In Credit

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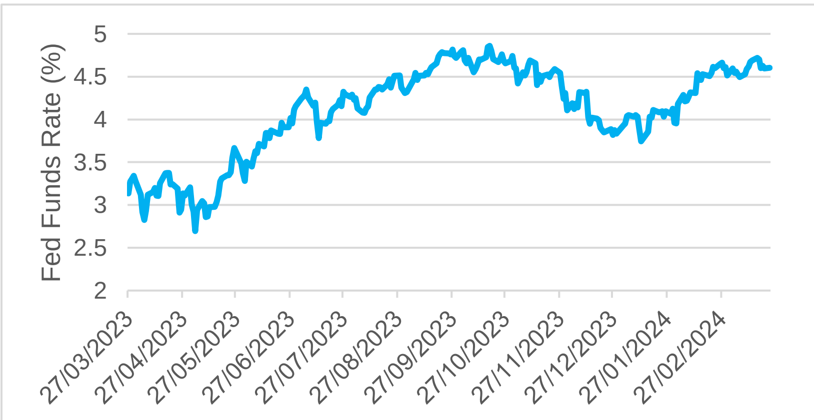
Wings of doves.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.22%	-8 bps	-1.1%	-1.1%
German Bund 10 year	2.35%	-9 bps	-1.7%	-1.7%
UK Gilt 10 year	3.96%	-14 bps	-2.1%	-2.1%
Japan 10 year	0.73%	-5 bps	-0.7%	-0.7%
Global Investment Grade	99 bps	0 bps	-0.1%	-0.1%
Euro Investment Grade	113 bps	2 bps	0.2%	0.2%
US Investment Grade	92 bps	-1 bps	-0.2%	-0.2%
UK Investment Grade	94 bps	0 bps	0.0%	0.0%
Asia Investment Grade	159 bps	3 bps	1.1%	1.1%
Euro High Yield	370 bps	23 bps	1.5%	1.5%
US High Yield	308 bps	-8 bps	1.4%	1.4%
Asia High Yield	708 bps	7 bps	5.5%	5.5%
EM Sovereign	289 bps	-9 bps	1.3%	1.3%
EM Local	6.3%	1 bps	-2.1%	-2.1%
EM Corporate	280 bps	4 bps	2.2%	2.2%
Bloomberg Barclays US Munis	3.4%	5 bps	-0.2%	-0.2%
Taxable Munis	5.0%	-11 bps	-0.9%	-0.9%
Bloomberg Barclays US MBS	48 bps	0 bps	-1.3%	-1.3%
Bloomberg Commodity Index	229.97	-0.4%	1.3%	1.3%
EUR	1.0835	-0.7%	-2.1%	-2.1%
JPY	151.15	-1.6%	-6.8%	-6.8%
GBP	1.2644	-1.1%	-1.0%	-1.0%

Source: Bloomberg, ICE Indices, as of 22 March 2024. *QTD denotes returns from 31/12/2023.

Chart of the week – December 2024 Fed Funds Expectations – LTM



Source: Bloomberg, Columbia Threadneedle Investments as of 25 March 2024.

Macro / government bonds

Bond yields fell in a constructive week for fixed income markets, as central bank messaging maintained a dovish tilt.

The week started with the Bank of Japan becoming the last central bank to abandon its negative interest rate policy. It moved from a negative interest rate of -0.1% to a band of 0.0% to +0.1%. The BoJ also announced it would stop buying ETFs and bring an end to its yield curve control policy. The yield on the Japanese 10-year barely shifted, oscillating around 0.7%, while the swaps market priced in the prospect of interest rates reaching 0.3% by year end. There had been concern in financial markets about the BoJ bringing an end to its negative interest rate policy in case higher domestic interest rates increased bond market volatility by triggering the repatriation of overseas assets by Japanese life insurance companies.

At the same time as the BoJ normalised monetary policy, the Reserve Bank of Australia kept its cash target on hold at 4.35%. Its governor, Michele Bullock, repeated the well-worn message that the Australian central bank needed greater confidence that inflation was returning to target before it would take action.

The most important central bank meeting last week was that of the US Federal Reserve. The Fed left rates on hold within its target range of 5.25% to 5.50%. The Fed’s approach to monetary policy could best be seen through changes to its quarterly median projections. The Fed revised up its median projection of changes to Real GDP from 1.4% to 2.1% for 2024, reflecting the recent strength of incoming data. Core PCE Inflation for year-end 2024 was revised up from 2.4% to 2.6%. Fed Chair, Jay Powell, commented that it still expected to get to its 2% target, although perhaps in a fairly bumpy manner. He attributed the higher-than-expected inflation numbers for January and February to seasonal effects and stated that the Fed was not going to overreact to two months of data. The median projection for the unemployment rate reduced from 4.1% to 4.0% in 2024. Powell pointed out that while the labour market remained tight, labour market demand and supply was coming into better balance, which would have a positive impact on disinflation. The Fed also left its median projection for the Fed Fund’s rate for year-end 2024 unchanged at 4.6%, while it pared back the depth of interest cuts for 2025 with year-end rates of 3.9% instead of 3.6%. Powell said that the Fed’s policy rate is likely at its peak of this current tightening cycle and that it would be appropriate to dial back policy restraint at some point this year. There was a collective sigh of relief in markets that the Fed meeting had passed off with little change to its narrative of disinflation. The swaps market priced in the increased probability that a rate cut could occur in June, while the US treasury curve steepened over the course of the week, as 2-year rates fell from 4.7% to 4.6%. The US treasury market continued to exert its powerful gravitational impact on global bond markets with the 2-year German Bund dropping 12bps over the same period from 2.9% to 2.8%. Risk assets benefited from the news that the Fed’s monetary loosening show remained firmly in place.

Following the Fed, the Swiss National Bank cut interest rates from 1.75% to 1.5%, stating that it had been effective in reducing inflation, but that this did not represent the start of an aggressive easing stance.

The last major central bank to report on monetary policy was the Bank of England. The BoE kept rates on hold at 5.25% in an 8-1 decision. The Bank said that its restrictive stance was having a material impact on reducing more persistent and slower moving components of inflation, and while wage growth remained too high, it expected it to moderate. One factor that caught the market’s eye was the decision of two of the Monetary Policy Committee’s (MPC) more hawkish members, Catherine Mann and Jonathan Haskel, to shift from voting for a rate hike to voting to keep rates unchanged. This raised a question in markets as to what Mann and Haskel had seen in the data to justify this shift. In a media interview following the rate-setting meeting, governor Andrew Bailey was upbeat, saying we were on our way to winning the fight on inflation. Unsurprisingly the UK was one of the best performing bond markets last week. The UK yield curve steepened, as the yield on the 2 years fell from 4.3% to 4.1%.

We remain constructive on fixed income markets. Last week we increased exposure to sterling, euro and US dollar denominated bonds before the Fed meeting with stops in place as an insurance policy against more hawkish than expected Fed communications. This positioning paid off, as yields subsequently fell.

Investment grade credit

Global investment grade spreads were fairly unchanged in the last week.

While a slowing in the fall in inflation and resilient economic data has reined in interest rate optimism, the rhetoric from central bankers last week and an actual reduction in rates in Switzerland (first in the G10) continued to support risk markets last week. Meanwhile, demand for the asst class remains robust as we approach April, which is typically a slower month for new issuance.So while it is difficult to argue (aside an exogenous shcok) for spreads to widen it is also increasingly clear that valuations or spreads are expensive. The outperformance seen recently from euro credit make the relative value of this market compared to the US dollar corporate index also less obvious.

Globally, by industry sector, the best performing areas of the market are banking and insurance where spreads are 18% tighter YTD with real estate only 1% behind. Laggards are media (-4%), healthcare and telecoms (-8%). The overall market has seen spreads tighten by 14%.

High yield credit & leveraged loans

European high yield had a challenging week (-44bps return) on the back of the largest week of corporate issuance YTD (+ €3.4bn via six deals) and negative headline news for some issuers (Altice France, Intrum). Spreads widened +23bps back to 370bps while yields rose +9bps back to 6.9%. This resulted in a return to strong decompression as only BBs had a positive return. Euro CCC’s collapsed last week returning a severely negative -6.9%, which wiped out the rating band’s positive performance YTD. In spite of the week’s performance, flows were still strong with +€364m entering the asset class, via both ETFs and managed accounts.

Intrum’s news this week: Post last week’s announcement that the firm is looking to overhaul its debt structure, was that a bond holder group (mix of long only, hedge funds and distressed funds) is forming as Moody’s and Fitch downgraded the name to Caa1 and B, respectively.

A bond holder group is also likely for Altice France as the firm announced its plan for discounted tenders (to be referred as “discount capture”) as part of its plan to reduce leverage to below 4x. This would force creditors to help towards the deleveraging. The news pushed bond prices sharply lower. In other French company news, it looks like ATOS’s last opportunity for a disposal to raise funds is gone as discussions of the potential sale of BDS to Airbus has been stopped. The firm is still in discussion with banks but without much progress so far.

Asian credit

During the China Development Forum in Beijing, Premier Li Qiang stated that China will strengthen macro policy adjustments and enhance policy coordination to increased domestic demand. Premier Li also spoke about promoting the development of a unified national market and people-centred urbanization as well as advancing large-scale equipment renewables and support the trade-ins of durable consumer goods. During the same forum, the NDRC head (Zheng Shanjie) added that the government will promote cross-border service trade and pilot the market asset to value-added telecommunications services, high tech and financial sectors. Ahead of the forum, the State Council issued a 24-point plan last week to attract foreign investments which broadly covers policy and tax support, fair competition, data flow and aligning domestic rules with international trade rules. Other points include facilitating the process for foreign nationals to work and live in China along with their family dependents, as well as increase the resumption of international flights at the key aviation hubs.

Structured credit

The risk rally that followed a relatively sanguine Fed meeting supported both credit and duration sensitive assets including Agency MBS. The sector was up +81bps as spreads narrowed in 30-year MBS specifically. Volatility trended lower with more clarity around the Fed's easing path in response to the deceleration in inflation. In housing news, both starts and permits were up. Housing starts posted a 10.7% increase, the largest increase since May and bouncing back from weather challenges in January. Building permits were also strongly positive and are now 19% above pre-pandemic averages. Existing home sales were also notably strong at +9.5% versus 3.1% last month, the fastest pace we have seen over the past year. It would seem that sellers and buyers are finally coming to grips with a 7% mortgage rate. In non-agency, the new issue market was active with c$2bn in RMBS deals pricing last week, including the first HELOC transaction for 2024. ABS spreads were flat WoW with the influx of supply offset by the dovish Fed meeting.

Emerging markets

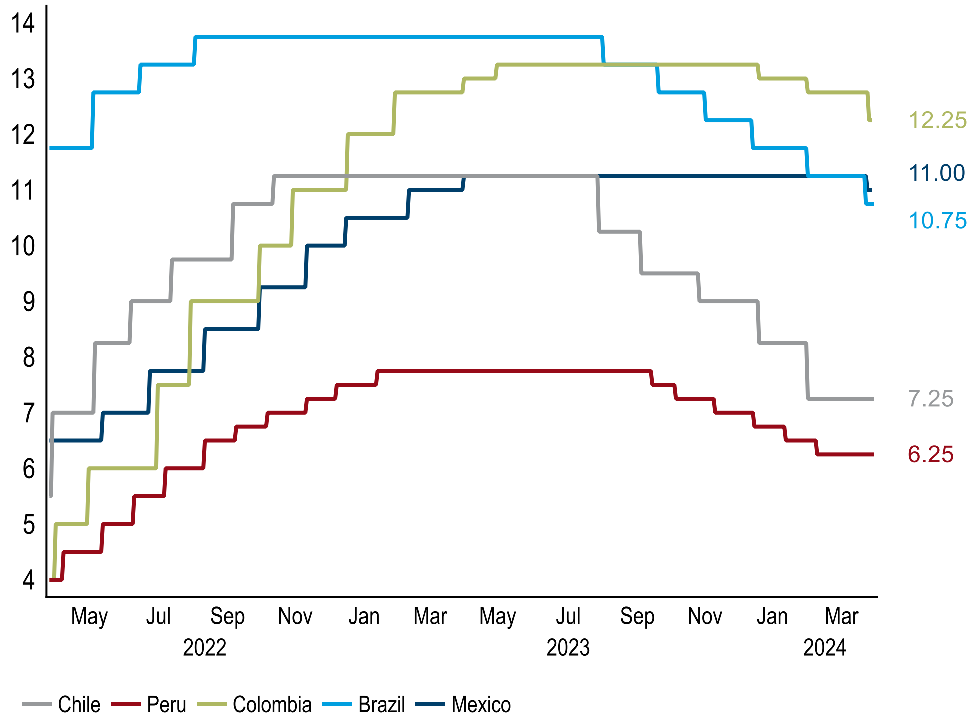
Improved risk sentiment post FOMC supported EM hard currency assets last week. The return on the index was +1.33%, driven by both tighter spreads and lower treasury yields. High yield assets outperformed investment grade with Africa leading the way from a regional perspective.

On Sunday, Senegal held elections with the opposition leader, Bassirou Diomaye Faye, now expected to win following early vote counts. Senegal has endured three years of political turbulence, which sparked violent anti-government protests; however, policies have been investor friendly. The market is hoping for stability with natural gas projects set to start production this year; GDP growth expected to hit double digits by 2025; and a recently secured $1.9bn IMF package.

It was a busy week for central banks, particularly in Latin America. Colombia cut rates 50bps to 12.25%, but still has higher interest rates compared to its main Latin American peers who are also fighting inflation. Colombia's inflation continued its downward trend printing at 7.7%. In Brazil, the Selic rate was cut 50bps to 10.75%. Mexican policy makers opted to ease policy with a 25bps cut to 11%; Banxico had held rates at the last 11 meetings having commenced its hiking cycle mid-2021. Easing cycles in the region are well underway (**see chart of the week 2**) this year with Peru and Chile also already loosening policy. Many Latin American central banks began their hiking cycles well ahead of the Fed.

Turkey surprised markets with a 5% hike taking rates to 50%. This followed rising inflation and the Lira depreciating and precedes upcoming local elections. Voters will go to the polls on 31 March and there is a chance that President Erdogan's party could regain victory in Istanbul and Ankara. Historically, one would not have expected rate hikes ahead of elections as Erdogan has always favoured low interest rates; however, this latest rise suggests that the recently appointed central bank governor is continuing the orthodox monetary policy implemented by his predecessor. In Indonesia, rates were held at 6%. This week we expect Hungary to cut and the South African Reserve Bank to hold at 8.25% in a bid to protect the currency ahead of upcoming elections in May.

Chart of the week 2 – Latin American monetary easing cycles underway



Source: Macrobond, and Columbia Threadneedle Investments

Responsible investments

A gender bond from Iceland will make it the first nation to issue such a bond. A gender bond is a social bond whereby the use of proceeds targets projects impacting gender equality. Iceland is not exactly new to leading the way when it comes to Gender Diversity as it has ranked first in the world for equality for the last 14 years. It may well encourage other nations to follow suit, which would mean capital being raised against one of the SDGs most lacking and on track to not be achieved by 2030 – SDG 5 for Gender Equality. Iceland says it has the framework in place and hope to issue the bond soon.

We have seen promising momentum for new issuance in the labelled bond market so far, as last week was the fourth week in a row the fixed income market issued above $20bn across green, social and sustainability bond, according to data from Bloomberg.

Fixed Income Asset Allocation Views

25th March 2024

COLUMBIA THREADNEEDL 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 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 war ■ 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 ¥ P 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	■ Inflationary dynamics become structurally persistent ■ Labour supply shortage persists; wage pressure becomes broad and sustained ■ Fiscal expansion requires wider term premiu ■ Long run trend in safe asset demand reverse
Currency ('E' = European Economic Area)	Short -2 -1 0 A$ EM ¥ € £ $ +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 bene of the Dollar
Emerging Markets Local (rates (R) and currency (C))	Under-weight -2 -1 0 C +1 R +2 Over-weight	■ 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 easi 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 additiona 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 great demand destruction, margin pressure and macro risks ■ Rally in distressed credits, leads to relative underperformance ■ Volatility in the short end of the curve, erodin 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 Fe tightening. Consumer (retail/travel) behaviou fails to return to pre-covid levels ■ Student loan repayments weaken consumer profile more than anticipated, affecting sprea 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