In Credit

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David Oliphant
Executive Director,
Fixed Income

Contributors

David Oliphant

Investment Grade Credit

Simon Roberts

Macro/Government Bonds

Angelina Chueh

Euro High Yield Credit

Chris Jorel

US High Yield Credit,
US Leveraged Loans

Laura Reardon

Emerging Markets

Kris Moreton

Structured Credit

Justin Ong

Asian Fixed Income

Charlotte Finch

Responsible Investments
Investment Grade Credit

Gary Smith

General Fixed Income

Sarah McDougall

General Fixed Income

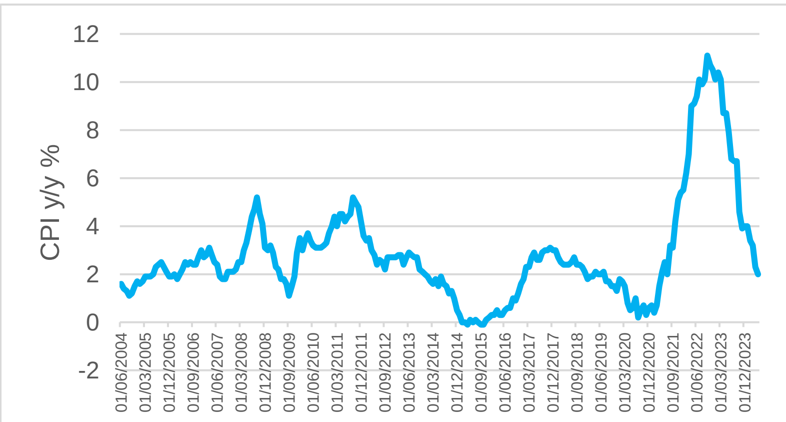
UK inflation back at target.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.26%	4 bps	0.7%	-0.2%
German Bund 10 year	2.42%	6 bps	-0.2%	-1.6%
UK Gilt 10 year	4.08%	2 bps	-0.4%	-2.2%
Japan 10 year	1.00%	5 bps	-2.2%	-2.7%
Global Investment Grade	103 bps	1 bps	0.6%	0.7%
Euro Investment Grade	119 bps	-1 bps	0.2%	0.6%
US Investment Grade	96 bps	1 bps	0.7%	0.6%
UK Investment Grade	100 bps	-2 bps	0.1%	0.1%
Asia Investment Grade	147 bps	2 bps	1.4%	2.7%
Euro High Yield	369 bps	-5 bps	1.4%	3.1%
US High Yield	321 bps	-8 bps	1.0%	2.6%
Asia High Yield	605 bps	0 bps	3.3%	9.3%
EM Sovereign	330 bps	-1 bps	0.9%	2.3%
EM Local	6.6%	-5 bps	-1.5%	-3.6%
EM Corporate	272 bps	-2 bps	1.6%	3.9%
Bloomberg Barclays US Munis	3.7%	1 bps	0.2%	-0.2%
Taxable Munis	5.1%	6 bps	0.3%	-0.1%
Bloomberg Barclays US MBS	44 bps	-2 bps	1.0%	-0.1%
Bloomberg Commodity Index	240.16	-0.6%	3.5%	5.8%
EUR	1.0721	-0.1%	-0.9%	-3.1%
JPY	159.47	-1.5%	-5.3%	-11.7%
GBP	1.2667	-0.3%	0.2%	-0.7%

Source: Bloomberg, ICE Indices, as of 21 June 2024. *QTD denotes returns from 31/03/2024.

Chart of the week – UK Inflation back to target, 2004-2024



Source: Bloomberg, Columbia Threadneedle Investments, as of 24 June 2024.

Macro / government bonds

Last week saw little change in government bond yields after the previous week's shenanigans. Indeed, it was a quiet week in most areas of the bond market.

There was good news (for the Bank of England) in the UK with inflation coming in at 2% y/y (**see chart of the week**) and back at the BoE's taget rate of 2%. Service sector inflation is still running a little 'hot', however, which meant that the BoE left rates unchanged at 5.25%.

European bonds calmed somewhat after the calling of a snap election in France early last week. The focus remains on budget deficits, however, with Bloomberg noting that 11 European countries are running deficits in excess of the 3% limit. The European Commision forecast that deficits in France and Italy will be at least 5% this year and above 4% next. Plenty of bonds to go around it would seem.

The US had a holiday shortened week. Retail sales data underwhelmed with a 0.1% increase and jobless claims also rose a little. Business confidence (PMIs), however, increased more than expected driven by gains in both the service and manufacturing sectors.

This week brings US PCE data, euro area inflation statistics and a televised debate between Presidential contenders Joe Biden and Donald Trump. The first stage of French elections will be held at the weekend.

Investment grade credit

Corporate bonds spreads were little changed last week, having widened the previous week on French political worries. Notably, French banking bonds were wider by an estimated 10-20bps while corporates are around 5-10bps wider since the election result of the prior weekend.

The Global IG index spread finished the week with a spread to government bonds of 103bps according to data from ICE indices. This index still trades around 10% tighter than at the start of the year. The tightening has been led by euro and sterling spreads which are 10/11% tighter respectively while US dollar spreads are only 8% better. Credit curves have steepened with shorter dated bonds tightening more than their longer dated cousins.

Globally, the real estate sector has performed best followed closely by banking and insurance. All sectors are tighter year to date aside media which is fractionally wider.

There was little specific news in a largely uneventful week with light primary market activity.

High yield credit & leveraged loans

US high yield bond valuations were stable over the week amid softer economic data, modest flows, and light new issuance.

The ICE BofA US HY CP Constrained Index rose 0.23% and spreads were 8bps tighter. The yield-to-worst of the index declined 0.02% to 7.81%. According to Lipper, retail high yield funds saw an $80m inflow. The average price of the Credit Suisse Leveraged Loan Index declined slightly to $95.8 as the asset class saw its first retail fund outflow in 26 weeks. That said, the week's outflow amounted to only $16m after a run of inflows totalling $11.4bn cumulatively.

European high yield returned 0.21%, reversing the previous week's loss as decompression returned. CCCs once again underperformed and was the only rating band with a negative return for the week. Flows were positive though softer this week (+€109m) and still focused on managed accounts. ETFs were negative and are still trading at a discount for a second week in a row. The primary market was relatively lighter but still clocked in at €2.0bn via five new deals. Refinancings continue to dominate with this past week's issuers (largely single B rated) working through their 2025 and 2026 maturity walls.

In credit rating news, Birkenstock was upgraded by S&P to BB positive from BB-. The rating agency cited strong operational performance, loan and RCF funding as well as commitment to continued deleveraging. There was good news in the food sector as Morrisons' senior secured debt was upgraded to BB from BB- at Fitch following the completion of £1.7bn debt reduction on the back of the filling stations disposal. It should be noted that this was widely expected and the issuer had been on positive watch for a while now.

In sector news, some softness in the auto industry was reported. EU May car sales fell -2.6% to 1.09m units with most OEM's reporting negative numbers, with high borrowing costs and low growth in the region being cited for the drop. This fall, however, comes after months of strength. Also, electric vehicle sales are down 11% as high prices continue to put customers off as well as concerns about range anxiety and charging infrastructure. There was more weakness in the financials sector, specifically in the debt collector space, as Intrum announced its restructuring proposal after an agreement with bond holders on its upcoming 2025 bonds, which will mean a 10% haircut and bond extension for a small equity stake. Lowell, another debt collector, announced that it is working with advisors to explore refinancing options.

Asian credit

The primary market was active with MGM China pricing a 7-year bond to pay down its revolving credit facility while Continuum Green Energy issued a 9-year amortizing bond to prepay the onshore debentures and fund the tender offer of its existing US dollar bond.

In India, Vodafone sold an 18% stake in Indus Towers for €1.7bn, of which Bharti Airtel acquired an additional 1% stake. This raised Bharti's stake to 48.95%, below the consolidation threshold for the tower business.

Genting Berhad announced that its 95%-owned subsidiary PT Layar Nusantara Gas has entered into an EPCIC (Engineering, Procurement, Construction, Installation and Commissioning) contract with Wison New Energies to construct a floating LNG facility. Genting Berhad intends to finance the project primarily with project debt and internally generated cash.

Emerging markets

A summer-like calm has descended on EM hard currency debt markets, with spreads barely changed on either the week or (adjusted for the Venezuela index inclusion) the quarter. Under the surface, there are flickers of intra-credit differentiation: weaker, high-beta credits like Nigeria, Ecuador, Kenya and Egypt all saw spreads widen, while the BBB cohort recovered some lost ground, led by Mexico, where the market's political nervousness subsided somewhat. Recent underperformance in the high yield segment of the market may provide some (very welcome) relative value investment opportunities, despite rather rich overall spread valuations.

Primary market activity has been fairly light: last week's highlight being Brazil's $2bn, 7-year sustainability bond.

Local markets have seen somewhat more interesting, the slide in EM currencies having abated for now. The sharp sell-off in local rates that occurred around elections in South Africa and Mexico has reversed, particularly in the former case; yields on South Africa's rand-denominated bonds are now at the lows of the year, reflecting substantial optimism around the country's embryonic Government of National Unity.

Fixed Income Asset Allocation Views

24th June 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 potential market volatility. **The group remains negative on credit risk overall, with no changes to the scorecard.** ■ 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 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 amid changes after 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 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 and 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 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	■ 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 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 sugar ■ o/w Zinc ■ o/w Gasoline ■ o/w Distillates ■ o/w Cocoa ■ u/w natural gas ■ u/w crude oil ■ u/w corn ■ u/w live cattle	■ Global Recession