COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

11 December 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

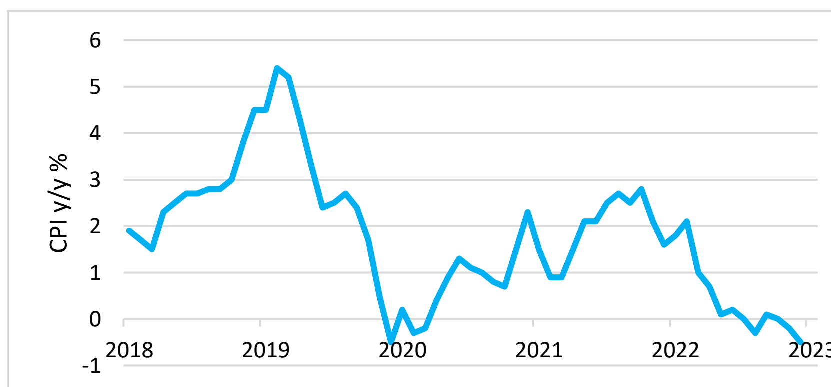
Downbeat data in China

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.23%	4 bps	3.2%	1.4%
German Bund 10 year	2.27%	-9 bps	4.4%	3.2%
UK Gilt 10 year	4.08%	-6 bps	4.2%	-0.6%
Japan 10 year	0.77%	7 bps	-0.3%	-0.8%
Global Investment Grade	120 bps	-2 bps	4.4%	5.5%
Euro Investment Grade	143 bps	-2 bps	3.7%	6.1%
US Investment Grade	110 bps	-1 bps	4.9%	5.3%
UK Investment Grade	118 bps	-2 bps	3.9%	5.1%
Asia Investment Grade	178 bps	-8 bps	3.2%	5.7%
Euro High Yield	438 bps	-14 bps	3.6%	10.1%
US High Yield	375 bps	-12 bps	3.9%	10.1%
Asia High Yield	810 bps	-5 bps	3.5%	-1.4%
EM Sovereign	332 bps	-14 bps	5.7%	6.8%
EM Local	6.4%	-5 bps	5.0%	9.5%
EM Corporate	318 bps	-15 bps	3.2%	6.7%
Bloomberg Barclays US Munis	3.5%	-9 bps	6.2%	4.7%
Taxable Munis	5.2%	0 bps	5.0%	4.9%
Bloomberg Barclays US MBS	52 bps	0 bps	4.3%	1.9%
Bloomberg Commodity Index	223	-3.5%	-5.7%	-8.9%
EUR	1.0763	-1.1%	1.8%	0.5%
JPY	146.11	1.3%	3.0%	-9.5%
GBP	1.2559	-1.3%	2.9%	3.9%

Source: Bloomberg, ICE Indices, as of 08 December 2023. *QTD denotes returns from 30/09/2023.

Chart of the week – China consumer price inflation, 2018-2023



Source: Bloomberg, Columbia Threadneedle Investments, as of 11 December 2023.

Macro / government bonds

Last week saw a bull market in US treasuries rudely interrupted. The market had looked to evidence of a cooling labour market, which would justify the switch over to easier monetary policy. The magnitude of the rally in the US treasury market by mid-week meant that peak optimism had been expressed through five quarter point rate cuts. For the rally to have further legs, however, the market needed confirmation that we were in a new market phase and that the US Federal Reserve could close the door firmly on further monetary tightening. The script did not turn out that way. On Friday, the publication of November's Non-Farm Payrolls showed job growth of 199k, in excess of market expectations. In addition, average hourly earnings rose by 0.4% month-on-month, while the unemployment rate slipped to 3.7% from 3.9%. These were not data outcomes that supported further market momentum but rather underlined the resilience of the US economy. They also increased the probability that the Fed may yet have to implement an insurance rate hike. US treasury valuations weakened, aided by block trades in futures markets, as did expectations of the extent of rate cuts by the Fed.

In Japan, we saw a sharp spike in bond yields from 0.63% to 0.78% at the 10-year maturity point. Deputy Governor of the Bank of Japan (BoJ), Ryozo Himino laid out in a speech to local politicians a hypothesis that neither companies nor households should be that badly affected by a rise in interest rates. BoJ Governor, Kazuo Ueda, meanwhile, told lawmakers that monetary policy could be even more challenging from year-end. The market interpreted these comments as smoke signals that a future shift in monetary policy could take place within a relatively short time frame, cognisant of the fact that the BoJ had used its last December meeting to make a tweak to its yield curve control policy. When a shift in monetary policy by the BoJ does occur, it will be a pivotal event for financial markets. By either raising short-term rates or by lifting further the cap on the 10-year yield, the BoJ will effectively withdraw liquidity from the global financial system. Higher domestic interest rates, and the current high cost of hedging, means that many domestic life insurance companies in Japan may decide to repatriate funds. Although there have been bets from speculative investors that we are on the cusp of meaningful change in Japan, what matters more to the profitability of any short rates strategy will be the extent of that change, and the rate of that change.

Investment grade credit

Investment grade spreads continued to narrow last week and are at their tightest level this year, and the narrowest since early 2022 with a spread of 120bps.

Investor demand for the asset class remains encouraging and is doubtless buoyed by the still high yields on offer. Data from JP Morgan suggests that inflows into US investment grade in 2023 have already unwound the outflows seen in 2022. A present yield of just over 5% is well above the average of around 3.5% seen in the last couple of decades according to data from ICE indices.

Euro denominated spreads remain above short (5-year) and long term (20-year) averages while US dollar spreads are inside these measures. It should be noted that the euro market has a larger financials weighting and a lower techonology sector footprint though both indices have an overall average A3 credit rating. Financials have lagged the performance of more cyclical sectors such as media, industrials and energy this year following revisions higher to 2023 economic growth expectatations and problems at SVB and Credit Suisse earlier in the year.

In specific news, airline giant Lufthansa will return to the investment grade world after a recent upgrade from credit rating agency Standard and Poors.

High yield credit & leveraged loans

US high yield bond valuations stabilized over the week as compared to November's ferocious rally while US treasury rates continued to provide support.

The ICE BofA US HY Cash Pay Constrained Index returned 0.28% and spreads were 12bps tighter. According to Lipper, retail high yield bond funds saw a $2.0bn inflow, primarily driven by ETF activity. This leaves YTD outflows at $10.0bn. Meanwhile, the average price of the J.P. Morgan Leveraged Loan Index increased $0.13 to $95.50. Retail loan funds saw an $82m inflow over the week. YTD loan fund outflows total $17.6bn.

Another solid week for European High Yield (EHY) as the asset class returned 65bps with spreads narrowing 14bps to 438bps while yields fell 5bps to 7.3%. It was a strong start for the last month of 2023. Decompression was very much apparent as BBs outperformed Bs and CCC weakness continued with a negative return on the week. Flows were positive but focused on managed accounts as ETFs finished the week flat. The primary market was still open with two deals (Iliad and Loxam) amounting to €1.25bn. They were well received with the price coming in well from initial price talk. A few more deals are expected this coming week before the 'shop is closed' for 2023. Overall EHY demand was strong supported by the recycling of funds exiting Ford and Lufthansa paper (on back of the upgrade to IG and given the issuers' size in the EHY universe) as well as money from tenders and calls. Liquidity is good for sales but is challenging for bond purchases given the demand.

In sector news, even as macro figures show signs of a slowdown, the average consumer is not giving up on their leisure travel. In Europe, travel related firms (including airlines) are not seeing any signs of a demand slowdown and are still expecting growth in 2024.

In credit rating news, Adient was upgraded to BB, from BB-, on improved operational performance and de-leveraging. Lufthansa will return to IG after S&P upgraded it to BBB- from BB+. This followed Fitch's upgrade to BBB- in early November.

Structured credit

The US Agency MBS market was essentially flat last week. With a return of +14bps, index spreads were a bit tighter and rates, which rallied early in the week, then sold off to end the week flat. We had weak mortgage apps in the data again. November prepay speeds outperformed expectations, down 10-15%. In ABS, issuance was flat MoM at $27bn in November. We saw a stabilization in delinquencies across subprime autos and credit cards MoM while both remain net higher y/y. Charge-offs in cards increased 2.5% and within marketplace lending deals data suggests higher defaults across all FICO groups but particularly in the lower segments. Consumer tailwinds such as strong household balance sheets, inflation relief and a continued strong labour market are offset by economic uncertainty going into 2024.

Asian credit

Moody's downgraded the ratings outlook for China from stable to negative while it retained the country's A1 rating on 5 December. Moody's expects the central government to be forced to take on a substantial portion of the public debt to support financially-stressed regional and local governments as well as state-owned enterprises. Moody's also highlighted the higher risks from lower medium-term economic growth and the decline in the property sector. Moody's expects China to post GDP growth of 4% in 2024 and 2025, followed by an average of 3.8% from 2026 to 2030. On the back of the rating outlook downgrade for China, Moody's also cut the ratings outlook for both Hong Kong and Macau to negative.

The economic data in China was broadly downbeat. While export growth was marginally positive in November at 0.5% y/y (October: -6.4% y/y), coming in above market expectations, this was largely due to the soft prior-year base that was impacted by Covid restrictions. Meanwhile, import growth fell 0.6% y/y in November (October: +0.3% y/y), slipping below market expectations of an improvement of 3.9% y/y. The weak domestic demand environment

resulted in the soft import numbers, reflecting the pressure on commodity and raw material import volume.

At the inflation front in China, CPI inflation dropped to -0.5% y/y in November (October: -0.2% y/y), materially weaker than consensus expectation of -0.2% y/y. The PPI inflation also fell to -3.0% y/y in November (October: -2.6% y/y). These figures underscore the weak economic environment through November (**see chart of the week**).

The residential property market remains distressed. During the first week of December, the housing sales in 30 major cities dropped sharply by 34% y/y, faring worse than the double-digit decline of 15% y/y in November. The market is watching to see if there is any improvement in the lending environment for the property developers amid calls by the authorities for the financial institutions to step up lending to the sector.

Emerging markets

Another week of positive returns for emerging market hard currency sovereign bonds, the index returned +1.01%, driven by spreads tightening 15bps. The investment grade sub-sector outperformed high yield but both sub-asset classes posted positive returns over the week.

The Indian Central Bank held rates for the fifth consecutive time at 6.5%, indicating that policy would not be loosened as inflation is still above its 4% target. The RBI also raised its 2024 fiscal year growth forecast 7% from 6.5%. Policy makers in Poland opted to hold rates at 5.75%.

Moody's upgraded Oman's rating one notch to Ba1. The country has enjoyed a windfall from higher oil prices and the government has demonstrated spending restraint – together these factors have helped lower its debt burden and consequently puts the nation in a stronger position to withstand future shocks. The upgrade brings it in line with the other ratings agencies who upgraded Oman to BB+ in September.

In Argentina, newly minted president Milei promised deep cuts on spending and that only radical change can pull the country out of the current crisis, which includes 40% of the population in poverty and inflation approaching 200%. Milei is expected to draft legislation outlining emergancy economic measures; however, he faces an uphill battle given his lack of majority.

Commodities

The BCOM index delivered a -3.5% return on the week with precious metals (-5.1%) and energy (-4.8%) seeing the biggest losses.

Energy losses were led by further declines in US natural gas prices, which hit a new yearly low. This week's decline takes yearly losses to 66.2% as tracked by the Bloomberg natural gas subindex. In crude, brent prices extended their decline by -3.5%. Crude prices have been weighed down by a combination of weaker demand from China (crude imports dropping 9.2% y/y); Saudi Aramco reducing its selling price for crude by $2; and a growing expectation that OPEC will not be able to follow through on their recent incremental cuts.

In precious metals, gold declined by 3.6%, climbing down post hitting all time highs. Non interest bearing gold gave back some gains following the market pricing in a slightly lower chance of the US Federal reserve cutting rates in March compared to a week ago.

Fixed Income Asset Allocation Views

11th December 2023

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	■ Valuations are within historic ranges, tightening back in over the past month. Technicals seem stable; fundamentals show modest pockets of weakness, but no thematic deterioration. **The group stands neutral on credit risk overall, with no changes to underlying sector views.** ■ 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 geopolitical tension, stricter lending, monetary policy tightening, persisting inflation, and weakening consumer profile.	■ Upside risks: the Fed achieves a soft landing with no labour softening; consumer retains strength; end to Ukraine and Israel-Hamas wars. ■ Downside risks: Fed is not done hiking and unemployment rises. Another banking crisis, this time from unrealised losses on securities and CRE, supply chain disruptions, inflation, volatility, commodity shocks re-emerge.
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 15bps tighter than last month, benefiting from lower global rates. Technicals are slower, outflow and weak issuance. ■ Conservatively positioned with most idiosyncratic opportunities in lower quality portion of index, focus on relval opportunities. ■ 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.	■ 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	■ US and EMEA spreads have tightened since last month. ■ Fundamentals have proved resilient with decent earnings. Global portfolios prefer EUR IG over USD on relval basis. ■ Fundamental concerns remain focused on commercial real estate, unrealised losses for banking sector, tight labor supply, and changing consumer behaviour.	■ Lending standards continue tightening, even after Fed pauses hiking cycle. ■ Rate environment remains volatile ■ Mass layoffs spike, worsening consumer profile. ■ Geopolitical conflicts worsen operating environment globally
High Yield Bonds and Bank Loans	Under-weight -2 -1 0 +1 +2 Over-weight	■ Spreads have tightened over the past month, while technical and high – quality HY fundamentals remain stable. October brought more rising stars, but also more defaults. Financial conditions continue to punish destressed names. ■ Conservatively positioned, but open to attractive buying opportunities in short HY, BBs and higher quality loans. ■ US HY defaults remain below historic averages, with greater default expectations for 2024. ■ Bank loan market volatility has improved in the past month. Themes: neutral retail fund flows, slow primary deal flow, improving CLO issuance, increasing burden, credit concern in lower quality loans. Market performance mostly reflects idiosyncratic credit stories, not wider industry themes.	■ 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. ■ Loans see retail fund outflows once Fed starts lowering rates.
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	■ Mortgage index tightened in the past month; spreads still wide of historic medians. ■ The group has reduced position sizing, but still overweight. Constructive view over longer time horizon. ■ Supply is manageable as higher rates and fall seasonals kick in. ■ Performance has been driven by the Fed's hiking cycle, with MBS widening into a bear steepener.	■ 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	■ Positive outlook because of decent risk-adjusted valuations in select high quality Non-Agency RMBS, CLOs and ABS. ■ RMBS: September saw spreads tighten. Home prices resilient, expect higher rates will slow growth. Delinquency, prepayment and foreclosure performance remains strong. We expect fundamentals to hold in as long as labor market strength remains. ■ CMBS: The group is cautious, especially on office and multifamily, however non-office sectors perform as expected. Delinquencies increasing as maturities come due. Credit curve remains steep. ■ CLOs: New issue steadily continues. Defaults remain low but CCC buckets continue to rise slowly with lower recoveries. ■ ABS: Attractive relval in some senior positions. Higher quality borrowers remain stable, lower quality borrowers underperform. Fairly strong start to student loan repayment.	■ 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, 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 11.12.2023, 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