Information for investment professionals

COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

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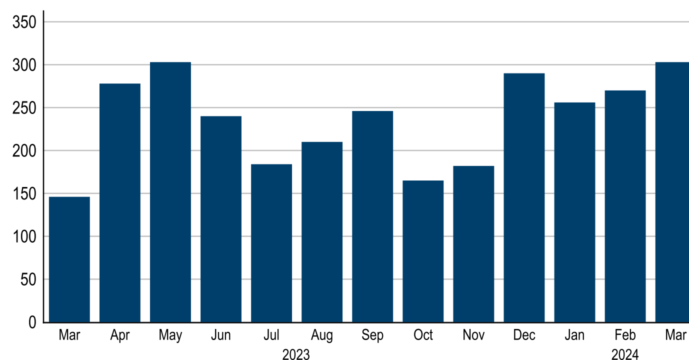
New quarter, similar themes

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.46%	26 bps	-1.1%	-2.0%
German Bund 10 year	2.45%	16 bps	-0.7%	-2.1%
UK Gilt 10 year	4.12%	19 bps	-1.3%	-3.1%
Japan 10 year	0.80%	9 bps	-0.2%	-0.8%
Global Investment Grade	98 bps	-1 bps	-0.7%	-0.6%
Euro Investment Grade	109 bps	-3 bps	-0.1%	0.3%
US Investment Grade	92 bps	-1 bps	-1.0%	-1.1%
UK Investment Grade	97 bps	1 bps	-0.7%	-0.6%
Asia Investment Grade	148 bps	-5 bps	-0.2%	1.0%
Euro High Yield	376 bps	6 bps	0.0%	1.7%
US High Yield	318 bps	6 bps	-0.5%	1.0%
Asia High Yield	668 bps	-1 bps	0.0%	5.7%
EM Sovereign	276 bps	-11 bps	-0.4%	1.0%
EM Local	6.3%	5 bps	0.3%	-1.9%
EM Corporate	268 bps	-8 bps	-0.3%	2.0%
Bloomberg Barclays US Munis	3.6%	12 bps	-0.6%	-1.0%
Taxable Munis	5.2%	18 bps	-1.8%	-2.3%
Bloomberg Barclays US MBS	47 bps	-2 bps	-1.0%	-2.1%
Bloomberg Commodity Index	239.96	3.5%	3.5%	5.8%
EUR	1.0823	0.4%	0.4%	-1.8%
JPY	151.92	-0.2%	-0.2%	-7.0%
GBP	1.2616	0.1%	0.1%	-0.7%

Source: Bloomberg, ICE Indices, as of 5 April 2024. *QTD denotes returns from 31/03/2024.

Chart of the week – US nonfarm payrolls MoM net change



Source: Macrobond and Columbia Threadneedle Investments as of 5 April 2024

Macro / government bonds

The market took a pause last week, as it increasingly challenged the assumption there could be three quarter point interest rate cuts this year by the US Federal Reserve (Fed). The catalyst for this was the continuing strength of economic data. Inflation readings continued to surprise to the upside while nonfarms payroll data – the most widely followed indicator of US labour market strength – once again underscored the resilience of the US economy. The reading for March came in at 303,000 (**see Chart of the week**). This was significantly higher than the average monthly gain of 231,000 over the prior 12 months. Every part of the report pointed to a robust US economy: job gains were broad-based; earnings ticked up; the average workweek increased; and there were net positive revisions to job creation numbers for January and February. The stronger labour data raised a question about the direction of the economy and whether the Fed would feel comfortable loosening monetary policy in the face of a resilient US economy. It also raised a question about where the neutral rate of US interest rates lay – the point at which interest rates are neither stimulative nor restrictive.

Jay Powell, Fed Chair, gave a speech in which he talked about the bumpiness of the disinflation process and that it could still be appropriate to lower interest rates later this year if the economy were to evolve broadly as the Fed expects. The greater sense of caution in his words put upward pressure on yields – a trend that would be compounded by the nonfarm payroll data at the end of the week. Alongside Powell, a plethora of policy makers spoke and, in general, covered themes of higher than expected inflation, US economic resilience, and the need for patience.

Market price action saw a bear steepening trend emerge in the US Treasury market, as longer dated yields rose more than shorter dated yields. Higher yields translated into a less constructive environment for fixed income. The market pushed back its expectations of when the first rate cut might take place, as well as the degree of cuts. This saw the market price 2.5 cuts by year end – a far cry from the six that the market predicted at the end of December and fewer than the Fed's median prediction of three. 10-year US Treasury yields rose to the upper end of their current trading range in the 4.3-4.4 yield area. However, the current strength of economic data and increasing uncertainty around the future path of monetary policy means this support level could easily be broken.

Price action in the US Treasury market continued to exert upward pressure on European bond yields. Within Europe there seems to be broad consensus that the first rate cut will take place in June, but debate has moved on to what will happen next. Will the European Central Bank follow that up with a July cut or wait until September until loosening once again. The restrictive level of interest rates in Europe has had a greater dampening impact on demand than in the US, making the decision of when to cut relatively easier for European policy makers.

In global rates portfolios last week we took the defensive measure of enacting stops on tactical long positions in the US Treasury market in the 10-year sector, while retaining long positions in the EUR and GBP interest rate markets where fundamental conditions are more supportive.

Investment grade credit

Global investment grade spreads were fairly unchanged in the past week, trading close to the tightest (most expensive) level sice early 2022 and well below short- and longer-term averages.

Investment Bank JP Morgan presented a list of interesting statistics around the strong health of the US IG market last week. They noted that $289 billion of IG bonds were upgraded in Q1 24, including around $7 billion migrating from HY to IG. Only $77 billion were downgraded. That leaves an impressive upgrade/downgrade ratio of nearly 4:1. They note, furthermore, that upgrades have exceeded downgrades every quarter for the past two years. The upgrades were broad based and led by the Energy, Capital Goods, Consumer and Utility sectors. Rising stars included Las Vegas Sands, Rolls Royce and First Energy.

It was less good news for heavily indebted UK company Thames Water, where bonds were downgraded at both Operating and Holding company level by rating agency Moody's. This followed the failure to extract further equity from existing holders – at least at this stage.

High yield credit & leveraged loans

European high yield delivered a muted 8bps return on the week taking year-to-date returns to 1.7%. High yield funds saw €201 million of inflows, which marked an impressive run of 16 consecutive weeks of inflows totalling €5.4 billion. We had two new issues, each being €850 million green bonds. The first was from BB+ rated Valeo, which offers a 4.5% coupon for a 2030 maturity. The second was electric utility firmTerna who came to market with a 2.375% hybrid issue.

In ratings news, travel retailer Avolta was upgraded to BB+ by S&P following strong operating performance in 2023 and tightening financial policy. This follows the recent upgrade of Rolls Royce to BBB- by Fitch. Rolls Royce, like Avolta, have been supported by strong demand for travel.

Elsewhere the CEO of Swedish debt collector Intrum, which is looking to overhaul its debt structure, said it is evaluating all options which may involve potentially being downgraded to selected default. The CEO avoided answering whether or not its July maturity will be repaid in full (for which it has the funds following a recent portfolio sale).

Asian credit

The China Construction Bank (CCB) has filed a winding-up petition against Shimao Group, which is related to the latter's financial obligation of HKD1.58 billion.

Following the earthquake in Taiwan, TSMC stated there was no significant damage to its facilities in Hsinchu Science Park, other than a small number of tools impacted at certain facilities. TSMC added that there was no damage to its critical chip-making equipment include the EUV (extreme ultraviolet) lithography tools. Within 10 hours of the earthquake around 70% of its chip-manufacturing operations had resumed, according to the company.

Hysan Development has commenced a partial tender offer, up to a maximum of $100 million, for the HYSAN 4.1% subordinated perpetuals.

PTT Exploration & Production (PTTEP) has raised its stake in the Yadana oil project (Myanmar) to around 63% from 37% after the exit of Chevron, which owned 41%. The state-owned Myanmar Oil and Gas Enterprises (MOGE) now owns the remaining stake in the project. Myanmar is a relatively important source of natural gas supply for Thailand, accounting for around 12% of supplies.

Genting Malaysia Berhad (GENM) has reportedly stated that its annual tax payment to the New York State will rise to more than $1 billion if it wins one of three new casino licenses. While the initial expectation was for the licenses to be awarded in 2024, the timing has been pushed back towards late 2025 due to an environmental review and an other land use review.

Structured credit

The US Agency MBS sector suffered a 1.04% loss last week on higher interest rates. Rates sold off on both slightly stronger data combined with hawkish speak from Fed governors. In turn, 15-year MBS outperformed 30 years and higher coupons did best as the curve bear steepened and spreads rallied. 30-year Agency MBS is now trading at new 12-month tights but remain wide of longer-term averages and look cheap relative to corporates. Net issuance was light, coming in at around $10.7 billion for March and a cumulative $26 billion for the first quarter.

In Non-agency RMBS, new issuance continued at a good clip with five new issues pricing last week. Secondary spreads tightened by 5-15 bps, evidencing solid demand for the sector. In

Commercial mortgage-backed securities the office sector remains challenged and is the only sector posting higher delinquencies (DQs). Otherwise, commercial risk was well bid with latest Remittance reports evidencing a declining trend in more than 60 DQs.

Emerging markets

EM hard currency spreads tightened another 11bps over the week, with gains coming from Ecuador and El Salvador. However, the continued spread compression wasn't sufficient to offset the loss from the move higher in US treasuries. The index return over the week was -0.34%

Panama was downgraded to high yield by Fitch. While the one notch cut to BB+ didn't come as a surprise, the timing did – it was expected the ratings agency would wait until after the forthcoming elections. Fitch cited challenges to reform given a backdrop of elevated social tensions, congress fragmentation and an expected slowdown in growth.

Over the weekend, Ecuador sparked international outrage by raiding the Mexican embassy to arrest a former vice president of Ecuador who was sheltered within the embassy. There is concern this may delay the nation's impending IMF deal. Ecuador's 10-year USD bond is down half a point as of Monday afternoon.

Fixed Income Asset Allocation Views

25th March 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, with no changes to underlying sector views.** ■ 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 improves as refinancing concerns ease; consumer retains strength; end to Global war ■ 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 premiu ■ Long run trend in safe asset demand reverse
Currency ('E' = European Economic Area)	A$ EM ¥ 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 bene 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 real rate reversal challenges EM easi cycles. ■ Geopolitical strife rekindles inflation ■ US macro outperformance strengthens US dollar.
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	■ EMD spreads tightened this month, supported by macro stabilisation and market-wide spread rally. Technicals have modestly improved, continued outflows but stronger 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 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 additiona 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. ■ Persisting COVID growth scars hurt economies & fiscal deficits.
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	■ Spreads have continued to move tighter since last month. The group is taking down credit risk because of flat spread curves and less spread compression upside. ■ Strong 2024 start for fundamentals and technical. Per ratings agencies, index credit quality has improved y/y. Supply may slow in March after record issuance in Jan/Feb. ■ 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 continued to tighten since last month. Modest weakness in fundamental outlook with sector bifurcation. ■ 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 tight spreads, improving technical. Underlying credit backdrop unchanged.	■ Lending standards continue tightening, increasing the cost of funding. ■ Default concerns are revised higher on great demand destruction, margin pressure and macro risks ■ Rally in distressed credits, leads to relative underperformance ■ Volatility in the short end of the curve, erodin potential upside where we are positioned for carry.
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	■ Mortgage index remain at tight levels; however, spreads are still flat to 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. ■ 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. ■ CMBS: The group is cautious, especially on office, floating rate, and near-term maturities. 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 remain 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 Fe tightening. Consumer (retail/travel) behaviou fails to return to pre-covid levels ■ Student loan repayments weaken consumer profile more than anticipated, affecting sprea 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 Copper ■ u/w Grains ■ o/w Soybean Meal ■ o/w Cocoa ■ o/w Oil ■ o/w Lead ■ o/w Zinc	■ Global Recession

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