In Credit

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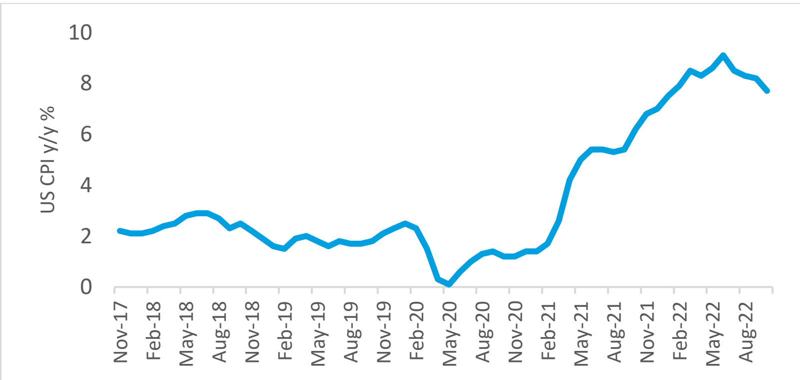
Lower inflation, higher bond prices.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	3.88%	-28 bps	-0.1%	-13.6%
German Bund 10 year	2.15%	-15 bps	-0.6%	-15.9%
UK Gilt 10 year	3.37%	-17 bps	5.3%	-22.4%
Japan 10 year	0.24%	-1 bps	1.4%	-3.6%
Global Investment Grade	170 bps	-6 bps	1.1%	-16.1%
Euro Investment Grade	192 bps	-16 bps	1.2%	-14.0%
US Investment Grade	158 bps	-3 bps	1.0%	-17.5%
UK Investment Grade	177 bps	-8 bps	6.5%	-17.5%
Asia Investment Grade	260 bps	-21 bps	-3.1%	-13.8%
Euro High Yield	530 bps	-58 bps	4.4%	-12.0%
US High Yield	481 bps	4 bps	3.1%	-11.9%
Asia High Yield	1126 bps	-207 bps	-8.6%	-29.7%
EM Sovereign	427 bps	-8 bps	3.0%	-19.9%
EM Local	7.1%	-34 bps	4.5%	-14.9%
EM Corporate	447 bps	12 bps	-0.7%	-16.8%
Bloomberg Barclays US Munis	4.0%	-19 bps	0.9%	-11.4%
Taxable Munis	5.3%	-31 bps	-0.7%	-22.7%
Bloomberg Barclays US MBS	56 bps	-8 bps	1.1%	-12.7%
Bloomberg Commodity Index	254.62	-0.4%	5.3%	19.6%
EUR	1.0333	3.9%	5.6%	-9.0%
JPY	140.44	5.6%	4.3%	-17.1%
GBP	1.1724	4.0%	5.9%	-12.6%

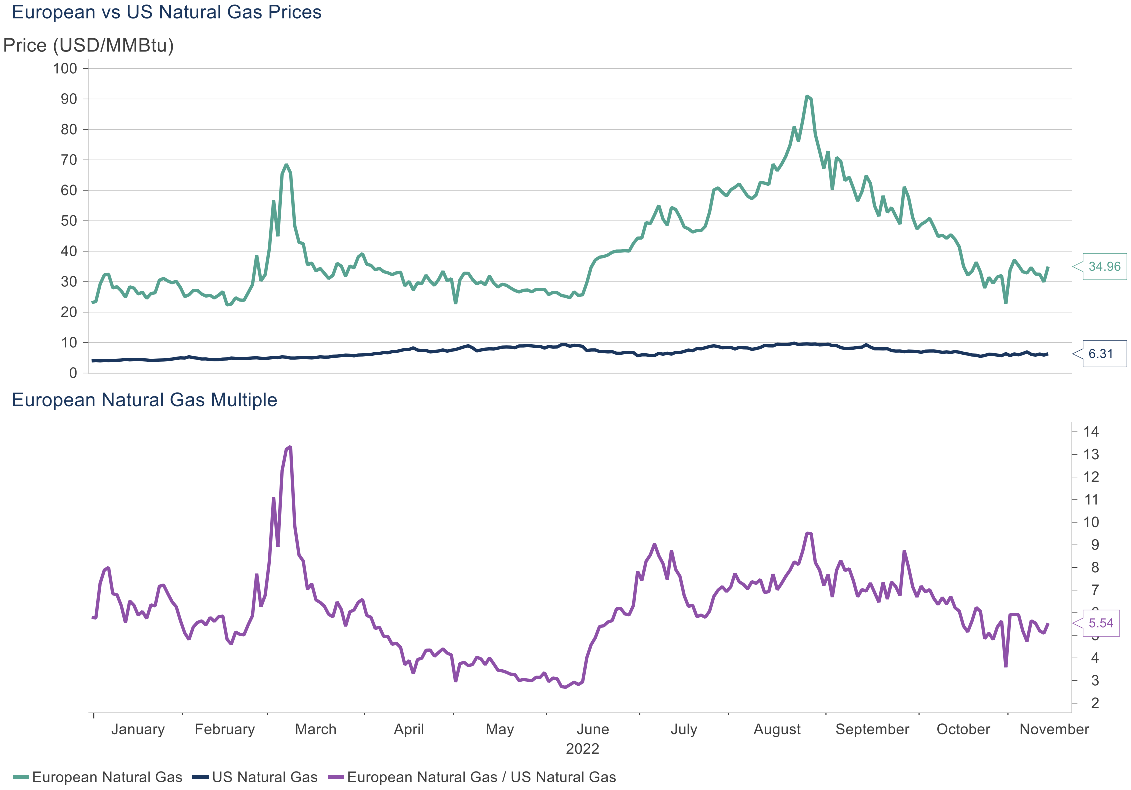
Source: Bloomberg, ICE BoML Indices, as at 11 November 2022.

Chart of the week 1: US CPI y/y %, 2017-2022



Source: Bloomberg, Columbia Threadneedle Investments, as at 14 November 2022.

Chart of the week 2: Natural Gas prices since January 2021



Source: Columbia Threadneedle, Bloomberg and Macrobond, as at 14 November 2022.

Macro / government bonds

It was a strong week for core government bond markets.

Lower inflation in the US, lower growth in the UK, a more muted mid-term US election result and the advance of Ukrainian military success helped pull interest rate expectations lower and pushed bond and equity prices higher. The US market was closed on Friday.

Last week's key data release was the consumer price inflation announcement from the US. Specfically, the month on month increase in October was 0.4%, below the consensus expectations of 0.6%. The core rate (ex food and energy) rose 0.3%, also below the consensus of 0.5%. This means that the year on year rate rose by 7.7%, which is some way below the rate of annual growth of over 9% recorded in June of this year **(see chart of the week 1).**

In the UK, GDP fell by 0.6% in September month on month. This means that in Q3, 2022 the economy contracted by 0.2%. In turn, this places the UK economy at the back of the G7 pack in terms of growth. The UK faces the dual headwinds of tighter fiscal and monetary policy, all the while recovering from the effects of covid and Brexit.

In other news, the US mid term elections saw fewer gains for the Republican Party than many had expected. Indeed, the Democrats have held onto the Senate. Meanwhile, in Ukraine the Russians abandoned the key regional capital of Kherson. In currency markets, the US dollar gave up gains as interest rate expectations fell after the consumer price inflation data. These so-called terminal rate of interest in the US has now declined to being below 5% over the course of the next 12 months. However, the weakest currency area was cryptomarkets. In the wake of the bankruptcy of FTX (a crypto exchange) such currencies declined materially over the week.

This week brings retail sales data in the US alongside corporate results from Walmart and Home Depot. We also see US producer price inflation news. In the UK, it is a big data week with retail sales, unemployment and consumer price releases. We also get Chancellor Hunt's fiscal statement where we expect to hear of plans for a further tightening in fiscal policy.

Investment grade credit

It was a very strong week for credit markets.

According to data from ICE indices, global investment grade spreads tightened to a spread of 170bps over government bonds. For context, such spreads were in the mid 180bps as recently as mid-october 2022. As in other areas of financial markets, credit spreads were supported by declining interest rate expectations in the US, following the better than expected consumer price inflation report. After performing particularly badly the euro market has performed best in the global context and spreads are now back below 200bps.

After a dearth of issuance last week brought a revival in the primary market. New deals were forthcoming often with attractive new issue premia. The technical background is supported by market inflows and several corporate and financial bond buybacks.

High yield credit & leveraged loans

US high yield bond yields declined 30bps over the week, driven entirely by lower interest rates, following Thursday's lower than expected CPI report.

The 10-year US treasury rate was 35bps lower over the week, ending at 3.81%. The ICE BofA US HY CP Constrained Index returned 1.30% while spreads were 6bps wider. US high yield retail funds posted net inflows of $1.04bn for the week, marking a fourth straight positive reading, and the longest uninterrupted inflow streak since the summer of 2020, according to data from Morningstar.

Meanwhile, leveraged loan returns were positive but underperformed bonds given the rate driven nature of the move. The Credit Suisse Leveraged Loan Index returned 0.37% as the average price of the index increased $0.28 to $92.71. US loan funds posted an outflow of roughly $695m for the week. This comes a week after the asset class saw an inflow of $379m after 10 straight weeks of losses.

European High Yield (EHY) continued its positive march, returning +2.5% last week. Single B's outperformed BB and CCCs while sterling high yield marginally underperformed EHY. Returns benefitted both from credit spread tightening (-58bps to 530bps) as well as the fall in the underlying government bond yields as EHY yields fell 62bps to 7.67%. Flows returned to negative with €325m out via both ETFs and managed accounts. Corporate primary market remained subdued with only the Forvia (formerly Faurecia) sustainability-linked deal coming to the market. An indication of market demand was that the offering was upsized by an additional €300m (to €700m) with the 3.5 year bonds priced at 7.25%, coming at the tighter end of the initial price talk. Market talk is that there are now only about three weeks left for issuance before things close down for the Christmas period.

The relatively positive tone for third quarter reporting continued. Cyclicals, like the auto sector, in general showed supportive results with numbers meeting or beating expectations as well as confirming the year's guidance.

In credit rating news, Rexel's corporate rating was upgraded to Ba1 from Ba2 by Moody's. Interestingly, the bonds were upgraded 2 notches to Ba1 from Ba3 as Moody's cited good de leveraging and improved balance sheet commitment from the management.

The effect of private capital on high yield markets continues and grows. Towards the end of last week, Superior Industries, a US car parts manufacturer, was downgraded to B- from B by S&P, who cited concern over increased refinancing risk as more than 50% of its debt is coming due within the next two years in an environment of rising inflation and macroeconomic uncertainty. The day after the downgrade, M2 capital, a private equity group, announced a tender to purchase 100% of the company, with cash, at an almost 40% premium of the company share price. Bonds rallied strongly on the news, finishing up for the week, returning to a price last seen just before Russia invaded Ukraine this year.

Structured credit

It was a big week for the agency MBS market on the back of a significant rally in rates. The sector outperformed other quality sectors posting a +2.85% total return as volatility continued to taper. That said, investors remained focused on the supply/demand balance despite historically high spreads in agency MBS. While net supply is coming down, with lower loan sizes, declining average FICO scores in new origination and higher cash-out refi fees, the Fed's run-off means money managers must step-up in size to make up the shortfall.

In non-agency, performance remains strong. The 7% mortgage rate has created a meaningful headwind for prepays and transaction activity with affordability down roughly 50%. As a result, we've now had three successive months of home price declines. Spreads remain very attractive at around +250bps for AAA and +1000bps for B rated non-agency MBS.

In ABS, new issuance for October increased vs. September but remained low. YTD volumes are 14% less than 2021 with increases in credit cards and Prime Auto. Spreads are wider with delinquencies continuing to rise in Marketplace Lending and Cards, specifically. Consumer health is deteriorating; however, some of this is a return to normal trend. In CMBS, spreads were mostly wider last week on higher supply.

Asian credit

PBOC and CBIRC (China Banking and Insurance Regulatory Commission) jointly issued a notice that lays out plans to ensure the stable and healthy development of the property sector. The notice includes a comprehensive set of 16 measures that include property development loans and homebuyers' incentives. Interestingly, the measures also include the maturity extension of banks loans and trust borrowings (due within six months) to one year.

The regulators also instructed the second-tier banks to extend an additional CNY400bn ($56bn) of financing to the property sector for Nov-Dec 2022, in the form of loans, mortgages and bond investments. This is an addition to the CNY600bn ($85bn) of net financing that PBOC and CBRIC told the six largest banks in China to extend to the property sector for the final four months of 2022.

Additionally, the regulators will also determine the next batch of property companies for the issuance of state-guaranteed CNY bonds. According to REDD, the property developers (Longfor Group, Seazen Holdings, Midea Real Estate) could receive around CNY5bn-CNY20bn of bond quota, which will be backed by China Bond Insurance Corporation Limited (CBICL). The property developers have to provide collateral for the state-guaranteed bonds. These potential CBIC-guaranteed bond issuances came on the heels of the news last week that the National Association of Financial Institutional Investors and the PBOC could approve CNY250bn ($35bn) of financial support for Chinese private enterprises, including the property developers.

Emerging markets

EM bonds enjoyed the treasury rally at the end of last week with hard currency sovereigns returning 2.62%. Spreads tightened 17bps, sub-Sahara Africa performed very strongly. EM currencies fared well as the US dollar weakened with Asian currencies and Colombian Peso particularly benefitting from the risk-on sentiment. Brazilian assets, on the other hand, performed poorly following Lula’s announcement on the alteration of the spending cap, leading investors to fear gradual fiscal erosion. Lula's subsequent taunting of the market by calling the reaction "sensitive" did not help.

Nigeria was downgraded one notch by both Moody’s and Fitch to B3 and B- respectively. Moody’s also placed the country on negative watch. Despite the higher oil price this year, Nigeria has seen a steep fall in oil production and the fuel subsidy system it has in place effectively erodes the increased revenue it generates.

In China, covid quarantine times were lowered from 10 to 8 days for identified close contacts of those testing positive and those traveling into China. This consists of 5 days in a centralised location and 3 days at home. Authorities will also stop suspending inbound flight routes due to the detection of infected passengers and no longer track people beyond close contacts of covid infections.

In Turkey an explosion in Istanbul has left 6 dead and 81 wounded. Turkey blames Syrian PKK and the US backed PYD militants. Turkey’s interior minister Soylu compared US messages of condolence akin to “a murderer returning to the crime scene” and vowed to “respond heavily” to the attack. The tragedy is negative for both US/Turkish relations and stability in the Middle East.

Egypt has secured a $550m package in support of its NWFE energy pillar initiative that aims to address the global climate emergency. This initiative is expected to raise up to $10bn in private investment to install 10GW of wind and solar energy in Egypt by 2028. Egypt also now aims to achieve a 42% renewable generation target by 2030, brought forward from 2035.

Commodities

The BCOM index declined modestly with strength in the base metals complex being offset by weakness in energy markets. Commodities were supported by a weakening US dollar (-4.1%) making commodities cheaper to non-US buyers.

Energy markets have been caught between the weakening global growth outlook and the recent easing of China's covid controls. US Natural gas, the BCOM index's highest individual weighting, sold off 7.3%, despite a bullish EIA report. The report forecasts the highest real gas price since winter 2009-10 at an average of $6.09. This is driven by storage at 4% below normal levels and higher LNG demand when the Freeport LNG terminal (the one that exploded) comes back online. Following the recent sell off in US natural gas, US prices are x5 cheaper than European counterparts **(see chart of the week 2).** US gas has been much cheaper, and a lesser squeeze on the consumer thanks to US shale.

We also got further details on the EU's Russian crude price cap. From 5 December EU and UK companies will be prohibited from providing shipping, financing and insurance for tankers carrying Russian oil above the cap to a third country. This follows the EU's ban of Russian crude. This comes with a loophole: "refined products" such as diesel made from Russian crude outside the EU block are exempt from the outright ban, meaning Russian crude (sold below the price cap) could be insured by and transported by EU companies to a third country outside the block then refined and sold to the EU.

Base metals performed strongly with nickel prices rising the most on the week (+13.1%). After consideration the LME decided against banning Russian metal given a sufficient number of consumers plan to keep buying these metals. No explicit sanctions have been placed on Russian metals, but some consumers have been "self-sanctioning".

Responsible investments

As we enter the second and final week of the COP27 meeting in Egypt, the pressure is on for debates to start turning into decisions. As mentioned last week, a key focus on 'loss and damage' is now top of the agenda. Poorer countries unable to self-fund the repair and prevention of climate change are seeking an 'intermediary fund' to provide the finance they desperately need for the most recent effects of global warming. Calls for a longer term financing facility have been raised, but it seems the general feedback is that that's just not soon enough. The UK Prime Minister did announce in his speech last week that the UK government would be investing in Kenyan and Egyptian clean energy projects and fund rainforest protection in the Congo basin.

At the end of last week, Blackrock announced it would be removing the Article 9 label from 17 of its ETFs that amounted to a combined total of $26bn (as at 30/09/2022). This is after the guidelines from the EU on SFDR requirements were updated to now enforce that 100% of the assets in an Article 9 fund must be invested into sustainable assets (with allowances for cash and hedging). Blackrock isn't alone in this demotion of ESG labels as other big players have had to do the same.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

14th November 2022

COLUMBIA THREADNEEDLE 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	▪ Credit spreads have widened since the last meeting with volatility still high and a market-wide softening in technicals and fundamentals. This has **kept the group negative on credit risk with only sector change to upgrade Agency MBS.** ▪ We are past the peak of economic growth with first few hikes done and expectations for two more 75 hikes through the end of 2022. Pullback in liquidity created opportunity for market volatility. ▪ Uncertainty remains elevated due to fears surrounding pace of central bank hiking, inflation, recession probabilities, weakening consumer profile and the Russian invasion of Ukraine.	▪ Upside risks: the Fed achieves a soft landing, Europe sees commodity pressure easing, consumer retains strength ▪ Downside risks: simultaneous low unemployment, high inflation, hiking, and slowing growth cause a recession. Russian invasion spills into broader global/ China turmoil. New Covid variants. Supply chain disruptions, inflation, commodity shocks persists to 2023.
Duration (10-year) ('P' = Periphery)	¥ P $ Short -2 -1 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 ▪ Hiking cycles may be curtailed by weakening growth, as risk of a policy error increases ▪ change in UK fiscal position to contractionary is a positive for the front end	▪ 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)	¥ A$ EM Short -2 -1 0 +1 +2 Long $ €£	▪ The invasion of Ukraine will hit global growth, hinder risk markets and lend a bid to the Dollar ▪ The repricing of the ECB has so far failed to boost the Euro as Eurozone growth expectations have underperformed the US	▪ End of zero-covid strategy in China normalises supply chains and raises global growth, to the detriment of the Dollar
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	▪ Substantial monetary policy tightening now embedded into EM local rates; inflation peaking in some places ▪ Aggressive Fed pricing may now open the door to selective EMFX performance ▪ EM real interest rates relatively attractive, curves steep in places	▪ Negative sentiment shock to EM fund flows ▪ Central banks tighten aggressively to counter fx weakness ▪ EM inflation peaks higher and later ▪ EM funding crises drive curves higher and steeper ▪ Further rises in DM yields
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ EMD spreads wider since last meeting; still seeing bifurcation in market with value in MENA energy producers ▪ Fundamental headwinds: elevated fiscal deficits, rising debt to GDP ratios, significant inflation, central bank tightening, China lockdown/growth, idiosyncratic political risks, difficult global financing conditions (US rates and USD strength), increasing use of IMF programs, geopolitical risks ▪ Techincals (outflows and supply) remain a headwind	▪ Chinese reopening postponed – weakened property market and confidence drag on growth ▪ Continued spillover from Russian invasion: local inflation (esp. food & commodity), slowing growth in trade partners, supply chains ▪ Persisting COVID growth scars hurt economies & fiscal deficits
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ US & EMEA spreads have widening. ▪ Watching for upcoming disclosure in Q3 earnings and Q4 outlooks. Inflation, labor supply, low dispersion and monetary tightening remain headwinds pressuring margins and operating environment in 2H 2022. ▪ Technicals have continued to struggle with slow issuance, negative fund flows and poor liquidity	▪ M&A expected to slow; cash flow prioritizing shareholder payouts ▪ Market indigestion as central banks sell EMEA corporates ▪ Rate environment remains volatile ▪ Russian invasion worsens operating environment globally
High Yield Bonds and Bank Loans	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads have widened since August. Combined with greater downside risks, the group prefers conservative position while open to attractive buying opportunities. ▪ Technicals remain a headwind with light primary issuance and negative YTD fund flows, however default activity remains benign/idiosyncratic. Watching for Q3 earnings and outlook commentaries ▪ Bank loan market has moved lower from greater volatility and fund outflows, but seeing stable CLO formation and less new loan issuance; concerns about recession and interest cost remain headwinds	▪ Default concerns are focused on demand destruction, margin pressure and macro risks ▪ Loan technicals & flows weaken ▪ Global consumer health weakens ▪ Russian invasion & spillover ▪ Commodity prices continue to retrace
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Mortgage spreads have widened in past month to the cheapest level in a decade; valuations and long-term fundamentals pushed the group to upgrade Agency MBSCurrent coupon spreads near recent wides ▪ Headwinds as money manager demand is small relative to Fed, bank, REIT and overseas selling pressure ▪ Looking to add as preference shifts to high quality assets	▪ Housing activity slows and rising rates move prepays to normal levels without hurting mortgage servicing rates. ▪ Fed continues to shrink position even as hiking is paused in recessionary scenario
Structured Credit Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Our preference remains for Non-Agency RMBS ▪ RMBS: Increase in mortgage rate creates headwinds for prepays and fundamentals. Delinquency performance remains strong, but housing is slowing. Reducing risk ▪ CMBS: Mostly solid fundamentals but weakening. Spreads flat MoM. Better relval in other sectors, continue to trim. ▪ CLOs: AAA spreads leaking wider as market deals with outflows. Default rate low but increasing. ▪ ABS: Lower income, renters, lower fico borrowers continue to underperform. Higher quality borrowers' performance remains with expectations. Reducing exposure to inflation-sensitive borrowers	▪ Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening, consumer retail/travel behavior fails to return to pre-covid levels ▪ Work From Home continues full steam-ahead post-pandemic (positive for RMBS, negative for CMBS). ▪ SOFR deals slows CLO new issue ▪ Rising interest rates dent housing market strength
Commodities	Under-weight -2 -1 0 +1 +2 Over-weight	▪ o/w Copper ▪ o/w Softs ▪ u/w Gold ▪ o/w Oil ▪ u/w Silver	▪ Global Recession