COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

9 October 2023

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

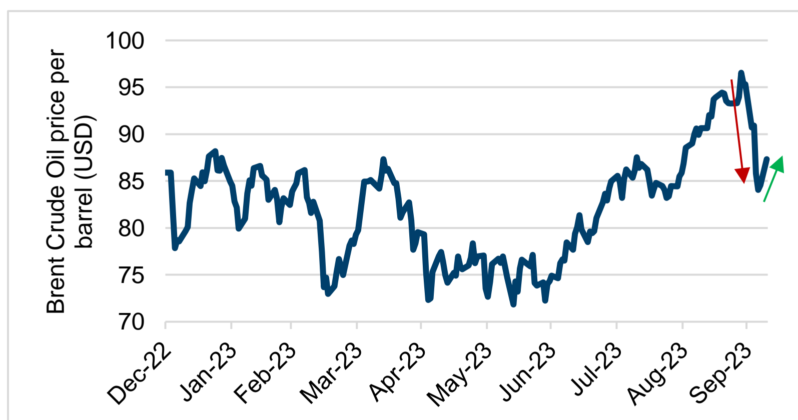
US employment stays higher for longer

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.80%	23 bps	-1.1%	-2.9%
German Bund 10 year	2.77%	-7 bps	-0.4%	-1.6%
UK Gilt 10 year	4.48%	4 bps	-1.5%	-6.0%
Japan 10 year	0.81%	4 bps	-0.5%	-1.0%
Global Investment Grade	138 bps	6 bps	-1.1%	-0.1%
Euro Investment Grade	160 bps	11 bps	-0.4%	1.9%
US Investment Grade	129 bps	5 bps	-1.5%	-1.0%
UK Investment Grade	135 bps	3 bps	-1.0%	0.2%
Asia Investment Grade	195 bps	-7 bps	-0.5%	1.9%
Euro High Yield	494 bps	37 bps	-0.8%	5.5%
US High Yield	433 bps	30 bps	-1.4%	4.5%
Asia High Yield	919 bps	8 bps	-0.4%	-5.1%
EM Sovereign	378 bps	16 bps	-2.0%	-0.9%
EM Local	6.9%	12 bps	-2.4%	1.8%
EM Corporate	337 bps	9 bps	-1.0%	2.4%
Bloomberg Barclays US Munis	4.4%	11 bps	-0.6%	-2.0%
Taxable Munis	5.8%	18 bps	-2.1%	-2.2%
Bloomberg Barclays US MBS	65 bps	-1 bps	-1.2%	-3.5%
Bloomberg Commodity Index	235.16	-2.1%	-2.1%	-5.4%
EUR	1.0536	0.1%	0.1%	-1.1%
JPY	148.72	0.0%	0.0%	-12.2%
GBP	1.2198	0.3%	0.3%	1.3%

Source: Bloomberg, ICE Indices, as of 6 October 2023. *QTD denotes returns from 30/09/2023

Chart of the week – Crude oil price collapse and rebound



Source Bloomberg, Columbia Threadneedle Investments, as of 9 October 2023.

Macro / government bonds

Last week's price action in global rates markets reflected contrasting signals in the US labour market.

The strength of the US labour market matters as it is directly correlated with the level of demand in the economy. When the economy is running hot and there is competition for workers, wages have to rise, exerting upward pressure on inflation. Once evidence emerges that the labour market has started to crack, markets can look towards a downshift in interest rates.

Although we are within a hair's breadth of reaching terminal rate levels, we are not quite there yet, and for that reason sentiment in the bond market remains sensitive to any changes in labour market data. The Job Openings and Labour Turnover survey (JOLTs) report for August, which came out last Tuesday, revealed that 9,610k new jobs had been created. This compared to the prior figure of 8,827k, which was itself revised upward to 8,920k. The data appeared to cement the case for a further interest rate rise in the US, which more hawkish members of the FOMC have been keen to promote through their media communications. US treasuries breached important technical levels on the back of the news, with the 10-year touching briefly 4.9% and the 30-year breaching 5.0%. Helping to juice the rise in bond yields higher were capitulation trades, as market participants closed out long speculative positions in core fixed income markets. The importance of the US bond market in setting interest rates globally meant that rates in other bond markets also rose higher.

In contrast, the ADP report, which tracks non-farm private employment, came in lower than expected on the following day. New jobs came in at 89k for September. This compared to a prior ADP figure of 177k for August, which was revised up to 180k. In addition, the 5.9% median pay increase, recorded by ADP, was the smallest gain in two years. For a market desperate to rally, this was exactly the type of news market participants craved and yields edged lower as a result. Market volatility, however, did not ease. Non-Farm Payrolls, published on Friday, which accounts for jobs created by the private sector and government agencies, delivered a blockbuster 336k for September, while the figure for August was revised up from 187k to 227k. Part of the rise in jobs could be explained by growth in the leisure and hospitality sector, which has still to return to pre-Covid Levels. It could also be attributed to an element of labour hoarding given the tightness of the US labour market.

Although bond yields subsequently rose, it seemed the data had resolved little in the course of the week. The pace and magnitude of monetary tightening means it has yet to be fully felt in the real economy. While there was little change to interest rate expectations over the course of the week, yield curves in the US, the eurozone and the UK maintained their steepening trend, as investors mulled the persistence of inflation and rising issuance. Although the US avoided a government shutdown, political agreement between Republicans and Democrats only postponed the decision on funding until 17 November. Ongoing political dysfunction in the US highlighted the prospect of rising issuance needs, amid widespread consensus that expansive fiscal policies are set to continue.

Investment grade credit

After a lengthy period of very low spread volatility, the investment grade market was weaker last week. Spreads which had hovered around 130bps for the global market headed wider towards 140bps, according to data from ICE Indices. Weakness felt in other risk markets was the chief reason and led to a slowing in primary market activity last week. The euro market was the weakest globally at the margin.

In issuer specific news, UK water utility Thames Water bonds were weaker, with the company in need of an equity injection from shareholders. They in turn want to be able to derive higher equity returns from any investment, which would need to be permitted by the regulator OFWAT. Discussions between the company and regulator continue.

BUPA, the healthcare provider, was a victim of more nervous market sentiment with its inaugural €500m, 7-year bond deal failing to be fully covered with some investory reportedly left sitting on issuers bank's books. Bonds widened after issue as a result.

Finishing on some encouraging news, corporate health has been one of the most supportive factors in our view about the outlook for IG credit. JP Morgan noted last week that in the US the share of the US dollar index that is BBB- rated (lowest IG rating) reached the lowest in seven years last quarter. Further, they note that the quantity of upgrades relative to downgrades was 2.3x. Issuers such as Boeing, Baxter and UBS were notable upgrade examples in the period.

High yield credit & leveraged loans

US high yield valuations rose sharply over the week amidst large fund outflows and sharply higher Treasury rates. The ICE BofA US HY CP Constrained Index returned -1.35% and spreads were 30bps wider.

The yield-to-worst increased to 9.30%, an eleven-month high. According to Lipper, retail high yield bond funds reported a $2.6bn outflow. Meanwhile, floating rate loans performed better relatively, but were not completely spared from the broader weakness. The average price of the J.P. Morgan Leveraged Loan Index declined $0.36 over the week to $95.14. Retail loan funds saw a $942m withdrawal, the largest weekly outflow since May.

European High Yield (EHY) had another negative performance week on the back of widening spreads. High yield spreads rose 37bps to 494bps as yields rose a modestly smaller 33bps to 8.25% (A yield level the market hasn't seen since early November 2022). It was a decompression week as BBs outperformed Bs and CCCs (the latter two returning exactly the same performance). For once, sterling high yield underperformed EHY. Flows also returned to negative as almost €400m exited, via both ETFs and managed accounts. This brings the YTD figure to almost -€500m. This was even as the October primary market started with strong demand for the three deals (totalling €1.25bn) offered via a hybrid (Accor); a green bond (Valeo); and small issue from Guala Closures (Italian packaging). Interestingly, the EIB was seen heavily participating in the green bond, taking 17% of the new issue.

In auto news, Volvo, Renault, and CMA announced they will set up a new company to create electric vans. In the chemicals sector, there is a suggestion that the earlier weakness seen in specialty chemicals may be bottoming out as customers from the surgical glove production side said that its inventory build up appears to be coming to an end.
In credit rating news, Rolls was upgraded by Fitch to BB, finally catching up to the other credit rating agencies' earlier upgrades. There was more good news in the leisure sector as TUI Cruises was upgraded to CCC+ by Fitch. This reflects expectations of continued profit improvement driven by occupancy recovery, ramp up of new operating capacity, and as price increases offset cost inflation. However, there was unfortunate news for Eutelsat who was downgraded to Ba2 by Moody's, becoming the first fallen angel for October, as it still is investment grade at S&P and Fitch. The reasons cited were declining core business, negative free cash flow, and ability to meet 2025 maturity wall.

Structured credit

The US Agency MBS market was down 1.22% last week mostly on higher interest rates. Over the course of the week, mortgage spreads experienced heightened volatility, trading wider than the levels seen at the peak of the regional bank stresses. But spreads settled back down to end the week essentially flat. While mortgages remains historically attractive on a relative value basis, lower volatility is deemed to be the necessary factor to bring buyers, specifically banks, back in. Lower volatility essentially equates to a stabilization in rates and higher conviction that the US Fed is done with its hiking regime. On a positive note, FX hedged yield for Japanese investors has significantly improved and mortgage rates in the 8% range have slowed prepayments considerably.

New issue in non-agency RMBS is now down 55% relative to 2022 YTD and in CRT, specifically, negative net issuance has supported tighter spreads. Supply in CRT has been constrained by both plunging originations in agency MBS and poor primary market conditions with less attractive collateral given the rise in home prices.

Asian credit

In Macau, the rebound in the volume of visitors during the 8-day Golden Week holidays (Mid-Autumn Festival and National Day) is supportive for the gaming sector. The visitor arrivals reached 932,365, with Mainland visitors accounting for 76%. The average daily visitor volume was around 84% of the pre-pandemic Golden Week 2019 level.

According to Cailian, Country Garden plans to announce an offshore debt restructuring over the coming days. In late September, Bloomberg reported that Country Garden was holding talks with Houlihan Lokey and China International Capital Corp to potentially appoint them as financial advisers for an offshore debt restructuring plan.

PTT Global Chemical has continued with its opportunistic bond buyback activities by repurchasing and cancelling $36.2m of its PTTGC ‘31s bond. Earlier in March and June 2023, the company had repurchased and cancelled $100m of its PTTGC ‘32s bond.

Emerging markets

The move higher in US treasury yields hurt EM assets over the week, coupled with EM spreads widening 16bps the overall return for the JP Morgan EMBI Global Index was -2.01%. While the “higher for longer” narrative is painful for risk assets, EM spreads, excluding the lowest quality names, are trading tighter than long-run averages and have in general been relatively well contained despite the global macro volatility.

Moody’s surprised markets by downgrading Egypt from B3 to Caa1 on Friday, which is two notches below the ratings from Fitch and S&P. Despite authorities having successfully executed the first tranche of the privatization agenda, as well as the current account deficit narrowing significantly, the ratings agency nevertheless had concerns about whether the country will be able to conclude a successful IMF review by the end of the year

The Romanian Central Bank held interest rates at 7%, in line with expectations, which is in contrast to some of its CEE peers who have been cutting rates.

Zambia is expected to sign a memorandum of understanding to restructure $6.3bn worth of debt following its default in 2020. A recent deal in principle lead by China (Zambia’s biggest creditor) and France agreed interest on the outstanding debt will be cut to 1%, with a maturity extension to 2043.

Commodities

The BCOM index delivered a -2.1% return on the week lead by sharply falling energy and industrial metals markets.

In crude, brent declined from $95.3 to $84.6 **(see chart of the week)** facing downward pressure from a weakening global demand outlook and macro concerns, this was only exacerbated by the stronger than expected non farms payroll print on Friday, upping the odds of an additional US Federal Reserve hike. We also had news of US gas (petrol) consumption hitting the lowest seasonally adjusted level since 1998.

In more bullish news, OPEC raised its longer-dated demand forecasts, predicting a 16% rise in oil consumption to 116m barrels per day in 2045 (from 110m previously). The change was driven by higher expected consumption from road transportation, petrochemicals and aviation,

OPEC also cited nations such as the UK rolling back on net zero commitments. OPEC maintains that the overall fossil fuel consumption will peak in 2030.

Pricing turned following the Hamas attacks on Israel over the weekend, with brent rallying just shy of $3 to $87.3. While there is currently no direct impact on production the rally is focused on the impact of Iran, who is accused of supporting Hamas. Iranian crude production is up 700k barrels per day in 2023, thanks to the US relaxing some enforcement of sanctions on Iranian sales, a relaxation that could be in jeopardy if US intelligence finds Iran guilty of supporting the attack. There's also concern of how Israel would respond to Iran if it was found to have direct involvement. This comes at a time where the US strategic petroleum reserve is at its lowest level in 40 years.

Responsible investments

There's a gloominess in the ESG bond market as reports state that the US has slowed down immensely in issuing ESG-related bonds, as the motivation and support to issue such debt is diminishing. Unfortunately, politics may have a large influence in the slowdown as some Republicans are actively trying to persuade voters that climate change isn't real, and that it's "anti-American", words from Ron DeSantis, Florida's Governor. Besides the politics, a weakening in the economic environment has also hindered new issuance – as mentioned in the Investment Grade Credit report above.

Elsewhere, the UK DMO is set to release the next tranche of the Green Gilt totalling £10bn. This is despite Rishi Sunak's multiple U-turns and push backs on climate change policies witnessed last month.

Fixed Income Asset Allocation Views

9th October 2023

Strategy and positioning (vs risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Valuations continue to be rich overall. Technicals seem stable following seasonal issuance; fundamentals show modest pockets of weakness, but no thematic deterioration. **The Group stands neutral on Credit risk overall favouring higher quality credit.** ▪ The CTI Global Rates base case view is no cuts in 2023, with one more possible hike left in the hiking cycle. Focus remains on wages, labor market, financial conditions, and inflation expectations. ▪ Uncertainty remains elevated due to stricter lending, monetary policy tightening, persisting inflation, weakening consumer profile and ongoing geopolitical tension.	▪ Upside risks: the Fed achieves a soft landing with no labour softening, no lasting changes to fundamentals following banking crisis, consumer retains strength, end of Russian Invasion of Ukraine ▪ Downside risks: Rising unemployment, especially if wage growth remains high and the Fed continues hiking. Supply chain disruptions, inflation, volatility, commodity shocks reemerge.
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. ▪ EM real rates relatively attractive, curves still steep in places	▪ 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	▪ EM central banks slowing or terminating hike cycles ▪ Sharply reduced Fed expectations may permit EMFX strength ▪ EM real interest rates relatively attractive, curves steep in places	▪ Severe US recession and/or financial crisis drives stronger US dollar and portfolio outflows from EMD ▪ Sticky global inflation or wage/ price spiral keeps EM interest rates higher for longer ▪ 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 23bps wider than last month, reversing the early summer rally. Technicals are stable but slow. ▪ Conservatively positioned with most idiosyncratic opportunities in lower quality portion of index; prefer local to hard currency. ▪ Tailwinds: Central bank easing in less inflationary countries, IMF program boost for distressed names. ▪ Headwinds: higher debt to GDP ratios, wider fiscal deficits, geopolitical risks, domestic political uncertainty.	▪ China/US relations deteriorate; China property sector challenges not contained ▪ Issuance slows ▪ Spill over from Russian invasion: 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	▪ US and EMEA spreads are at similar levels to last month; minor fundamental deterioration at a sector level, but management is positioning conservatively. EUR valuations are attractive; prefer USD and Euro to Sterling. ▪ Typical seasonal issuance to start Sept, but less than estimated and skewed towards the shorter end of the curve. Credit metrics are solid amidst recession uncertainty. Fundamental concerns remain focused on commercial real estate for Banking sector, tight labour supply, changing consumer behaviour.	▪ Costlier funding and tighter lending standards from bank crisis ▪ Volatility remains high and 2023 supply is below expectations. ▪ Market indigestion as central banks sell EMEA corporates ▪ Rate environment remains volatile ▪ Geopolitical conflicts worsen operating environment globally
High Yield Bonds and Bank Loans	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads remain inside historic medians and are roughly unchanged since August. Technicals have been slow but stable, with more issuances in the pipeline. Fundamentals continue deteriorating slightly due to financial conditions, but with no significant impact so far outside of distressed names. ▪ Prefer conservative position; open to attractive buying opportunities in short HY & BB's and higher quality loans where financial conditions are less of a headwind. ▪ US HY defaults remain below historic averages, with further default expectations now being pushed into 2024. ▪ Bank loan market continuing May's rally, with overall market dispersion. Themes: moderating retail fund outflows, delayed defaults, limited issuance, increasing interest burden, credit concern in lower quality loans.	▪ Costlier funding and tighter lending standards from bank crisis ▪ Default concerns are revised higher on greater demand destruction, margin pressure and macro risks ▪ Rising stars continue to outpace fallen angels, shrinking HY market ▪ Rally in distressed credits, leads to relative underperformance ▪ Pockets of weakness improve, HY spreads show resistance to widening that typically follow tightening policy. ▪ 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 at similar lever to last month with spreads wide of historic medians, the group views agencies as attractive. ▪ Record low real estate transactions leading to low supply of new MBS. ▪ Place to add, prefer high coupon assets; constructive view over longer time horizon.	▪ Costlier funding and tighter lending standards from bank crisis ▪ Rising rates cause prepayments to normalise 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	▪ Our preference remains for quality Non-Agency RMBS ▪ RMBS: Home prices resilient despite headwinds, but with all-time low transaction activity. Delinquency, prepayment, and foreclosure performance remains strong; difficulty seeing deterioration of home prices given labor market strength. ▪ CMBS: We feel cautious, especially on office and multifamily. Delinquencies increasing as maturities come due. Credit curve remains steep. AAAs have mostly retraced post SVB widening, but BBBs remain at widened levels. ▪ CLOs: Pick up in new issuances leading to slightly tightened spreads. Defaults remain low. ▪ ABS: Attractive relval in some senior positions; higher quality borrowers remain stable, lower quality borrowers continue to underperform. Market is active with decent valuations.	▪ 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 spreads on a secular level. ▪ Rising interest rates turn home prices negative, denting housing market strength. ▪ 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 09.10.2023, 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