Information for investment professionals

COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

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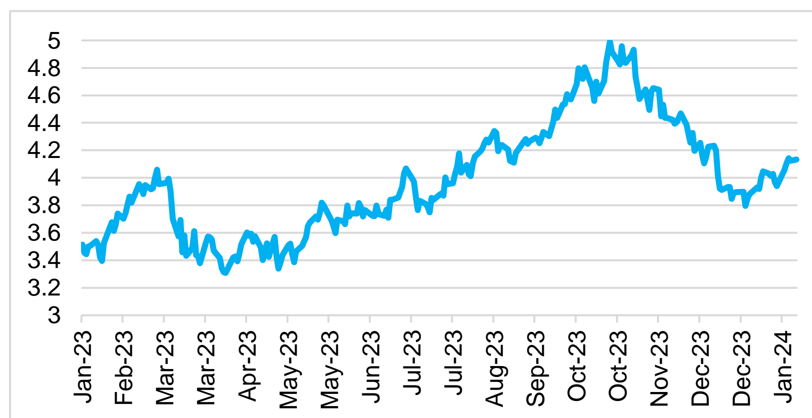
After the gold rush.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.09%	15 bps	-1.3%	-1.3%
German Bund 10 year	2.29%	11 bps	-1.9%	-1.9%
UK Gilt 10 year	3.89%	9 bps	-3.4%	-3.4%
Japan 10 year	0.66%	5 bps	-0.3%	-0.3%
Global Investment Grade	112 bps	-2 bps	-1.1%	-1.1%
Euro Investment Grade	134 bps	-3 bps	-1.1%	-1.1%
US Investment Grade	101 bps	-1 bps	-1.0%	-1.0%
UK Investment Grade	116 bps	1 bps	-2.1%	-2.1%
Asia Investment Grade	180 bps	-7 bps	-0.3%	-0.3%
Euro High Yield	394 bps	-7 bps	0.2%	0.2%
US High Yield	354 bps	-2 bps	-0.7%	-0.7%
Asia High Yield	767 bps	-3 bps	1.8%	1.8%
EM Sovereign	334 bps	1 bps	-2.0%	-2.0%
EM Local	6.2%	7 bps	-1.9%	-1.9%
EM Corporate	307 bps	-8 bps	-0.2%	-0.2%
Bloomberg Barclays US Munis	3.5%	15 bps	-1.0%	-1.0%
Taxable Munis	5.1%	16 bps	-2.1%	-2.1%
Bloomberg Barclays US MBS	47 bps	2 bps	-1.6%	-1.6%
Bloomberg Commodity Index	222.06	-1.1%	-1.6%	-1.6%
EUR	1.0888	-0.5%	-1.3%	-1.3%
JPY	147.90	-2.2%	-4.8%	-4.8%
GBP	1.2711	-0.4%	-0.2%	-0.2%

Source: Bloomberg, ICE Indices, as of 19 January 2024. *QTD denotes returns from 31/12/2023.

Chart of the week – US 10-year yield, LTM



Source: Bloomberg, Columbia Threadneedle Investments, as of 22 January 2024.

Macro / government bonds

Last week saw the market reprice interest rate risk, as markets pushed back on when loosening might start and the magnitude of rate cuts that might take place over the remainder of 2024. In the US, the probability of an interest rate cut in March reduced from 80% to around 50% over the course of the week, while the number of expected quarter point rate cuts decreased from 6.7 to 5.4. A similar pricing trend emerged in the eurozone and UK interest rate markets.

In the US, the catalyst for this was the relative strength of the US consumer, as US retail sales came in much stronger than the market had been expecting. Prior to January, financial markets had come a long way, following the US Fed's signalling of a lower interest rate environment. Retail sales came in at 0.6% for December versus 0.3% the previous month. To get to a first rate cut in March, however, requires a continuous affirmation that we were on a disinflationary path. Like a Greek chorus, Fed policy markets pushed back at any early move on interest rates. Waller, Fed Governor, urged caution on moving too quickly on inflation, while Atlanta Fed president, Bostic, delivered a similar message, arguing for the need to see further progress towards the 2% inflation target before taking action.

One byproduct of the repricing of interest rate expectations has been a change in technical market conditions. Since the start of the year, yield levels across maturities have been in an up-channel trend. The debate within the market is whether current upwards momentum in yields can be broken, as higher yields encourage tactical dip buying, or whether further examples of economic resilience in the US prompt yields to settle at a new higher level. In Europe, ECB President Lagarde pushed back on a March rate cut, noting that early rate cut calls were a distraction, and that while economic growth in the eurozone has weakened, labour markets remain tight. In the UK, inflation data surprised to the upside putting upward pressure on gilt yields. However, the primary driver of return, in both the UK and the European markets, was their beta or gravitational pull to the larger and more influential US treasury market.

On the global rates desk, we are long core fixed income markets but continue to manage long exposures tactically as we navigate key data releases.

Investment grade credit

Investment grade bonds continue to perform well, at least in terms of spread changes.

Global spreads are 3% tighter this year led by the US market, and especially longer-dated bonds. Sector wise, real estate, insurance and healthcare sectors have been the strongest with telecoms and autos the weakest; albeit that all sectors have recorded tighter spreads YTD.

The market remains supported by inflows against a backdrop of healthy primary market activity. This week sees the start of European banking earnings (e.g. Swedbank) and US numbers from Tesla and ASML amongst others.

High yield credit & leveraged loans

US high yield bond yields rose modestly over the week as resilient macro data and Fed rhetoric drove US treasury rates higher. The ICE BofA US HY CP Constrained Index returned -0.53% and spreads were unchanged. According to Lipper, retail high yield bond funds saw a $1.0bn inflow, entirely ETF driven. The primary market was active as well with nine new bonds priced for a total of $7.2bn of par value.

The average price of the Credit Suisse Leveraged Loan index was unchanged over the week at $95.6 amidst the largest amount of re-pricing activity for the asset class in three years. Retail loan funds saw a small outflow of $3m, just the third outflow over the last 12 weeks.

It was a soft week as European High Yield was pulled in opposite directions with credit performing solidly as spreads tightened 6bps to 394bps. This was counteracted by yields rising 8bps to 6.9% due to higher underlying government bond yields. Performance finished down 30bps. Compression continued as CCCs outperformed BBs by 3x, with the former returning +0.5%. Demand for EHY continued as inflows improved for both ETFs and managed accounts. The primary market remains light with only another two new corporate issues (€1bn). Issuance is now where it was at the same time last year (€3.2bn), which is smaller than was earlier expected. Issuers (e.g. in the auto sector) do not seem in a rush to come to the market, even with the better spread and yield levels and the demand for even lower rated credits seen on the other side of the Atlantic.

Credit rating news saw the continuation of more upgrades than downgrades since the start of the year. Moody's finally joined the other agencies in giving Lufthansa the nod to move to investment grade, upgrading it to Baa3. Adient, the car seat manufacturer, was also upgraded by Moody's from B2 to B1 citing improving profitability (better profit margins and free cash flow) and expectations of positive business trends. Unsurprisingly, S&P downgraded the beleaguered Atos, the digital services company, to B-. This came just days after the issuer announced another management reshuffle and that free cash flow would come in below target. Rumours of problems with the sale to Kretinsky did not help.

On the corporate front, the Red Sea attacks have not manifested into any increased concerns for shortages (e.g. electronic chips, food, auto parts) as corporates have mentioned buffer stocks and looking into alternative shipping routes. Lessons were learnt from the last years.

Structured credit

The US Agency MBS sector reversed some of its earlier gains and posted a 1.37% loss last week bringing YTD returns to -1.6%. Rate volatility resumed on stronger than expected retail sales, strong consumer sentiment and comments from Fed governors that there is no need to move quickly on rate cuts. 15-year MBS outperformed 30-year as spreads widened. There was a modest beat on housing starts and permits. Multi-family units under construction remain near the peak over a 40-year lookback but broadly speaking are not out of line with demographics. Mortgages continue to look cheap relative to other risk sectors. The swing factor remains an unexpected shift in Fed policy expectations or a change in bank demand, which has just started to swing positively in December.

Asian credit

According to Reuters, China has instructed heavily indebted local governments to delay or halt some state-funded infrastructure projects. For 12 regions that are at the highest debt risk level, the State Council has reportedly instructed these regions to suspend projects where less than half of the planned investment has been mobilized. The directive does not impact the affordable housing segment. This seems to be one of the latest moves to handle the tight balance of controlling financial risk and supporting economic growth.

China is also stepping up efforts to promote its NEV sector (the New Energy Vehicles) which includes battery electric vehicles, hybrids and fuel cells. Most of the initiatives are not new and the intent is to accelerate the implementation of charging infrastructure and pushing the usage of electric vehicles in the public sector and commercial sector.

Moody's has downgraded the ratings of the four large national asset management companies (AMCs) by one to two notches. While Great Wall, China Orient and Cinda continue to be rated investemnt grade after the downgrade, Huarong is now rated Ba1 (previous: Ba2) with its senior bonds rated at Ba2 (previous: Ba1). Moody's highlighted the scope for lower government support for the AMCs, which led to a reduction of the government support uplift to five notches (previous: six notches).

In India, the governor of the Reserve Bank of India (RBI) highlighted the durable signs of sustained growth momentum and that structural reforms in taxation, banking and manufacturing are positive for the country. The RBI governor noted the risk of capital outflow in the index inclusion of India's government bonds but the RBI takes comfort with the country's huge foreign currency reserves and the greater confidence that market participants have in the Indian rupee.

Emerging markets

Whilst EM spreads were unchanged last week at 400bps over US treasuries, the move higher in US treasury yields led to a negative return (-1.03%) for the EM hard currency sovereign index last week. Longer-duration assets fared the worse due to the treasury move while high beta names in Africa performed the best. The yield on offer is 8.2%, which we believe presents an attractive entry point.

2024 has kick started with a flurry of new issuance from predominately investment grade countries. YTD new issuance stands at $29.9bn and Chile joined in last week with a $1.7bn five-year social bond.

In ratings news, Colombia's outlook was cut to negative by S&P, while it maintains its BB+ rating. The outlook downgrade was due to prospects of a weaker economic growth.

In Pakistan, the IMF has revised its projection for the nations external financing needs for the current fiscal year: the revised figure stands at 7.1% of GDP (at $25bn), down from 8.1% previously. As part of the review Pakistan has received $700m from the IMF as part of its previously agreed $3bn programme.

In South America, Ecuador is battling a drug trafficking fuelled crime wave. This follows a prosecutor who was investigating the links between organised crime and government corruption being shot dead. Ecuadorian president Noboa has since declared 22 gangs as terrorists.

Responsible investments

Sovereigns have kicked off the year with a flurry of new issuance in the ESG bond market. Numerous nations are set to issue in the coming weeks, including Chile, Mexico and France. Qatar is also on the list with its first ever green bond anticipated to come to market "very soon", says Gulf state's finance minister Ali Al-Kuwari. He also said, "we are not hungry for money, but it will be mainly to send a strong statement".

Elsewhere, estimates for this year's total issuance are starting to come in, most of which anticipate it to be in line or lower than 2023's total, with the majority coming from sovereigns, agencies and supranationals. However, sales this year are already up over 27% on this time last year, according to Bloomberg.

Fixed Income Asset Allocation Views

22nd January 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 improve 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)	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 have widened this month, benefitting from lower global rates and the market-wide spread rally. Technicals remain challenged, with continued outflows and weak 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. ▪ 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	▪ Spreads are unch to modestly tighter since last month. The group is taking down credit risk because of flat spread curves and less spread compression upside. ▪ Fundamentals are supportive of technical strength. Global portfolios prefer EUR IG over USD on relval basis. ▪ Market pricing indicates investors are at ease with credit risk, with more optimistic views on fundamentals and US banking risk (CRE exposure, interest rates).	▪ 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 remain at historically tights levels. Modest weakness in fundamentals from bearish earnings outlooks, see bifurcation between sectors. ▪ 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 spread compression, 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 continued tightening over the past month; however, spreads are still 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. ▪ 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, CLOs 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 multifamily, however non-office sectors perform as expected and overall market sentiment improving. Delinquencies increasing as maturities come due. ▪ 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 ▪ o/w Grains ▪ u/w Gold ▪ o/w Soybean Meal ▪ o/w Oil ▪ o/w Lead ▪ o/w Zinc	▪ Global Recession

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