In Credit

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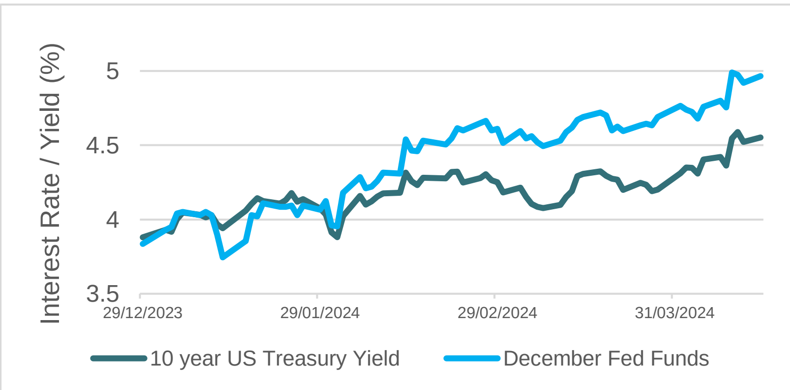
Hopes of US rate cuts are cut.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.56%	16 bps	-1.7%	-2.6%
German Bund 10 year	2.39%	-1 bps	-0.2%	-1.6%
UK Gilt 10 year	4.19%	12 bps	-1.6%	-3.5%
Japan 10 year	0.86%	7 bps	-1.1%	-1.7%
Global Investment Grade	98 bps	0 bps	-1.1%	-1.0%
Euro Investment Grade	112 bps	3 bps	0.0%	0.4%
US Investment Grade	92 bps	0 bps	-1.7%	-1.7%
UK Investment Grade	98 bps	1 bps	-1.0%	-1.0%
Asia Investment Grade	145 bps	-3 bps	-0.8%	0.5%
Euro High Yield	386 bps	10 bps	0.0%	1.7%
US High Yield	325 bps	7 bps	-1.1%	0.3%
Asia High Yield	669 bps	1 bps	-0.4%	5.4%
EM Sovereign	283 bps	7 bps	-1.3%	0.0%
EM Local	6.4%	12 bps	-1.4%	-3.5%
EM Corporate	266 bps	-2 bps	-0.6%	1.7%
Bloomberg Barclays US Munis	3.6%	2 bps	-0.7%	-1.1%
Taxable Munis	5.3%	9 bps	-2.4%	-2.8%
Bloomberg Barclays US MBS	49 bps	2 bps	-1.9%	-3.0%
Bloomberg Commodity Index	239.29	0.1%	3.7%	6.0%
EUR	1.0657	-1.8%	-1.4%	-3.6%
JPY	153.86	-1.0%	-1.2%	-8.0%
GBP	1.2486	-1.5%	-1.4%	-2.2%

Source: Bloomberg, ICE Indices, as of 12 April 2024. *QTD denotes returns from 31/03/2024.

Chart of the week – Dec 24 Fed Funds and 10-year US bond yields



Source: Bloomberg, Columbia Threadneedle Investments, as of 15 April 2024.

Macro / government bonds

Another week, another rise in government bond yields.

It has been a difficult year for this area of the bond market. 2024 began with much hope that interest rates would be cut in the face of declining inflation and only modest economic performance. But since then the major theme in government bond markets has been a reframing of those interest rate expectations. The catalyst this time was higher than expected US CPI data released last Wednesday (March CPI rose 0.4%, above the consensus of 0.3%; while the core measure also rose 0.4%, also 0.1% above expectations). This unwind of rate cut expecations has created a major hurdle for US bond yields to fall as can be seen in **Chart of the week.** In terms of timing in the US, the expectation of the first interest rate cut has been moved out from June / July to September, with only around one and a half rate cuts now 'priced in' by end of December 2024.

In Europe, the ECB as expected left policy rates on hold but offered more hope of easier policy conditions. A couple of dovish phrases stood out after the meeting. The ECB noted that it is: "data dependant… not US Fed dependant" and "in June we will get a lot more data". Christine Lagarde pointed to subdued growth in the eurozone and gradually diminishing price pressures. She also sought to create 'clear water' between the ECB and the Fed.

Turning back to the US, we also had PPI inflation data last week, which came in softer than expected. This softness contributed to preventing a further break out higher in US bond yields. The data underlined a familiar story of upward price pressures from services and downward price pressures from the goods sector.

In other European data, German & French inflation came in line with expectations of 2.2% and 2.3% y/y respectively, both of which were a decline from the prior months.

Investment grade credit

Global investment grade spreads were largely unchanged in the last week ending at 98bps at close of business on Friday. Spreads closed Q1, 2024 at 101bps according to data from ICE indices. Present valuations (spreads) look stretched compared to short and longer-term averages and are fairly unattractive. Though given the move in government bonds, yields remain relatively high.

New issuance was quieter last week against positive inflows into the market. We currently have a positive view on the structural backdrop for IG credit (supply versus demand).

US banking giants JP Morgan, Wells Fargo and Citibank kicked off reporting seasons at the end of the week. In summary, these banks are facing falling margins; rising credit losses (to above normalised levels); and anaemic loan growth (illustrative of tighter lending conditions). However, capital levels are high (and rising) and earnings are strong. As a result, we currently summarise US banking fundamentals as neutral.

High yield credit & leveraged loans

US high yield valuations widened over the week amid a firmer than expected CPI report that drove a repricing of Fed expectations. The ICE BofA US HY CP Constrained Index fell -0.62% and spreads were 7bps wider, while yields increased 22bps to 8.07%. According to Lipper, retail high yield bond funds reported a $476m outflow, the sixth outflow over the last nine weeks. The leveraged loan market was resilient in the face of a higher for longer environment. The average price of the Credit Suisse Leveraged Loan Index was unchanged at $96. Retail loan funds reported a 16th consecutive weekly inflow with a $676m contribution.

It was a heavy week of new issuance and the largest number year-to-date, with six corporate offerings totalling almost €3bn. Though European high yield performance was flat for the week, these new issues were well received with pricing coming at the tighter end of initial pricing.

Flows into the asset class continued with another €270m added via both ETFs and managed accounts. This brings the YTD figure to €5.1bn.

It was a tough week for French companies as Bio Group – the lab testing group – was downgraded to B3 while Atos, the beleaguered technology firm was downgraded to CCC- by S&P on the expectation of debt for equity swap or distressed exchange. The real estate sector fared poorly as Fitch downgraded Peach Property senior unsecured debt to BB- given the firm's constrained liquidity ahead of 2025 maturities. There was better news in leisure with Tui Cruise upgraded by Moody's to B3 (from Caa1), just in time for its new bond issuance last week.

Liability management exercises continued last week with more shenanigans at SFR, Intrum, Ardagh and with the aforementioned Peach Property said to be also talking of adding an advisor to consider its options.

Asian credit

The Macau gaming companies have started to access the US dollar bond market again for debt refinancing. Melco Resorts issued a $750m bond to refinance its revolving credit facilities and extended the maturity of the facilities by two years to April 2027. Studio City launched a second tender offer for up to $100m for the STCITY '25s bonds which, if completed, will reduce the amount outstanding of this bond to $297m. Hysan Development launched a tender offer of up to $100m for its 5.5% subordinated perpetual.

PTT Exploration & Production has raised its stake in the Yadana oil field project (Myanmar) to around 63% (from 37%) after Chevron exited the project. Chevron had announced plans to exit its investment in Myanmar in January 2022, due to the US sanctions on the state-owned Myanmar Oil and Gas Enterprises who is another major stakeholder in the Yadana project.

S&P has downgraded Longfor Group from BBB- to BB+ with a stable outlook to reflect the company's leverage that will remain elevated over the next 12-24 months. Longfor Group is now rated Ba1/BB+ by all three rating agencies.

The US Department of Commerce and TSMC Arizona has signed a non-binding preliminary memorandum of terms (PMT) for up to $6.6bn in direct funding under the CHIPS and Science Act. Under the PMT, there is also a proposed loan of $5bn to TSMC. TSMC plans to apply for the Investment Tax Credits of up to 25% of the qualified capital expenditure at TSMC Arizona. TSMC has announced plans to build a third fab (factory) that will produce chips using two million or more advanced processes, by the end of the decade. Altogether, with the third fab, the capital expenditure of TSMC Arizona will amount to more than $65bn (first two fabs: $40bn).

Emerging markets

The combination of higher US treasury yields following the CPI print, as well as rising tensions in the Middle East resulted in EM hard currency sovereigns posting a negative return of -0.93% over the week. Spreads widened 7bps and the weakness was broad based with higher beta names bearing the brunt. GCC names as well as Egypt and Jordan underperformed amid concerns over escalation. Israeli bonds sold off at the end of the week though saw some recovery Monday morning.

This week IMF meetings will be held in Washington DC where geopolitics will likely take centre stage. The IMF has been pivotal in helping vulnerable EM countries implement structural reforms, thus reducing default risk which is one reason why EM sovereign spreads have tightened so much this year.

Peru surprised markets with a 25bps interest rate cut to 6% as inflation resumed its downward path and printed at 3.05% in March. EM bond funds enjoyed a second consecutive week of inflows as hard currency funds posted net inflows though local currency funds saw outflows.

Responsible investments

Issuance on the labelled bond market has continued to flourish, with year-to-date issuance now up 12% on this time last year, according to Bloomberg. As usual, a large portion of this is green bond issuance with the majority of bonds coming from EMEA-based issuers.

A water provider in the Philippines is hoping to come to the market with a blue bond as soon as next month. A blue bond ensures proceeds are ringfenced to projects providing solutions to improve pollution in the ocean and rivers. Plastic waste has grown to become one of the world's biggest pollution problems, with an estimated $80-120bn worth of plastic packaging lost from the economy each year due to lack of proper recycling procedures, according to a study by The World Bank. The study states that the Philippines is the third largest contributor to this waste with around 750,000 metric tons of plastic entering the ocean every year. This blue bond from Maynilad Water Services will aim to address solutions to both clean up the waste, as well as prevent more plastic entering the ocean. These projects would link to the UN SDG 14 – Life Below Water.

Fixed Income Asset Allocation Views

15th April 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, with no changes to underlying sector views.** ▪ 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 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)	Short -2 -1 0 +1 +2 Long A$ EM ¥ € £ $	▪ 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 benefit of the Dollar
Emerging Markets Local (rates (R) and currency (C))	Under-weight -2 -1 0 +1 +2 Over-weight R 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 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 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 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. Supply may slow in March after record issuance in Jan/Feb. ▪ 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. ▪ 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. ▪ 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. ▪ CMBS: The group is cautious, especially on office, floating rate, and near-term maturities. 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 remain 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 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. ▪ 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 Copper ▪ u/w Grains ▪ o/w Soybean Meal ▪ o/w Cocoa ▪ o/w Oil ▪ o/w Lead ▪ o/w Zinc	▪ Global Recession