COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

11 March 2024

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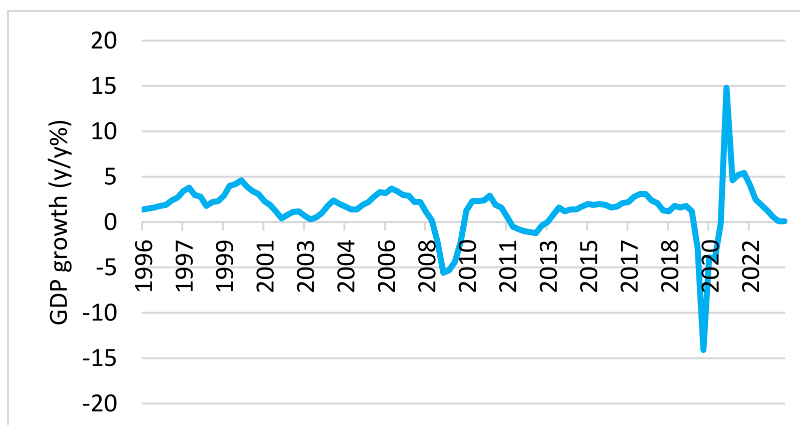
Going nowhere fast.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.07%	-11 bps	-0.5%	-0.5%
German Bund 10 year	2.26%	-15 bps	-1.3%	-1.3%
UK Gilt 10 year	3.95%	-16 bps	-2.3%	-2.3%
Japan 10 year	0.76%	4 bps	-0.6%	-0.6%
Global Investment Grade	105 bps	-2 bps	0.0%	0.0%
Euro Investment Grade	118 bps	-2 bps	0.1%	0.1%
US Investment Grade	99 bps	-2 bps	-0.1%	-0.1%
UK Investment Grade	98 bps	-3 bps	-0.6%	-0.6%
Asia Investment Grade	169 bps	12 bps	1.2%	1.2%
Euro High Yield	363 bps	2 bps	1.8%	1.8%
US High Yield	326 bps	-6 bps	1.1%	1.1%
Asia High Yield	720 bps	18 bps	4.9%	4.9%
EM Sovereign	309 bps	0 bps	0.7%	0.7%
EM Local	6.2%	0 bps	-0.8%	-0.8%
EM Corporate	292 bps	5 bps	1.9%	1.9%
Bloomberg Barclays US Munis	3.4%	-6 bps	0.0%	0.0%
Taxable Munis	4.9%	-10 bps	-0.1%	-0.1%
Bloomberg Barclays US MBS	44 bps	-7 bps	-0.6%	-0.6%
Bloomberg Commodity Index	227.64	0.9%	0.4%	0.4%
EUR	1.0937	0.9%	-0.9%	-0.9%
JPY	146.60	2.1%	-4.1%	-4.1%
GBP	1.2842	1.6%	1.0%	1.0%

Source: Bloomberg, ICE Indices, as of 8 March 2024. *QTD denotes returns from 31/12/2023.

Chart of the week – Eurozone GDP growth, 1996-2023



Source: Bloomberg, Columbia Threadneedle Investments as of 11 March 2024.

Macro / government bonds

Last week saw little destabilisation on the path to a lower rate environment. In the US, Jay Powell, Chairman of the US Federal Reserve stuck to his script in the semi-annual testimony to Congress and the Senate, stating that interest rate cuts can and will start this year and that the Fed is not that far from receiving sufficient evidence on disinflation to act. Aside from these comments, there was little further light on the direction of US monetary policy. The market had to content itself with parsing economic data. While there were no blockbuster numbers, there was a continuing trickle of evidence that the labour market is cooling. Job openings declined, as did the rate of people quitting their roles, which is associated with a less buoyant economy. Although Non-Farm Payrolls, one of the most widely followed US labour market data points, came in stronger than expected, there were some market friendly data points contained within the labour market statistics, which prevented a knee jerk rise in US Treasury yields. The US unemployment rate ticked up from 3.7% to 3.9% for February, while average hourly earnings month on month came in at 0.1%, relative to 0.6% the previous month. The context for the data was the higher than expected readings on inflation and the labour market in January, which had raised the question as to whether the data was an aberration or evidence of a reacceleration in inflation. The tone to recent economic data suggested that the market could, for the time being, breathe a collective sign of relief, and continue with its hypothesis that the path to interest rate cuts this year remains intact. Over the week, there was a greater fall in interest rates at the long-end of the US Treasury market than at the short-end, resulting in a bull flattening trend, which was replicated in core interest rate markets globally.

In Europe, the European Central Bank met and decided to leave interest rates on hold at their current level of 4.5%. The ECB also released quarterly projections for economic growth and inflation. The ECB downgraded its growth projection for 2024 from 0.8% to 0.6% prior to a pick-up in subsequent years, while it decreased its core inflation projection from 2.7% to 2.3% for 2024. The framework for evaluating growth is that that the fall in core inflation should increase real incomes over the longer term and thereby support household consumption and business investment. The key variables the ECB has been looking at are wage negotiations and corporate profits, and whether these are stabilising at lower levels. Christine Lagarde, ECB President, stated that they would know a little more on disinflationary trends in April, but a lot more in June. This dovetailed with previous comments she had made that June seemed an appropriate time to cut interest rates, given ongoing weakness in the broader eurozone economy. This raised a new question in markets, as to whether the ECB could move before the Fed. Market pricing of the first rate cut remains anchored around June / July, as it is in the US. The relative weakness of the eurozone relative to the US, however, could prompt a first move.

In the UK, we had the spring budget, which will set the tone for the coming general election. In headline measures, the government used available fiscal headroom to deliver tax cuts, by reducing national insurance by 2p, while the upper limit for child benefit was also increased from £50k to £60k. The government did not make any changes to the personal allowance, so any largesse on taxes was therefore offset by the impact of fiscal drag, which brought more people into the tax net. While borrowing would increase in the near term, it would start to gently fade by the end of the forecast period of 2028-29. The Office of Budget Responsibility expects the policies to provide a near time stimulus to demand while marginally increasing supply in the medium term. The OBR also pointed to declining inflation and stagnating growth. All the measures were widely trailed in the media and there were no proverbial rabbits plucked out of hats. This allowed the gilt market to take the budget in its stride. Price action in the US Treasury market remained the primary determinant of gilt price movements.

In Japan, there was continued speculation about an end to the Bank of Japan's negative interest rate policy, exerting marginal upward pressure on yields on 2-year and 10-year securities. The ending of negative interest rates will mark a historic point for global interest rate markets, which may encourage domestic life insurance companies to repatriate capital from overseas bond markets back to Japan to the domestic bond market.

As a desk, we remain constructive on interest rate risk, although we continue to manage exposures tactically.

Investment grade credit

Global investment grade spreads edged tighter by around two basis points last week. The move was led by financials and sterling credit.

This move means that Global IG spreads are around 10bps tighter YTD with the euro market outpacing US dollar credit spreads. There was also a notable slowing in primary market activity, which had been heavy recently.

Specicifically German Banks rallied on the back of more confidence about Deutsche Pfanbriefbank. In the UK, Virgin Money rallied strongly on news it is to be acquired by rival Nationwide.

High yield credit & leveraged loans

US high yield bond spreads were largely unchanged over the week amidst limited surprises in economic data, an active new issue market, and in-line earnings reports.

The ICE BofA US HY CP Constrained Index returned 0.58% and spreads were 5bps tighter. According to Lipper, retail high yield funds reported $347m of inflows over the week, leaving YTD inflows at $3.5bn. Meanwhile, the average price of the Credit Suisse Leveraged Loan Index rose $0.13 to $96.06, a high since May 2022, amidst robust CLO origination, a lull in primary issuance, and retail fund inflows. Retail loan funds saw $497m contributed over the week, the largest weekly inflow YTD, pushing YTD net inflows to $1.9bn.

European High Yield had a strong start for March, returning almost 1% in the first week. This was largely supported by the fall in underlying government bond yields as spreads held steady over the week. Market compression continued with strong performance from euro CCCs, outperforming BBs and Bs. The market was supported by continued inflows, with ETFs also participating this week. The primary market picked up this week with three new corporate issuances totalling €2.35bn (the largest weekly issuance YTD).

In credit rating news, RollsRoyce was upgraded by Moodys to Ba1 while Cellnex was upgraded to BBB- to S&P. The latter is now fully in the IG space. Grifols, the Spanish healthcare company was hit by a another shortseller report, questioning the company's "transparency, integrity, and ethical conduct." This was rebutted by the company who finally filed its annual accounts at the end of the week, as KPMG signed off on the financials.

Regarding potential deals, ALTICE, the French telecom, is in talks with the Saudis who have put in the highest bid for Altice Portugal. This works well with founder Drahi's plan to sell assets. At the same, French prosecutors have announced their own probe into possible corruption, post the Pereira and Altice Portugal debacle. Watch this space.

Asian credit

Chinese regulators including National Administration of Financial Regulation have reportedly asked large financial institutions to expand financing support for China Vanke. The company has deposited funds into a designated bank account to pay the $630m that matured on 11 March. China Vanke's liquidity position continue to be tight with around $800m of equivalent offshore and CNY3bn onshore public bonds coming due in Q2, 2024.

Overall, however, the central government has not made any significant policy change during the recent Two Sessions legislative conferences. The Ministry of Housing and Urban-Rural Development reiterated the policy thinking of "housing is for living in, not for speculation". Local governments are allowed to adjust their respective local property policies such as easing the local home-purchase restrictions (HPRs) but the impact on home purchases will likely be limited given the weakness in home purchase confidence.

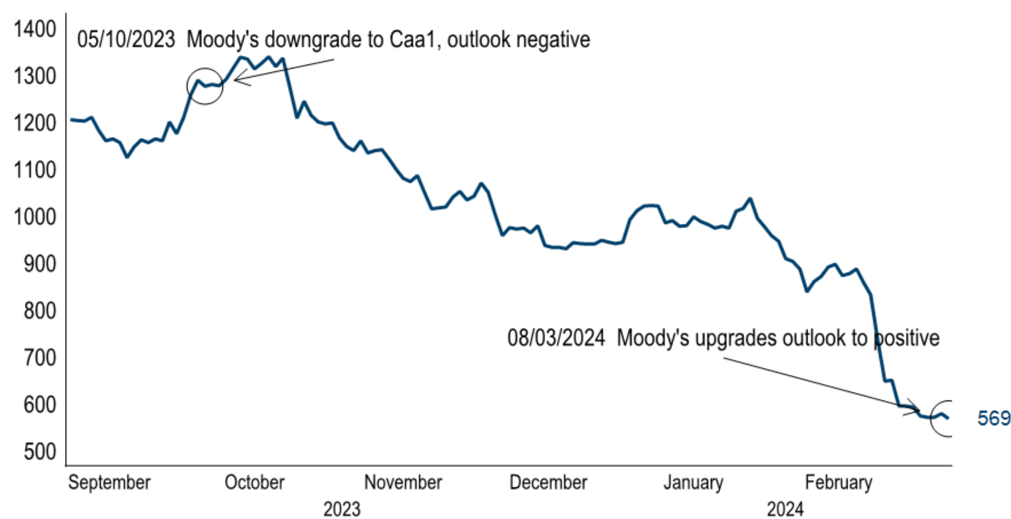
Emerging markets

Emerging market hard currency sovereigns returned +1.03% last week as both spreads and US treasuries contributed positively. High yield once again outperformed investment grade and we continue to see lower rated names such as Egypt, Angola and Ecuador driving performance. Spreads tightened 2bps to 365bps.

The IMF announced last week that it had finally reached a Staff Level Agreement (SLA) with Egypt following the agreement of economic reforms, including moving to a flexible exchange rate system. The Egyptian authorities last week devalued its currency to around 50 Egyptian pounds to the US dollar from almost 31 and also hiked the overnight interest rate by 600bps. Amid a more challenging external environment the authorities requested an increase of the original arrangement from $3bn to about $8bn. Following the positive news, Moody's upgraded Egypt's outlook from negative to positive, having only downgraded the country to Caa1 outlook negative in October. Spreads have tightened significantly since then and with the updated outlook, it now makes an upgrade back to B3 more likely later in the year.

Second Chart of the week – Moody's upgrades Egypt's outlook to positive

J.P. Morgan EMBIG Diversified Egypt Sovereign Spread



Source: Macrobond, and Columbia Threadneedle Investments

In Pakistan, sovereign spreads tightened by 117bps to 776bps. Bonds have been supported by the resolution of the recent election, which removes the risk of a contested election and prolonged political crisis. More recently, the IMF announced it was open to engaging with the new government to create a new medium term support programme: Pakistan's $3bn stand-by arrangement runs out in April.

Turkey was upgraded by Fitch to B+, outlook positive, as a result of tighter than expected monetary policy. The ratings agency cited that inflation expectations have eased, reserves are higher and the current account deficit is narrowing.

Primary market activity over the last week has included triple tranches deals from Israel and Poland. The former issuing $8bn over 5, 10 and 30-year bonds while the latter also launched $8bn but over a 5, long 10 and 30-year bond.

Commodities

The BCOM index rose by 0.8% on the week with gains in precious metals (+4.5%) and grains (+2.1%) offsetting losses in the energy complex (-2.2%).

In precious metals, gold and silver had a stellar week rallying by 4.3% and 5.1% respectively. Gold reached its highest level since 1979 on Thursday and has been supported by geopolitical uncertainty that comes with ongoing wars and the impending US election. Gold has been buoyed by rising expectations of a US rate cut (which makes non-interest bearing gold more attractive) and China increasing its gold reserves, which it added to for the 16th straight month. Silver (a part industrial and part precious metal) followed the move higher in gold. Macquarie expects silver to outperform gold as part of its base case global growth pick-up.

Agricultural commodities were supported by the US Department of Agriculture (USDA) revising down its corn production and soybean inventory estimates. The USDA also revised down global wheat inventory estimates.

In base metals, iron ore declined to its lowest levels since August 2022 dragged down by disappointing demand from China. Monday's national people's congress offered little in terms of support measures as Beijing refrained from broad infrastructure support stimulus, retaining its stance that homes are for living not speculation (a negative for the real estate sector).

Fixed Income Asset Allocation Views

11th 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.** ▪ 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 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 £P] 0 [$ € +1] +2 Long	▪ 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) Short -2 -1 [EM A$ 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)) Under-weight -2 -1 [0 C] [R +1] +2 Over-weight	▪ 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 easing 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 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. ▪ 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. Inflows are exceeding net supply despite record IG new issuance in January. ▪ 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 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 remain at tight levels; however, spreads are still flat to wide of historic long-term averages. ▪ Lower coupons have underperformed driven by rate move and regional bank headlines. ▪ 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, 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 near-term maturities, however non-office sectors perform as expected and overall market sentiment improving. ▪ 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 ▪ 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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