In Credit

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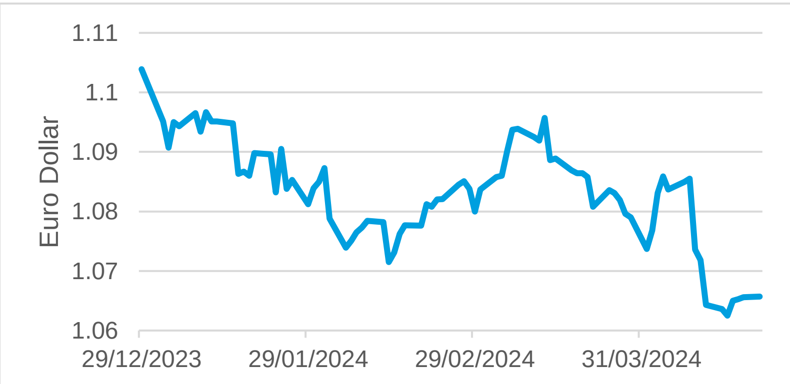
More patience required.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.66%	14 bps	-2.1%	-3.0%
German Bund 10 year	2.54%	18 bps	-1.3%	-2.7%
UK Gilt 10 year	4.25%	11 bps	-2.5%	-4.3%
Japan 10 year	0.89%	4 bps	-0.8%	-1.4%
Global Investment Grade	101 bps	3 bps	-1.8%	-1.7%
Euro Investment Grade	114 bps	2 bps	-0.8%	-0.4%
US Investment Grade	94 bps	2 bps	-2.3%	-2.4%
UK Investment Grade	100 bps	2 bps	-1.7%	-1.6%
Asia Investment Grade	145 bps	0 bps	-0.9%	0.3%
Euro High Yield	385 bps	-1 bps	-0.3%	1.4%
US High Yield	337 bps	12 bps	-1.7%	-0.2%
Asia High Yield	684 bps	15 bps	-1.0%	4.8%
EM Sovereign	286 bps	3 bps	-2.0%	-0.6%
EM Local	6.5%	8 bps	-2.6%	-4.6%
EM Corporate	266 bps	1 bps	-1.0%	1.3%
Bloomberg Barclays US Munis	3.7%	6 bps	-1.0%	-1.4%
Taxable Munis	5.4%	9 bps	-3.2%	-3.6%
Bloomberg Barclays US MBS	55 bps	6 bps	-2.8%	-3.8%
Bloomberg Commodity Index	238.57	0.2%	3.9%	6.2%
EUR	1.0637	0.1%	-1.2%	-3.5%
JPY	154.76	-0.9%	-2.1%	-8.8%
GBP	1.2316	-0.7%	-2.0%	-2.8%

Source: Bloomberg, ICE Indices, as of 19 April 2024. *QTD denotes returns from 31/03/2024.

Chart of the week – Euro / dollar Exchange Rate – YTD



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

Macro / government bonds

Last week we saw a further rise in yields across sovereign bond curves. Momentum was only checked temporarily last Friday amid a rise in geopolitical tensions in the Middle East after Israel bombed Iran in a retaliatory attack. During the week, the yield on the US 2-year rose 7bps to 4.99%, setting the tone for bond markets globally. The catalyst for the rise in yields was the growing tension between the resilience of the US economy and the path to lower US interest rates. Although Jay Powell, Fed Chair, had used terminology such as “bumpy” to describe the disinflationary process, he could no longer publicly ignore the strength of recent inflation readings. He changed the tone of his messaging, affirming that it was likely to take longer than expected for inflation to return to their 2% target – a view the market had already arrived at. Various Fed speakers supported his message, describing monetary policy as being in a good place and calling for the need for patience on disinflation. At a conference, New York Fed President, John Williams, in response to a journalist’s question on the potential for higher inflation, admitted there could be a scenario where monetary policy could tighten, although this was not his base case scenario. His remarks caused some temporary market indigestion.

The big data numbers for last week included US retail numbers, which came in stronger than expected. The data underlined the strength of the US consumer, supporting the narrative of a robust US economy. The market continued to respond to the re-pivot to the ‘higher for longer’ message, by pricing out rate cuts by year end. In the space of just four months, the market has moved from pricing 6 quarter point rate cuts by year end to just 1.6 quarter point rate cuts. The rise in yields across the US yield curve attracted buyers, providing support to valuations and preventing any knee-jerk gap wider in yields.

At the European Central Bank, ECB president Christine Lagarde continued to prepare the way for looser monetary policy, pointing to the fading impact of past supply shocks, lower commodity prices, and tight monetary policy. She repeated her message that further disinflation would depend upon the interplay of labour costs and profit margins. The June meeting remained firmly in her cross hairs for loosening monetary policy. The question for the ECB is how much to cut interest rates by, ahead of the Federal Reserve, without triggering euro weakness, which would have an inflationary impact. The other key question for the ECB is what happens after June, and what the sequencing of interest rate cuts would look like.

In terms of broad positioning on our Global Rates desk, we are neutral on the US, while we retain long positions in the UK and Europe. To take advantage of the widening in yield spreads between Germany and UK, we stitched out of Germany into the UK last week at the 10-year maturity point. We remain constructive on fixed income with a focus on generating alpha through relative value cross market and curvature strategies.

Investment grade credit

Global investment grade spreads drifted wider after recent calm ending the week with a spread for the global market of around 101bps (around 3bps wider for the week).

This week brings a heavy roster of corporate results with around 175 of the S&P 500 reporting. High profile companies issuing earnings statements include Alphabet, Microsoft, Verizon and Tesla. This comes at a time of recent weakess in risk markets including equities. Meanwhile, in spite of lower volumes of new issuance in the corporate bond market – related to the release of earnings – there were also outflows from some credit markets for the first time in quite a while, accroding to data from JP Morgan.

The outlook for credit markets remains mixed in our view. On the positive side, growth estimates are being upgraded, especially in the US. This comes at a time of robust corporate and banking sector health with low levels of leverage and high levels of capital respectively. However, valuations / spreads are rich when compared to government bond yields and the hope of a market supportive easing in policy conditions seems further away than ever according to market pricing for the US.

High yield credit & leveraged loans

US high yield valuations widened to YTD highs amid resurfacing geopolitical tensions, increasing equity volatility, and sizeable fund outflows. The ICE BofA CP Constrained Index returned -0.58% and spreads were 12bps wider. The yield-to-worst of the index increased to 8.22%. According to Lipper, retail high yield bond funds reported a $3.7bn outflow for the week. This was the largest weekly outflow since March 2023's regional banking driven volatility. Meanwhile, the average price of the Credit Suisse Leveraged Loan Index declined only slightly to $95.8 amid the risk-off tone with strong technicals continuing to support the market. Retail loan funds extended their inflow streak to 17 weeks with $153m contributed.

European High Yield was weak last week with spread decompression, the first net outflows from the asset class since mid-December 2023 and ETFs pricing at a discount for the first time this year. Spreads finished the week basically unchanged at 385bps, though yields rose marginally (+4 bps) to 7.20%. The -0.30% performance decline came on the back of especially poor performance in CCCs (-1.3%), while €179m exited EHY via both ETFs and managed accounts (after a respectable YTD inflows of €5.6 bn). The primary market was busy with six new issues totalling €2.55bn gross: these new bonds were generally oversubscribed with pricing coming in well inside initial price talk. That said, some weakness is starting to creep in as a few of them soon traded below initial offering in the secondary market. The coming week is also expected to be primary heavy with the potential of €3bn including talk of a €1bn deal from Grifols, the Spanish healthcare group.

In rating news, Mahle the Germany auto supplier was downgraded to Ba3 from Ba2 by Moody's. This came the day after the comapny announced lower leverage (with continued focus for further deleveraging) but also lowered its forecast for global automotive production.

In M&A news, there is talk of interested parties in Altice France's XFibre unit with valuations of €6-7n being mentioned. Creditor-on-creditor 'violence' stories continued with news that two creditor groups of ATOS, the French IT firm, have joined forces and are pushing for a 50% haircut on the bonds with half of the debt converted into equity.

Asian credit

TSMC posted positive Q1,24 results and management moderated its guidance for the semiconductor market (excluding memory chips) and the foundry sector. TSMC expects the semiconductor market to grow by around 10% y/y, lower than its previous guidance of more than 10% y/y growth. It expects the foundry sector to grow in the mid-to-high teens, compare with its previous guidance of 20%.

According to Caixin, China is assessing the potential to establish a national platform to acquire unfinished property projects and to mitigate downside risk for the sector. The newly built units would be sold or rented out as part of social housing initiatives. This support measure could be an addition to the 'white list' initiative which lists out projects that are eligible for funding support from banks. That said, the timeliness of funding support from banks to 'white list' property projects is dependent on the completion of due diligence by the banks.

Structured credit

The Agency MBS sector was down 84bps alongside other high-quality bonds as interest rates moved higher.

15-year MBS outperformed 30-year and higher coupons did best as the curve bear flattened. Spreads also moved wider, which brought in both domestic money managers and foreign buyers. Mortgage applications were up 3% led by purchases while housing starts and building permits both came in lower. Non-agency supply was boosted by about $1.4bn in new issuance, which was very well bid with healthy oversubscription.

It was an active week in CMBS with four private label deals pricing. Spreads were mixed relative to guidance as secondary spreads widened down the capital stack. Downgrades continue to outpace upgrades in the sector with a 5:1 ratio last week. The ABS market was also busy: 14 deals priced totaling $11bn with another 8+ deals coming this week. Spreads were relatively stable.

Emerging markets

Rising geopolitical tensions and hawkish Fed speak as a result of strong data out of the US resulted in negative returns for the EM hard currency sovereign asset class last week (-0.76%) as spreads widened 5bps to 343bps. While spreads currently seem a little rich versus long term averages, the yield on offer remains attractive at 8.2%.

S&P downgraded Israel from AA- to A+ citing that the recent increase in confrontation with Iran heightens already elevated geopolitical risks.

The US House of Representatives approved a $61bn aid package for Ukraine following months of delays. Ukrainian bonds were trading higher Monday morning on the back of this news.

Against a backdrop of uncertain geopolitics, the news that Armenia has agreed to withdraw from several Azerbaijani border villages was welcomed. Tensions have been high between the two countries and the demarcation of the border is seen as a positive major breakthrough to ongoing peace deal talks. It raises the probability of an agreement being reached this year, as well as further narrowing the residual tail risk of an Azerbaijan attack, which Armenia PM continues to warn about. Despite this, security tensions will likely linger.

China posted higher than expected GDP for Q1 2024; 5.3% annual rate versus 4.8% estimates and 5.2% for the prior quarter. Industrial production and retail sales were, however, weaker and house prices fell again.

The IMF released its growth estimates last week with the emerging markets forecast at 4.3% for 2024 versus 1.6% for developed markets.

Fixed Income Asset Allocation Views

22nd April 2024

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	▪ 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 cycle is uncertain. With the recent CPI prints, the timing and magnitude of cuts have been pushed back. ▪ 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 outlook 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)	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 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.	▪ 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 improvement in distressed credit and stability in GCC despite geopolitical risk. ▪ 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 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. ▪ 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 continued to move tighter since last month. 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 furth increase the risk in the distressed and highly leveraged segment. We expect this to accelerate in the coming months. ▪ 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. ▪ The decline in interest rate volatility since Fed signalled a definite end to the hiking cycle has been a tailwind for MBS, however the recent increase following hotter than expected CPI has started to undo this process. ▪ 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: 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 ▪ o/w Soybean Meal ▪ o/w Cocoa ▪ o/w Oil ▪ o/w Lead ▪ o/w Zinc	▪ Global Recession