	-3.5%
Japan 10 year	1.08%	7 bps	-1.4%	-3.3%
Global Investment Grade	86 bps	1 bps	-1.7%	3.4%
Euro Investment Grade	98 bps	-1 bps	0.4%	4.3%
US Investment Grade	80 bps	3 bps	-2.7%	2.9%
UK Investment Grade	85 bps	-1 bps	-1.0%	1.1%
Asia Investment Grade	119 bps	-2 bps	-1.1%	5.4%
Euro High Yield	334 bps	-3 bps	0.9%	7.9%
US High Yield	272 bps	9 bps	-0.2%	7.8%
Asia High Yield	499 bps	3 bps	0.3%	14.8%
EM Sovereign	299 bps	5 bps	-2.1%	5.8%
EM Local	6.3%	4 bps	-5.9%	-1.3%
EM Corporate	237 bps	-3 bps	-0.9%	7.5%
Bloomberg Barclays US Munis	3.6%	-1 bps	-0.8%	1.5%
Taxable Munis	5.1%	10 bps	-3.7%	0.9%
Bloomberg Barclays US MBS	43 bps	3 bps	-3.2%	1.2%
Bloomberg Commodity Index	232.17	-2.0%	-3.7%	2.0%
EUR	1.0561	-1.7%	-5.3%	-4.5%
JPY	154.97	-1.1%	-6.9%	-8.6%
GBP	1.2625	-2.3%	-5.7%	-0.9%

Source: Bloomberg, ICE Indices, as of 15 November 2024. *QTD denotes returns from 30 September 2024

Chart of the week: US mortgage rates are rising

Source: Bloomberg, as of 18 November 2024

Macro/government bonds

Last week was characterised by steeper curves across core markets, as longer-dated yields rose. In the US, core CPI and PPI data came in 0.3% for October, broadly in line with expectations. This could be mostly attributed to still sticky services inflation. Retail sales also surprised to the upside at 0.4% for October. However, it was the revisions to the previous month's data that underscored the strength of consumption in the US economy. We also heard from several Federal Reserve speakers. Neel Kashkari, of the Minneapolis Fed, told markets that they would have another six months of data before they would need to take another interest rate decision. He also talked about productivity gains in the US economy, posing the question as to whether the neutral rate should be higher. This matters as the Fed tries to guide monetary policy back to a neutral level, at which interest rates neither stimulate nor dampen demand.

Jay Powell, Fed Chair, spoke at an event organised by the Dallas Fed. He underlined the robustness of the economy while pointing out that inflation remains on track to meet its 2% objective – although the journey might be bumpy. Perhaps more importantly, he also said that the economy is not yet sending signals that the Fed needs to be in a hurry to lower interest rates. Market expectations of a quarter point rate cut in December rolled back from a probability of 65% to 58%. The flipside to weaker bond valuations was US dollar strength and higher mortgage rates (see **Chart of the Week**), as markets bet that the path to lower interest rates in this cycle might be shallower.

The other factor weighing on interest rates valuations, at least for longer-dated securities, was a rise in term premia. For US Treasuries this rose from 0.15% to 0.28% over the course of the week, underscoring how investors expect to be recompensed for holding longer-dated debt. The elephant in the room was Donald Trump who has articulated broad policy aims such as higher tariffs, migrant expulsion and tax cuts. All of these point to fiscally expansive policies, which could prove inflationary. The difficulty for the market is that there is still no policy detail.

In Europe, price action reflected that of the US. Investors have been trying to understand the impact and scale of potential tariffs on the EU from the US. This was covered by several policymakers from the European Central Bank, while there was also push back against any assumption that a December rate cut was a done deal. The direction of eurozone bond yields mirrored that of the US given the linkages between theses economies. While the eurozone may appear to provide a haven to nervous investors in the US on a cross-market basis, any significant rise in tariffs could put upward pressure on eurozone inflation and herald higher yields.

Investment grade credit

Investment grade bond spreads drifted a little wider last week after the post-US election surge. The market has also been buffeted by higher underlying government yields since the middle of September. The Global index yield has risen from the lowest point of the year, 4.24%, to 4.64% by the end of last week.

At the margin, US dollar markets underperformed and widened by 3bps, while its euro cousin saw spreads narrow by a basis point, according to data from ICE indices. Weaker sectors included pharmaceuticals – following the appointment of vaccine sceptic Robert F. Kennedy Jr – to the role of US Health secretary. US banks faired better as interest rate expectations are recalibrated higher. Indeed, JP Morgan saw its rating increased to A by agency S&P.

Last week was also notable for the "reopening" of the primary/new issuance market with plenty of deals for the market to focus on.

High yield credit & leveraged loans

US high yield bond valuations remained stable amid receding growth concerns, rising interest rates, fund inflows, light new issuance and uneventful earnings reports.

The ICE BofA US HY CP Constrained Index returned -0.44%, while spreads were 9bps wider ending at +297bps. The index yield-to-worst increased 0.16% to 7.3%. According to Lipper, US high yield bond retail funds saw a $2.1 billion inflow for the week. The average price of the Credit Suisse Leveraged Loan Index increased slightly to $96.4, a three-month high, as the asset class saw continued inflows and expectations for less Fed easing. Retail loan funds saw $2.2 billion contributed for an eighth consecutive weekly inflow and the largest since February 2022.

European high yield returned another solid week of +0.17% performance, with spreads tightening 3bps to 334, as the yield fell 6bps to 6.27%. It was also another decompression week as BBs and Bs outperformed CCCs, with the lower credit returning a small negative performance for the week. Flows were light at -€31 million, with ETFs seeing some inflows that were more than offset by outflows from managed accounts. The primary market saw a second quiet week as issuers stayed in the curtain wings. New issuance is expected to pick up this week as there are as many as 10 deals looking to price by the end of November.

In credit rating news, chicken processor Boparan was upgraded to B stable by S&P. The question going forward is how severely the firm will be hit by the increase in national insurance tax and any farm-unfriendly decisions coming out of the recent UK budget announcements. The packaging sector wasstill on the weak side, as Moody's downgraded the glass packaging firm Ardagh's CFR to Caa2, with a negative outlook. This comes after the compnay provided lower guidance on the back of a slower than anticipated recovery. Finally, debt collector Intrum declared Chapter 11 on Friday so it can start implementing its restructuring plan. The issuer was able to get agreement from more than two-thirds of bond holders, as well backing from a majority of the lenders for the restructuring plan.

In sector news, autos finally saw some recovery last week as more supportive valuations started to feed in, given how much the bonds had suffered over the past few months. Also helping is recent talk that China might be less hard on tariffs with European auto manufacturers.

Structured credit

The US Agency Mortgage-backed Securities sector had a rough week, posting a negative total return of 91bps. Shorter bonds and higher coupons performed best in the rate back-up. Spreads also widened with valuations now fair when viewing them over the past 12 months, but cheap on a longer-term basis.

While money managers net reduced in the third quarter, banks are making some positive strides with net investment of about $20 billion a quarter. These are not big numbers, but are a good sign. Post the US election there have been significant headlines around GSE (government-sponsored enterprises) reforms. Some of these ideas we consider easier to accomplish versus others – for example, replacing the head of the Federal Housing Finance Agency is one that could be done relatively quickly. A new appointee could move to shrink the footprint of the GSEs in "fringe" markets, those areas outside the core of the GSE mission such as second/vacation homes, jumbo mortgages and second liens. Loan level pricing adjustments and higher fees, as well as lower guarantee levels, would impact those volumes pretty quickly. The bigger lift would be a recapitalisation/privatisation of the GSEs, which has been an ongoing debate.

In credit sectors, spreads remain very tight and value is harder to find.

Asian credit

The JACI index posted a negative week of returns, -47bps, largely due to the movements in Treasuries, which were down -38bps.

In China, authorities are planning to lower taxes for home purchases by removing the different tax rates for ordinary and luxury residential units. In Shanghai, apartments that are larger than 144 square metres (1,550 square feet) fall under the category of non-ordinary or luxury residential units, which are subject to 3% in home purchase tax. By potentially lowering the tax for non-ordinary residential units to 1%, this could incentivise home upgraders to purchase larger units.

Adani Green Energy Ltd (AGEL) still plans to issue a 20-year bond after delaying the launch last month. There are, however, certain changes to the new deal: the issuance size is US$600 million, down from the previous $1.2 billion, and the Restricted Group assets have a capacity of 1,140MW, down from 1,840MW. In this revised deal, SECI is the only offtaker of the power generated by the Restricted Group. In the previous deal, Adani Electricity Mumbai (a related party of AGEL) was the second offtaker (700MW).

Alibaba Group Holding plans to issue USD$5 billion of USD and CNH bonds, of which the proceeds will be used largely for debt refinancing and share repurchase. Alibaba has a $2.2 billion bond that matures at the end of November. By also issuing CNH bonds, Alibaba aims to match the currency base of its assets and liabilities, diversify its investor base and lower its borrowing costs.

In Thailand, Thai Oil is evaluating the cost impact of the delay in commissioning the Clean Fuel Project (CFP). The delay is attributed to the payment disputes among its contractors (main contractor versus sub-contractors). The UJV (Unincorporated Joint Venture, comprising Samsung Thailand, Petrofac, Saipem) is the main contractor for the CFP project. In October, several contractors protested that UJV has not made payments to them, which led to a reduced workforce at the CFP site. The issue has not been resolved and Thai Oil has been urging UJV to settle the overdue payments to the subcontractors. Another company, PTT Global Chemical (PTTGC), is taking decisive steps to exit loss-making businesses. It has announced that it will withdraw from PTTAC, a 50/50 JV with Asahi Kasei. PTTAC has a propane-based technology that is not competitive versus propylene-based products.

Emerging markets

The resilience observed post-US election reversed towards the end of the week as risk sentiment turned cautious. This led to some de-risking activities. Emerging market bond spreads ended the week 7bps wider after hitting year-to-date tights at 323bps, while EM local lost 1.65% on the week. Most of these losses were attributed to EMFX weakness as EM rates were relatively resilient to the move higher in US Treasuries.

The primary market regained momentum as China, Ecuador and South Africa successfully tapped the market for external funding, while EM saw another week of outflows amounting to $1.4 billion – a deceleration from the week before.

The recent broad positive credit rating trend broadly continued. South Africa saw its outlook revised to Positive by S&P on increased political stability and a better growth outlook owing to stronger reform impetus. Meanwhile, Argentina scored a two-notch upgrade from Fitch on increased confidence around the authorities' ability to make upcoming debt repayments without seeking any form of relief. On the flip side, Mexico saw its Baa2 rating outlook revised to Negative by Moody's owing to concerns around judicial reforms, fiscal rigidity and uncertainty around PEMEX support.

Responsible investments

Last week, Citi brought a $3 billion social bond issue to the market. This two-tranche issue is the second labelled bond from Citi this year, after they raised €750 million in a green bond in May. It's not often the labelled bond market sees such a large issue come to market, especially from one of the leading Wall Street banks. Use-of-proceeds are mainly to refinance existing loans linked to an eligible project as described in their social bond framework, such as social housing, access to finance and targeting those on low-income.

There has been no immediate hault to new ESG-focused labelled bonds coming from the US since the election result. With less then two months left in the year, it has been speculated that total labelled bond issuance gloablly could exceed 2021's record of $1.2 trillion.

Fixed Income Asset Allocation Views

18th 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	▪ Spreads are modestly tighter since last month and fundamentals remain stable, despite elevated volatility and slowing of macroeconomic data. ▪ **The group remains negative on credit risk overall and downgraded Agency MBS to a modestly positive outlook.** ▪ The Federal Reserve began the easing cycle in September with 50bp rate cut. 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.	▪ 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 are close to 5-year tights while spread volatility remains elevated. ▪ The Group remains conservatively positioned and disciplined regarding valuations, reducing exposure where risk premium has compressed materially. ▪ Tailwinds: China stimulus, stronger growth, central bank easing, IMF programs. ▪ Headwinds: Escalating tensions in Middle East, higher debt to GDP ratios, wider fiscal deficits, US election, geopolitical uncertainty, 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 have tightened back near year-to-date tights, are rich to long-run averages ▪ Results and commentary from issuers do not indicate fundamental deterioration. ▪ IG Analysts expect strong fundamentals and decade-low leverage for 2024/2025. ▪ Current valuations limit spread compression upside and provide little compensation for taking on additional risk.	▪ 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	▪ Spreads have continued tightening and are rich to long-term averages. ▪ Earnings season did not indicate broad deterioration; 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 remains conservatively positioned given valuation backdrop but is 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ The Group downgraded Agency MBS because spreads are closer to fair value following the September FOMC and the housing market remains pressured. ▪ 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Neutral outlook because of decent fundamentals and relval in select high quality issues. ▪ RMBS: Spreads have continued to tighten. Fundamental metrics such as delinquencies, prepayments, and foreclosures, remain solid overall. ▪ CMBS: We are in the early stages of the office deterioration story. Outside of office and multifamily housing, however, 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 rising. Spreads unchanged MoM, the group has been reducing positions in consumer and auto sectors.	▪ 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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