In Credit

12 August 2024

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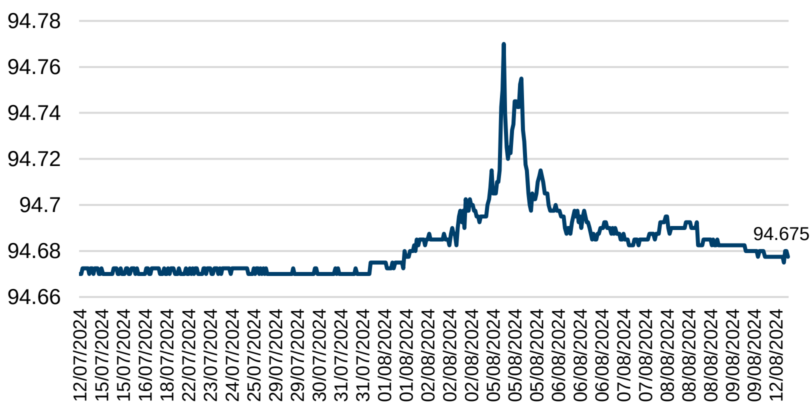
In, Out, Shake it all about

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	3.96%	17 bps	3.1%	2.3%
German Bund 10 year	2.25%	8 bps	2.3%	0.1%
UK Gilt 10 year	3.96%	13 bps	2.4%	-0.6%
Japan 10 year	0.85%	-10 bps	1.3%	-2.0%
Global Investment Grade	109 bps	0 bps	2.5%	2.7%
Euro Investment Grade	120 bps	2 bps	1.8%	2.3%
US Investment Grade	105 bps	-1 bps	2.8%	2.8%
UK Investment Grade	101 bps	4 bps	1.7%	1.6%
Asia Investment Grade	162 bps	-12 bps	1.9%	4.5%
Euro High Yield	398 bps	-1 bps	1.2%	4.4%
US High Yield	349 bps	-23 bps	1.9%	4.5%
Asia High Yield	600 bps	0 bps	1.7%	11.6%
EM Sovereign	360 bps	-12 bps	2.4%	4.3%
EM Local	6.3%	0 bps	4.1%	0.2%
EM Corporate	286 bps	-7 bps	1.9%	5.8%
Bloomberg Barclays US Munis	3.5%	7 bps	1.4%	1.0%
Taxable Munis	4.8%	18 bps	3.6%	2.3%
Bloomberg Barclays US MBS	44 bps	2 bps	3.5%	2.5%
Bloomberg Commodity Index	228.81	0.9%	-4.8%	0.0%
EUR	1.0928	0.1%	1.9%	-1.1%
JPY	148.19	-0.1%	9.7%	-3.8%
GBP	1.2774	-0.3%	0.9%	0.2%

Source: Bloomberg, ICE Indices, as of 12 August 2024. *QTD denotes returns from 30/06/2024.

Chart of the week – 30 Day Federal Funds Futures



Source: Bloomberg, Columbia Threadneedle Investments, as of 12 August 2024.

Macro / government bonds

Last week the market priced out some of the Fed rate cut euphoria that followed the weak Non-Farm Payrolls number release. There was a sense that the market had gone too far, too fast, helped by thin summer trading conditions (see **Chart of the week**).

The move to higher yields was nudged by the initial jobless claims. Claims came in at 233k – a drop of 17k on the previous month. Two-year US Treasury yields gapped 7bps higher on the news to 4.04%.

Fed speakers Daly and Barkin both made the point that it was too early to tell whether the labour market was normalising. All this contributed to lacklustre auctions of 10-years and 30-year US Treasury bonds.

In other markets, the Reserve Bank of Australia kept rates on hold at 4.35%, maintaining a hawkish stance. Government bond prices weakened on the news. The RBA justified its stance by pointing to the persistence of elevated inflation levels.

We saw the minutes of the Bank of Japan's meeting last week, which pointed to an eventual further tightening of monetary policy. Sustained wage hikes and the continued evidence of costs being passed through are expected to keep upward pressure on Japanese inflation and domestic bond yields.

The global rates desk increased its long duration position ahead of the Non-Farms Payroll number and took some profits on Monday. However, the team maintains a structural long duration position.

Investment grade credit

Spreads in core markets widened in reaction to the weak US data last week. Global IG spreads widened to 116bps from 109bps before calming back down to where it started the week. In Europe, spreads reached 127bps from 118bps, but retracted back down to 120bps. Lastly, in the UK, spreads widened less dramatically from 97bps to 102bps, and closed on Friday at 101bps.

New issuance last week was low, owing to market volatility.T-mobile postponed a US deal early on in the week before Meta Platforms Inc came to market on Wednesday as things were cooling off. This was followed by euro deals from Coca-Cola (€1bn) and VW (€500m) igniting the market back to life.

High yield credit & leveraged loans

US high yield spreads widened to YTD highs early in the week as investors digested last week's soft labour market data. Spreads ultimately recovered roughly half of the widening, as measured from late-July levels, as the week progressed with dovish BoJ commentary and additional economic data points that soothed concerns somewhat. The ICE BofA US HY CP Constrained Index returned 0.30% and spreads were 24bps tighter. The yield-to-worst of the index ended largely unchanged at 7.65% after briefly approaching 8.00% intra-week. According to Lipper, retail high yield funds saw $1.2bn of outflows over the week, largely concentrated within ETFs. This was the largest outflow in four months.

Similarly, the average price of the Credit Suisse Leveraged Loan Index recovered approximately half of its drawdown from late-July levels over the week, increasing $0.45 to $95.5. Retail loans funds saw a $3.1bn outflow over the week. This was the largest outflow since March 2020 and approximately 80% concentrated in ETFs.

In spite of the market volatility last week, European High Yield's initial spread widening at the start of the week reversed, ending up doing a round trip and finished the week largely unchanged with spreads at 398bps (-1bps) and yields at 6.88% (+0.01%). Performance for the week was a modest positive (+0.08%), with further decompression seen as CCCs underperformed higher rated credits, returning a negative performance (-0.57%). Sterling high yield also underperformed EHY. There was a small outflow from EHY, solely from managed accounts as ETFs still experienced modest inflows. The summer lull has started with primary markets closed last week: they are not expected to re-open until September.

JaguarLandRover was upgraded by Moodys to Ba2 from Ba3 with outlook positive, citing "significantly improved credit metrics on the back of its consistently strong operating performance over the past two years, which has continued with the first quarter results…"

For Thames Water, the risk of the utility losing its licence due to the loss of its IG rating has been put to rest, for now. Ofwat, the regulator, has provisionally agreed to Thames' proposal to regain its credit rating to put the issuer back into compliance with the licence requirements. Thames has agreed to take steps to deliver an equity raise by securing backing from investors, as well as the addition of two experienced independent non-executive directors who will supervise its turnaround plans and report back to the regulator.

Structured credit

The Agency MBS sector backed up last week alongside other duration sensitive asset classes on a resumption of risk appetite. As the week came to a close, spreads widened slightly, and rates rose nearly 20bps reversing the positive trend earlier in the week. 30-year mortgages underperformed 15-year mortgages and higher coupons outperformed lower coupon bonds.

In Non-agency RMBS, spreads widened across most sectors: Non-QM 5-10bps, CRT 10-30bps, 2nd liens: 5bps. In ABS, the primary market commenced its August slowdown as it priced just $3.4bn this week, up from a single $536m deal in the prior week. One deal was postponed due to unfavourable market conditions following the release of last week's payroll numbers. We have about $12.5n in the new issue pipeline for this week. Meanwhile, the secondary market widened on the payroll release on Friday. As is typical in times of stress, we saw the offered side widen by about 5bps, the bid/offer spread widen and bids on BWIC's about 10bps wider. Some accounts viewed this as a buying opportunity as it was not a credit event and added paper at more attractive levels.

The CLO primary market was busy with seven new issue deals ($3.28bn), 14 resets ($7.42bn), and 2 refis ($0.62bn) pricing as of EOD Thursday. YTD new issue volume is up to around $120bn, which is 85% higher y/y and remains on pace with 2021, which was a record issuance year. Primary spreads felt a bit soft with the risk off tone to start the week with but held in relatively well. In secondary, there was a fair amount of spread weakness across the credit stack. AAA/AA spreads widened 10bps, A spreads widened 20bps, BBB spreads widened 25bps, and BB spreads widened 50bps. BWIC volume for the week was the highest we have seen since the last week in June.

Asian credit

The export data in China for July was underwhelming and implies a weakening external environment for global demand. Export growth in US dollar terms decelerated to 7% in July (June: 8.6%) against the consensus expectation of an increase. The slowdown in export growth was due to the weaker demand in Asia, notably Japan and South Korea. On another hand, import growth was 7.2% y/y in July, higher than consensus.

Hon Hai reported a positive trend in monthly revenue in July, driven by strong demand for AI servers and computing components. Its cloud business posted the strongest y/y growth and the company maintains its Q3,24 revenues target of positive y/y and q/q growth.

Emerging markets

A volatile week with EM debt taking its cue from the deterioration in broader risk sentiment on Monday before subsequently rallying back throughout the remainder of the week. Spreads finished the week 12bps tighter and back to unchanged relative to pre-payrolls levels at the start of August. Despite the volatility, EM Debt has delivered a 0.58% total return month-to-date on the move lower in rates, while EM local currency debt has been the standout with a 1.75% return so far in August.

While subject to the broader whims of the macro environment, EM did see a couple of positive idiosyncratic developments. The IMF released a statement on its progress with El Salvador, indicating a higher likelihood of a funded programme coming together this year than previously expected, which saw the country's bonds as one of the main outperformers on the week up 3.4%. Additionally, Ukraine launched its exchange and consent solicitation as the final step to restructuring its $23bn outstanding Eurobond stock, which should proceed relatively smoothly given a market-friendly approach by the authorities.

Despite the market turmoil there were several central banks cutting rates over the week, with Mexico, Peru, Romania, and Kenya all easing by 25bps. Most interesting was the decision by Mexico, where the unwinding of the MXN carry trade cast doubt on the bank's willingness to cut. Ultimately the bank sided with downside risks to growth amidst high real rates as justification for cutting combined with forward guidance for additional easing in coming months, although it was a split 3-2 decision.

For EM, macro remains in the driver's seat over the near-term and with credit spreads remaining resilient at the tighter-end of recent ranges, investors will likely remain cautious until markets achieve greater clarity over the state of both US monetary policy and global growth.

Fixed Income Asset Allocation Views

12th August 2024

COLUMBIA THREADNEEDL
INVESTMENTS

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 have widened a bit but still remain at tight, unattractive levels. Economic data has weakened but hasn't yet translated into any significant spread widening. Current valuations limit the spread compression upside and are misaligned with potential market volatility. ▪ **The group remains negative on credit risk overall, with an upgrade to Agency MBS to +2.** ▪ The CTI Global Rates base case view is that the hiking cycle is over, and the start of the cutting cycle is uncertain. With the recent CPI prints, the impetus is on the fed to bring the timing and the magnitude of cuts forward. ▪ Uncertainty remains elevated due to sensitive monetary and fiscal policy schedules and elections in various countries.	▪ Upside risks: the Fed achieves a soft landing with no labour softening; lower quality credit outlook improves as refinancing concerns ease; consumer retains strength; end to Glob 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 premiu ▪ Long run trend in safe asset demand reverse
Currency ('E' = European Economic Area)	A$ EM ¥ Short -2 -1 0 +1 +2 Long € £ $	▪ Dollar has been supported by US growth exceptionalism and depricing of the Fed while the ECB looks set to embark on a cutting cycle. ▪ Dollar likely to continue to be supported into year end, where a Trump presidency looks most likely, and with it a return to tariffs and America First policy.	▪ 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 carry trade unwinds intensify, hurting EMFX performance. ▪ Stubborn services inflation aborts EM easing cycles. ▪ Uptick in volatility. ▪ Disorderly macro slowdown boosts USD on flight-to-safety fears
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ EMD spreads have remained stable this month, following the improvement in distressed credit and stability in GCC despite geopolitical risk amid changes after the elections. ▪ Investment Grade spreads are at historical tights while High Yield still offers some value. ▪ 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. ▪ Potential for the start of a new war in the conflict between Israel and Iran.
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads have remained stable but are near record lows. The group is taking down credit risk because of flat spread curves and less spread compression upside. ▪ Due to the tight spreads across the board, the compensation for taking on additional risk, in seeking higher yields, seems unattractive. ▪ 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 remained stable but tight since last month. ▪ Anticipate credit selection will be the performance differentiator in 2024. Looking to avoid defaults/distress, focusing on credit recovery and deleveraging theses. ▪ Increased lender on lender violence and aggressive liability management exercises further increase the risk in the distressed and highly leveraged segment. We expect this to , accelerate in the coming months. ▪ Default forecasts for lower rated issuers, particularly in Europe, is deteriorating with default rates projected to go up.	▪ 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	▪ Spreads are still flat to wide of historic long-term averages. ▪ The decline in interest rate volatility since Fed signalled a definite end to the hiking cycle has been a tailwind for MBS. ▪ 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; seeing small increase in delinquencies for non-prime borrowers. ▪ CMBS: There is ongoing pressure, particularly on AAA securities. 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 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) behaviour 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 sugar ▪ o/w Zinc ▪ o/w Gasoline ▪ o/w Distillates ▪ o/w Cocoa ▪ u/w natural gas ▪ u/w corn ▪ o/w lead ▪ o/w silver ▪ o/w soybean meal	▪ Global Recession