COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

5 February 2024

David Oliphant
Executive Director,
Fixed Income

Contributors

David Oliphant
Investment Grade Credit

Simon Roberts
Macro/Government Bonds

Angelina Chueh
Euro High Yield Credit

Chris Jorel
US High Yield Credit,
US Leveraged Loans

Laura Reardon
Emerging Markets

Kris Moreton
Structured Credit

Justin Ong
Asian Fixed Income

Charlotte Finch
Responsible Investments
Investment Grade Credit

Jake Lunness
Commodities
Emerging Markets

Sarah McDougall
General Fixed Income

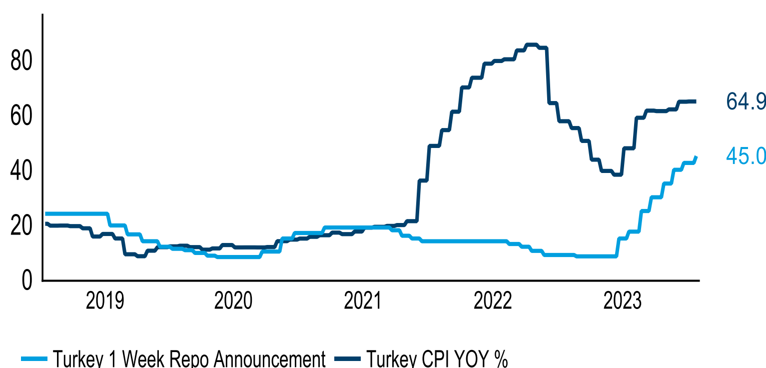
Patience is a virtue.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.12%	-2 bps	-0.6%	-0.6%
German Bund 10 year	2.30%	0 bps	-1.3%	-1.3%
UK Gilt 10 year	3.99%	3 bps	-3.3%	-3.3%
Japan 10 year	0.73%	1 bps	-0.2%	-0.2%
Global Investment Grade	110 bps	3 bps	-0.3%	-0.3%
Euro Investment Grade	130 bps	2 bps	-0.4%	-0.4%
US Investment Grade	102 bps	5 bps	-0.3%	-0.3%
UK Investment Grade	107 bps	-4 bps	-1.5%	-1.5%
Asia Investment Grade	171 bps	-7 bps	0.9%	0.9%
Euro High Yield	390 bps	6 bps	0.9%	0.9%
US High Yield	347 bps	8 bps	0.0%	0.0%
Asia High Yield	736 bps	-29 bps	2.9%	2.9%
EM Sovereign	329 bps	-5 bps	-1.2%	-1.2%
EM Local	6.2%	-8 bps	-1.9%	-1.9%
EM Corporate	300 bps	-4 bps	0.7%	0.7%
Bloomberg Barclays US Munis	3.3%	-15 bps	-0.2%	-0.2%
Taxable Munis	4.9%	-12 bps	-0.3%	-0.3%
Bloomberg Barclays US MBS	48 bps	2 bps	-0.9%	-0.9%
Bloomberg Commodity Index	221.70	-2.0%	-1.5%	-1.5%
EUR	1.0739	-0.6%	-2.3%	-2.3%
JPY	148.46	-0.1%	-4.9%	-4.9%
GBP	1.2554	-0.6%	-0.8%	-0.8%

Source: Bloomberg, ICE Indices, as of 2 February 2024. *QTD denotes returns from 31/12/2023.

Chart of the week – Turkish inflation and interest rates



Source: Macrobond, Columbia Threadneedle Investments as of 5 February 2024.

Macro / government bonds

The strength of recent economic data in the US pointed one way. ECB President Christine Lagarde's wish for greater confirmation that inflation was easing would be echoed by both the US Federal Reserve and the UK Bank of England. At its January meeting, the Fed left the policy rate unchanged. The Fed recognised that it had pushed monetary policy into restrictive territory and that while the economy remained in a relatively robust state, progress was being made on inflation. Jay Powell, Fed Chair, reaffirmed the end of the tightening cycle and that its current challenge was to manage the double-sided risk of either acting too quickly or waiting too long. He reminded his audience that while they had had six months of good inflation, they needed to see further evidence of disinflation before taking action. He pushed back at the idea of a March rate cut. The market priced out the probability of a March rate cut from 50% to just over 20% over the course of the week, coalescing around May as the most probable date for the first cut in US interest rates.

The market adjustment to the Fed's stance was muddied by news of commercial real estate losses at the New York Community Bank, which temporarily raised the spectre of another regional banking crisis in the US. This triggered the defensive buying of US treasuries until further analysis of the New York bank's balance sheet revealed that risks were more likely to be idiosyncratic than systemic.

On the Friday, there was a knockout number from Non-Farm Payrolls – the most widely followed measure of labour market strength in the US. The NFP rose by 353k in January while unemployment remained at 3.7%. The December NFP number was also revised up by 116k to 333k. The data underscored the challenge for the Fed, as a tight labour market exerts upward pressure on services inflation, and aggregate inflation in turn. Initial market reaction to the news was typically knee-jerk, with the unexpected strength of the labour market triggering sales of US treasuries.

In the UK, the BoE, left rates on hold at 5.25%, in a 6-3 split. There was little surprise in the market given recent upside surprises to UK inflation and growth data. Andrew Bailey, BoE Governor, made the case for staying their hand. Although inflation is expected to fall below 2% in Q2, it is expected to rise again in Q3 and Q4 as energy makes an increasingly less negative contribution to prices. He noted that if bank rates were to follow the path implied by current market pricing, then it would likely overshoot its 2% inflation target over the medium term. Its major concern is combatting the persistence of inflation, especially given the elevated level of services inflation.

In terms of positioning, we combine a constructive duration stance in fixed income portfolios (ex Japan) with a strategic yield curve steepening bias. On a cross-market basis, we continue to prefer the US and Europe to the UK, as the BoE is likely to be the last central bank to enter rate cutting mode.

Investment grade credit

Investment grade bonds struggled for a clear direction last week after a strong start to the year in terms of spreads. So far in 2024, sterling and euro markets have performed more strongly than their US dollar cousin.

Markets are having to contend with a lower probability of imminent interest rate cuts, at least in the face of strong labour markets. On the flip side, economic growth estimates look to be raised and the performance of risk markets such as equities supports prices. US tech earnings last week also underlined a bullish mood. This comes at a time of ongoing inflows into the market.

Real estate, banking and insurance have been the best performing sectors this year thus far.

High yield credit & leveraged loans

US high yield bond valuations widened modestly over the week amid another active new issue calendar, an adequate start to earnings season, Fed pushback on easing expectations, and a stronger than expected jobs report. The ICE BofA US HY CP Constrained Index returned 0.04% and spreads were 9bps wider. The week's $9.5bn of issuance was the most for a week since September, leaving January as the most active month in over two years. According to Lipper, retail high yield bond funds saw a $2.4bn inflow, the 12th inflow over the last 13 weeks.

Meanwhile, the average price of the Credit Suisse Leveraged Loan Index was again unchanged over the week at $95.5. Repricing / refinancing activity remained elevated over the week, leaving January with a record $136bn of loan primary activity, nearly all of which was repricing / refinancing. Retail loan funds saw a $410m contribution, the largest inflow in three months.

European high yield finished with a strong January, returning almost 1% for the month as spreads tightened in 16bps to 401bps while yields were close to unchanged (only -2bps) at 6.82%. Compression was the January theme with CCCs sharply outperforming higher-rated credits, returning 3.6%, i.e. 5x the performance of BBs and 3.5x the performance of single Bs. Real estate was the strongest performing sector (and where a number of the CCC rated issuers sit). Flows into the asset class accelerated over the month, with €759m coming in the last week and bringing January's figures to €1.8bn, the largest amount for the month since 2015. The corporate primary market for the month, though below the 5-year average, still came in at a respectable €9.2bn of new issuance. This was bumped up last week by four new bonds, still largely refinancings. Interestingly, the majority were single B issues showing the increased confidence for lower-rated credits to come to the market. Bonds were well received.

In rating news, a number of downgrades were announced last week. S&P downgraded Atalian to CC and Synthomer to BB-, while Fitch downgraded TalkTalk to CCC and Eutelsat to BB-. Reasons given for the downgrades ranged from profit warning concerns to weak demand and higher than expected leverage. For Eutelsat, the rating downgrade was followed by an announcement that the issuer had "lost" a satellite. As the satellite was nearing the end of its "life" (only a few years left), this also means the satellite was no longer insured.

In other news, Renault followed VW in pulling a potential IPO on its EV business, saying it was not seeing the valuation that it had expected. This seems a theme in the auto sector at the moment as EV demand appears to be falling.

Structured credit

US Agency MBS sustained a positive total return for the week despite the sell-off on the final trading day. The sector was up 62bps overall but down 106bps on Friday. The back-up in interest rates on a better than expected labour report sent spreads wider after what was a strong week. Fortunately, the impact of renewed regional bank volatility was generally benign and not viewed as a possible contagion event. Prepay risk for the highest mortgage rate production cohort has increased and created some uncertainty for coupons at the high end of the spectrum, which tend to be larger loan sizes given home price appreciation over the last several years.

What is a positive for the mortgagee is not a positive for the mortgagor. In CMBS, issuance was up YoY on lower yields and spreads, and delinquencies were stable across property types, sans Office. In ABS, we are seeing higher delinquencies in Subprime creep into Prime deals as well.

Asian credit

For the China AMC sector (Asset Management Companies), Moody's has affirmed the ratings of Cinda AMC and Orient AMC with a negative outlook after an update to the agency's ratings methodology. Moody's has removed the designation of these two AMCs as government-related issuers.

According to Reuters, Country Garden Holdings has more than 30 projects under construction, which are listed in a new funding "white list". These are projects which could qualify for financing support from the Chinese local governments that will ensure the completion and delivery of properties to end-buyers. The focus over the coming months will be the timeliness and implementation of additional financial support for these projects under construction.

Emerging markets

There were positive returns for emerging market hard currency bonds last week as the sovereign index posted gains of +0.77% as spreads tightened 6bps. Friday's US treasury move did hurt risk assets, particularly in the local currency sector and EMFX fared poorly.

On Friday evening news broke that the Turkish central bank governor Hafize Gaye Erkan had resigned. Since her appointment last summer she has tightened monetary policy with much needed consecutive interest rate hikes, the most recent one just last week taking the rate to 45%. Her resignation follows allegations relating to her father's dealings with the central bank. A new governor was swiftly appointed; her deputy Fatih Karahan. He is regarded as a hawk and it is expected that the orthodox approach to monetary policy which Erkan had implemented will continue. Latest inflation figures which printed this morning show inflation at 64.9% YoY. With Karahan's appointment the odds of additional rate hikes are increased if high inflation persists (**See chart of the week).**

In other central bank news, Egypt hiked more than expected; 200bps to 21.25%. It comes on the back of further negotiations with the IMF where it has been noted that significant progress has been made on the programme. The current Extended Fund Facility that Egypt is expecting is worth $3bn but the market is expecting it to increase to between $8-10bn in total.

In Senegal, the President decreed that upcoming elections would be delayed due to alleged corruption. The heightened uncertainty has led to social unrest and bond prices have consequently traded lower this Monday morning.

S&P upgraded the rating of Paraguay to BB+, one notch below investment grade. The ratings agency cited that "Paraguay's consistent economic growth could mitigate expenditure pressure and support debt stabilization".

In El Salvador, current president Nayib Bukele has claimed victory after securing 83% of only 31% of votes counted. He also claims to have won 58+ of 60 national assembly seats. Bukele has cracked down heavily on crime, with 75,000 people arrested under emergency measures. Sovereign bonds have seen around 1000bps of tightening last year following buybacks and a pension debt exchange which prompted credit rating upgrades. Bukele is now working with the IMF where if his landslide victory claim is true would mean he has an unprecedented mandate to do this.

Commodities

The BCOM index delivered total returns of -2.0% for the week. Losses were lead by the energy complex that was down 5.9% on aggregate.

Like many risk assets crude markets faced downward pressure from the very strong US jobs report. Crude specifically has seen weakness on market expectations of a ceasefire / hostage swap between Israel and Hamas. Crude prices saw some resurgence on Monday morning following US / UK strikes on Houthi targets. In the US, the EIA weekly oil report showed US commercial crude inventories increase for the first time in three weeks.

Base metals saw weakness across the board last week with each constituent except for lead trading down since the start of 2024. Data from Chile showed domestic copper output up 11.4% MoM (to December), but flat on the year. Analysts are guiding to a deficit in copper this year following lower output guidance from Anglo American, Codelco and Vale Base Metals.

Responsible investments

Labelled bond issuance at the end of last week was up over 35% on the same period last year, according to data from Bloomberg. So far, $152bn has been issued as green, social, sustainability and sustainability-linked bonds with a majority labelled green. This is the sixth largest monthly issuance of ESG bonds since the first green bond was issued in 2007.

Fixed Income Asset Allocation Views

5th February 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 remain at historically tight, unattractive levels. Technicals and fundamentals are relatively unchanged with no thematic deterioration. Current valuations limit the spread compression upside and are misaligned with market volatility. **The group remains negative on credit risk overall.** ▪ The CTI Global Rates base case view is that the hiking cycle is over, and the start of the cutting is uncertain. The timing and magnitude of cuts will be dictated by the amount and speed of disinflation. ▪ Uncertainty remains elevated due to sensitive monetary and fiscal policy schedules, geopolitical tensions, persisting inflation, and weakening consumer & labor profiles.	▪ Upside risks: the Fed achieves a soft landing with no labour softening; lower quality credit improve 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 ¥ €$£	▪ Rising expectations around a soft landing and peak Central Bank rates have weakened the dollar ▪ EM disinflation to be more rapid than DM ▪ Drop in global rate volatility supports local flows.	▪ 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.	▪ Sustained high core rates thwart EM easing cycles. ▪ Energy persistence derails disinflation trend. ▪ US outperformance strengthens US dollar. ▪ Structurally higher global real rate environment subdues risk assets
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ EMD spreads have widened this month, benefitting from lower global rates and the market-wide spread rally. Technicals remain challenged, with continued outflows and weak issuance. ▪ Conservatively positioned in select high quality relval names, most idiosyncratic opportunities are in lower quality portion of index. ▪ Tailwinds: Stronger growth forecasts, Central bank easing, potential China rebound, IMF program boost for distressed names. ▪ Headwinds: higher debt to GDP ratios, wider fiscal deficits, geopolitical and domestic political uncertainty, restructurings slow.	▪ Weak action from Chinese govt, no additional support for property and commercial sectors. ▪ China/US relations deteriorate. ▪ Issuance slows. ▪ Spill over from Russian invasion and Israel-Hamas war: local inflation (esp. food & commodity), slow global growth. ▪ Persisting COVID growth scars hurt economies & fiscal deficits.
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads are unch to modestly tighter since last month. The group is taking down credit risk because of flat spread curves and less spread compression upside. ▪ Fundamentals are supportive of technical strength. Global portfolios prefer EUR IG over USD on relval basis. ▪ Market pricing indicates investors are at ease with credit risk, with more optimistic views on fundamentals and US banking risk (CRE exposure, interest rates).	▪ 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 remain at historically tights levels. Modest weakness in fundamentals from bearish earnings outlooks, see bifurcation between sectors. ▪ Anticipate credit selection will be the performance differentiator in 2024. Looking to avoid defaults/distress, focusing on credit recovery and deleveraging theses, ▪ Conservatively positioned, looking to reduce and diversify credit risk because spreads are likely near their cycle lows. ▪ Bank loan market continued to see spread compression, improving technical. Underlying credit backdrop unchanged.	▪ 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	▪ Mortgage index continued tightening over the past month; however, spreads are still wide of historic long-term averages. ▪ In late 2023 the group reduced position sizing into spread tightening but remains overweight the sector. ▪ Constructive view on fundamentals over longer time horizon.	▪ Lending standards continue tightening even after Fed pauses hiking cycle. ▪ Prepayments normalise as rates rise without reducing mortgage servicing. ▪ Fed continues to shrink position. ▪ Market volatility erodes value from carrying.
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, CLOs and ABS. ▪ RMBS: MoM spreads have tightened. Delinquency, prepayment, and foreclosure performance remains strong for prime borrowers; seeing small increase in delinquencies for non-prime borrowers. ▪ CMBS: The group is cautious, especially on office and multifamily, however non-office sectors perform as expected and overall market sentiment improving. Delinquencies increasing as maturities come due. ▪ CLOs: Despite new issue, spreads grind tighter. Defaults remain low but CCC bucket defaults are rising with lower recoveries. ▪ ABS: Spreads tighter MoM, prefer senior positions. Higher quality borrowers remain stable, lower quality borrowers underperform.	▪ 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. ▪ Rising 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 Copper ▪ o/w Grains ▪ u/w Gold ▪ o/w Soybean Meal ▪ o/w Oil ▪ o/w Lead ▪ o/w Zinc	▪ Global Recession

Important information: For use by Professional and/or Qualified Investors only (not to be used with or passed on to retail clients). Source for all data and information is Bloomberg as at 05.02.2024, unless otherwise stated.

This material in this publication is for information only and does not constitute an offer or solicitation of an order to buy or sell any securities or other financial instruments to anyone in any jurisdiction in which such offer is not authorised, or to provide investment advice or services. Offerings may be made only on the basis of the information disclosed in the relevant offering documents and the terms and conditions under the relevant application forms. Investment involves risk. You are advised to exercise caution in relation to this material. Please refer to the relevant offering documents for details and the risk factors. Past performance is not a guide to future performance. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. The analysis included in this publication has been produced by Columbia Threadneedle Investments for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice and should not be seen as investment advice. Information obtained from external sources is believed to be reliable, but its accuracy or completeness cannot be guaranteed. The mention of any specific shares or bonds should not be taken as a recommendation to deal. This document includes forward looking statements, including projections of future economic and financial conditions. None of Columbia Threadneedle Investments, its directors, officers or employees make any representation, warranty, guarantee, or other assurance that any of these forward-looking statements will prove to be accurate. This document may not be reproduced in any form or passed on to any third party in whole or in parts without the express written permission of Columbia Threadneedle Investments. This document is not investment, legal, tax, or accounting advice. Investors should consult with their own professional advisors for advice on any investment, legal, tax, or accounting issues relating an investment with Columbia Threadneedle Investments. This document and its contents have not been reviewed by any regulatory authority. **In the UK: issued by Threadneedle Asset Management Limited, registered in England and** Wales, No. 573204. Registered Office: Cannon Place, 78 Cannon Street, London EC4N 6AG. Authorised and regulated in the UK by the Financial Conduct Authority. **In Australia**: Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 (Cth) and relies on Class Order 03/1102 in respect of the financial services it provides to wholesale clients in Australia. This document should only be distributed in Australia to "wholesale clients" as defined in Section 761G of the Corporations Act. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws. **In Singapore**: Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore. **In Hong Kong**: Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058. **Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies**. columbiathreadneedle.com