COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

29 July 2024

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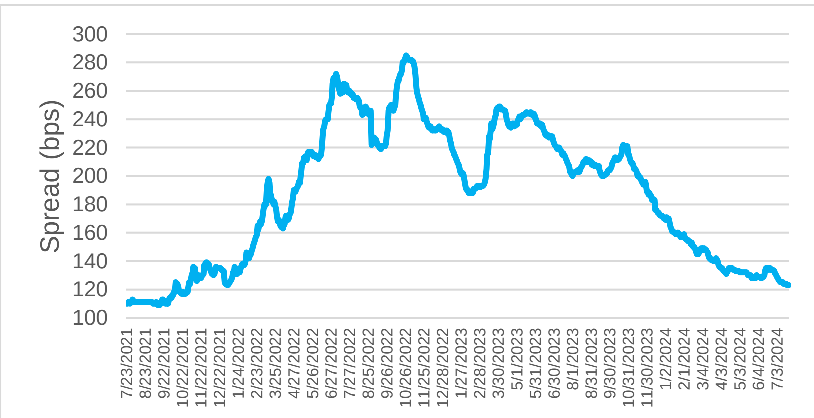
The rehabilitation of Real Estate

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.15%	-9 bps	1.4%	0.5%
German Bund 10 year	2.35%	-12 bps	0.9%	-1.2%
UK Gilt 10 year	4.02%	-10 bps	0.8%	-2.2%
Japan 10 year	1.03%	-2 bps	0.1%	-3.2%
Global Investment Grade	100 bps	2 bps	1.4%	1.7%
Euro Investment Grade	109 bps	1 bps	1.3%	1.8%
US Investment Grade	95 bps	2 bps	1.5%	1.6%
UK Investment Grade	97 bps	2 bps	1.0%	0.9%
Asia Investment Grade	152 bps	3 bps	1.0%	3.5%
Euro High Yield	369 bps	8 bps	0.9%	4.2%
US High Yield	310 bps	1 bps	1.7%	4.4%
Asia High Yield	598 bps	3 bps	1.5%	11.4%
EM Sovereign	349 bps	3 bps	1.4%	3.3%
EM Local	6.5%	-3 bps	1.9%	-1.9%
EM Corporate	276 bps	5 bps	1.2%	5.1%
Bloomberg Barclays US Munis	3.6%	-1 bps	0.8%	0.4%
Taxable Munis	5.0%	-4 bps	1.6%	0.4%
Bloomberg Barclays US MBS	44 bps	1 bps	1.7%	0.7%
Bloomberg Commodity Index	226.82	-1.5%	-4.6%	0.3%
EUR	1.0817	-0.2%	1.3%	-1.7%
JPY	153.89	2.4%	4.6%	-8.3%
GBP	1.2837	-0.4%	1.8%	1.1%

Source: Bloomberg, ICE Indices, as of 26 July 2024. *QTD denotes returns from 30/06/2024.

Chart of the week – Global IG Real Estate spreads, 2021-2024



Source: ICE Indices, Bloomberg & Columbia Threadneedle Investments, as of 24 July 2024.

Macro / government bonds

Following the path of the 10-year US Treasury yield can give the impression that not much is happening, as the 4.20% / 4.25% range is where we remain stuck. But, as with the proverbial gliding swan, paddling beneath the water line is non-stop.

During the week the US curve steepened to YTD extremes (-12bps for 2s10s, and +43bps for 5s30s) as market pricing of future cuts from the Fed fluctuated. Firstly, this was on the back of comments from retired Fed governor Dudley who argued for an August cut – before correcting when stronger than expected US GDP data for Q2 was published on Thursday. Both moves were probably accentuated by thin summer market conditions.

Accordingly, the easing priced into September Fed funds futures reached a high of 33bps before finishing the week at 25bps.

The global rates team maintain a long duration position, which is expressed predominantly in the US Treasury market. One trade of note last week was a shift out of UK gilts into a combination of Aussie and US government bonds.

Investment grade credit

It was a another quiet week for investment grade bonds.

Spread volatility remains low and Global IG spreads have traded in a range of around 10bps since early March. Low levels of spread volatility at a time of tight spreads were in evidence the years that preceded the Global Financial Crisis and more recently in 2021.

Credit curves have steepened in a reversal of last year's trend with shorter-dated bond spreads tighter on a percentage basis this year than their medium and longer-dated cousins.

Sector wise, globally, the real estate sector stands out as the best performing area of the market closely followed by banking and insurance. Quite a contrast to last year. The more defensive utility, healthcare and telecoms sectors have performed less well though spreads are tighter. The Global Real Estate Index spread had widened from aound 105bps in mid 2021 to over 280bps in October of the following year before tightening to around 125bps last week, accroding to data from ICE indices **(see Chart of the week).**

High yield credit & leveraged loans

US high yield bonds continued to perform well amidst the heaviest retail fund inflows YTD and an increase in primary market activity. The ICE BofA US HY CP Constrained Index returned 0.31% while spreads were 2bps wider. The asset class reported a $1.5bn inflow for the week, according to Lipper. The flow was split roughly 50/50 between ETFs and active managers. Meanwhile, the average price of the Credit Suisse Leveraged Loan Index declined slightly to $95.7. Retail loan funds saw $530m contributed over the week.

European High Yield (EHY) saw strong demand last week, even as spreads widened (+8bps to 369bps) while yields fell marginally (-2bps to 6.80%). Inflows into the asset class, via both ETFs and managed accounts, were €416m for the period with a decent chunk directed to short maturity EHY. Returns were modest for the week (+0.15%) on the back of decompression, specifically in the case of CCCs (+0.60% return) as single Bs were the worst performers, while BB marginally underperformed the market (+0.14% return). Sterling high yield outperformed EHY by more than 2x (0.34% return).

In M&A news, Apollo, the private equity group, is buying IGT and Everi's gaming and digital business, valuing it at $6.3bn. IGT will receive $4.05bn of gross cash proceeds and will likely use the cash mostly for debt reduction as well as shareholder returns. It should be noted that this amount is significantly more than the $2.6bn that IGT would have received under the old split of newco with the lottery remaining at IGT.

In credit rating news, Moody's downgraded CPI Property Group to Ba1. This follow's S&P's downgrade to BB+ that occurred at the end of May this year. Moody's cited the company's weak position considering the loss of equity credit for the hybrids; the challenges to address over upcoming medium term refinancings; and the group's structural complications. Moody's also downgraded Thames Water to Ba1 making the issuer the latest Fallen Angel. The issuer is still rated BBB- by S&P. Moody's indicated that the company may be challenged in finding new investment following the regulator's announcement that it will impose a "turnaround oversight regime" on the utility.

Structured credit

Lower rates and a steeper curve continued to progress this month and agency MBS posted a 30bps positive return on a generally good week for duration. 30-year agency MBS outperformed 15s, and the belly of the coupon stack did best. Sooner rather than later rate cuts are expected to lend support to the sector as volatility continues to decline. Meanwhile, existing home sales hit their lowest level since December and new home sales fell below November 2023 levels.

In ABS, new supply was slightly lower than the previous week. Autos continue to issue the largest portion of weekly issuance with Toyota, USAA, Carmax, Exeter and Chase all pricing deals. Two smallish single family rental deals and two unsecured consumer loan backed deals also priced. Deals were fairly well subscribed. Flows in the secondary market were modest as investor attention was on the primary market. Liquidity remains fairly robust.

The new issue machine is alive and well in CMBS in both sub-sectors, SASB and Conduit. A total of four SASB deals priced on Thursday for $2bn. We now have a total of 12 non-agency deals that have priced in July for a total of $9.5bn. YTD we have now priced $57bn in new issue private label deals, compared to around $22bn this time last year. Secondary spreads were unchanged last week despite the heavier than expected supply from primary deals. If this demand stays throughout the summer, we could see secondary start to move tighter given the lack of a primary calendar moving forward.

Asian credit

In China, PBOC's recent rate cuts to the 7-day OMO reverse repo rates and the LPR (Loan Prime Rates) have paved the way for rate cuts in the banking system. The major big four state-owned banks (Bank of China, ICBC, CCB and ABC) have made cuts to their time deposit rates, marking the fifth round of deposit rate cuts since spring 2022. Additionally, on the same day as the rate cuts by the banks, the PBOC also cut the MLF (medium-term lending facility) by 20bps to 2.3%.

The National Democratic Alliance, led by Prime Minister Modi's BJP (Bharatiya Janata Party), has presented its India Budget with more emphasis on fiscal consolidation. The fiscal target for FY24-25 is reduced to 4.9% (vs previous target of the interim budget: 5.1%) while the FY25-26 fiscal target is unchanged at 4.5%. The government expects to achieve this target through higher tax collections. While there is still a focus on infrastructure spending, the India Budget has more allocation for education and training to address the skill gaps in the country.

Emerging markets

A slightly softer week in EM credit, where spreads began (modestly) to reflect the souring in global risk sentiment. Still, with index spread only 3bps wider over the week, hard currency debt markets displayed remarkable resilience in the face of US political turmoil and the marked softening of developed market economic data, despite the meaningful uptick in volatility measures and curve steepness since the start of July.

The same cannot be said for EM local markets, where the dismantling of the Japanese yen carry trade has taken the wind from the sails of many of that strategy's EM beneficiaries. LATAM currencies have been hit by a combination of fiscal concerns, weaker commodities and governance concerns amid a testing global backdrop.

EM credit fundamentals continue to improve: Azerbaijan and Paraguay are the latest sovereign issuers to enjoy upgrades to investment grade (from Fitch and Moody's respectively). Meanwhile, primary markets remain open to issuers: last week saw supply in sectors such as Indian renewables, Chinese autos and Chilean energy.

After some enthusiasm for the prospect of political change (and sovereign bonds trading near recent highs), Venezuela's election seems to have delivered victory for the incumbent, Nicolas Maduro. Market prospects from here likely depend on the response in the streets and from the international community.

Fixed Income Asset Allocation Views

29th July 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 have widened a bit but still remain at tight, unattractive levels. Economic data has weakened but hasn't yet translated into any significant spread widening. Current valuations limit the spread compression upside and are misaligned with potential market volatility. ▪ **The group remains negative on credit risk overall, with an upgrade to Agency MBS to +2.** ▪ The CTI Global Rates base case view is that the hiking cycle is over, and the start of the cutting cycle is uncertain. With the recent CPI prints, the impetus is on the fed to bring the timing and the magnitude of cuts forward. ▪ Uncertainty remains elevated due to sensitive monetary and fiscal policy schedules and elections in various countries.	▪ 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)	A$ EM ¥ 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.
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ EMD spreads have remained stable this month, following the improvement in distressed credit and stability in GCC despite geopolitical risk amid changes after the elections. ▪ Investment Grade spreads are at historical tights while High Yield still offers some 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.	▪ 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 remained stable but are near record lows. The group is taking down credit risk because of flat spread curves and less spread compression upside. ▪ 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 relval basis.	▪ 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 remained stable but tight since last month. ▪ Anticipate credit selection will be the performance differentiator in 2024. Looking to avoid defaults/distress, focusing on credit recovery and deleveraging theses. ▪ 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.	▪ 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	▪ Spreads are still flat to 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. ▪ Constructive view on fundamentals over longer time horizon.	▪ 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 Non-Agency RMBS, and ABS. ▪ RMBS: MoM spreads remain tight. Delinquency, prepayment, and foreclosure performance remains strong for prime borrowers; seeing small increase in delinquencies for non-prime borrowers. ▪ CMBS: There is ongoing pressure, particularly on AAA securities. Non-office sectors, however, perform as expected with the overall market sentiment improving. ▪ CLOs: Despite 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 stable, lower quality borrowers underperform. Federal student loan payments near '18 / '19 levels with ~75% of borrowers active.	▪ 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ 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	▪ Global Recession