Information for investment professionals

COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

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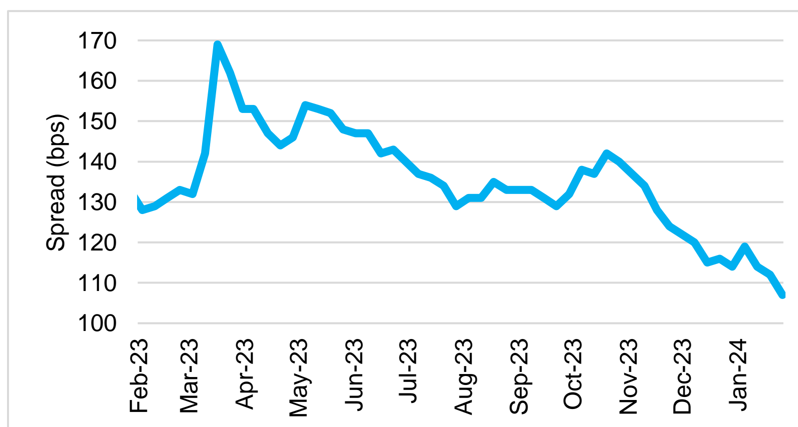
Under pressure.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.10%	-2 bps	-1.3%	-1.3%
German Bund 10 year	2.24%	-10 bps	-1.7%	-1.7%
UK Gilt 10 year	3.92%	-1 bps	-3.8%	-3.8%
Japan 10 year	0.72%	5 bps	-0.7%	-0.7%
Global Investment Grade	107 bps	-5 bps	-0.8%	-0.8%
Euro Investment Grade	128 bps	-6 bps	-0.5%	-0.5%
US Investment Grade	97 bps	-4 bps	-0.8%	-0.8%
UK Investment Grade	111 bps	-5 bps	-2.0%	-2.0%
Asia Investment Grade	179 bps	-2 bps	0.0%	0.0%
Euro High Yield	384 bps	-10 bps	0.9%	0.9%
US High Yield	339 bps	-15 bps	0.0%	0.0%
Asia High Yield	766 bps	-2 bps	2.2%	2.2%
EM Sovereign	334 bps	0 bps	-1.9%	-1.9%
EM Local	6.2%	-1 bps	-2.0%	-2.0%
EM Corporate	305 bps	-3 bps	0.1%	0.1%
Bloomberg Barclays US Munis	3.5%	2 bps	-1.1%	-1.1%
Taxable Munis	5.1%	-3 bps	-1.9%	-1.9%
Bloomberg Barclays US MBS	46 bps	-1 bps	-1.5%	-1.5%
Bloomberg Commodity Index	227.00	2.2%	0.5%	0.5%
EUR	1.0823	-0.4%	-1.7%	-1.7%
JPY	147.80	0.0%	-4.8%	-4.8%
GBP	1.2704	0.0%	-0.2%	-0.2%

Source: Bloomberg, ICE Indices, as of 26 January 2024. *QTD denotes returns from 31/12/2023.

Chart of the week – Global IG Spreads, LTM



Source: Bloomberg, ICE Indices, Columbia Threadneedle Investments, as of 29 January 2024.

Macro / government bonds

Core markets remained in range-bound territory over the week. There had been some optimism earlier in January that cooling economic and inflationary data in the US could open up a potential path to an interest rate cut as soon as March. The ongoing strength of US economic data continued to undermine this view. In the fourth quarter the US economy expanded at an annualised rate of 3.3%, while PMI data for the manufacturing and service sectors remained in expansionary territory. This pointed to a relatively resilient US consumer, even as core inflation edged below 3%. This has created a policy dilemma for the Fed: cut too early when inflation has not been fully squeezed out of the system and it could start to build up again. Cut too late and risk the expected soft landing transforming into a more painful economic outcome. Although the blackout period meant there was no guidance from policymakers, the Fed through its journalistic sources appeared to indicate that it will signal that the period of higher interest rates is firmly over at its next meeting. Last week also saw significant issuance in US treasuries, which looks set to ramp up over time given fiscal expansionary policies from both Biden and Trump.

In Europe, the European Central Bank kept interest rates on hold. Christine Lagarde (ECB President) pointed to stagnant economic growth, falling inflation, and weak credit dynamics. She pushed back at early talk of interest rate cuts, repeating the assertion she made at Davos that the summer would provide a more appropriate time frame for the first cut in rates. She argued that the eurozone economy needed to have progressed further down the disinflationary path before cutting rates. Lagarde pointed to the March projections from the ECB, which will provide an insight into thinking at the ECB on inflation and growth. The market has been clearly listening to recent ECB communications and pricing in the swaps market now reflects a first quarter point cut in interest rates by June. While US and UK 2-year government bonds traded within a narrow 4bps range, the yield on the German 2-year fell by 15bps amid speculation that the ECB was likely to meet the necessary criteria to cut rates before the US.

The Bank of Japan kept monetary policy unchanged with the main reference rate still in negative territory. While the BoJ is expected to tighten monetary policy this year, any decision is likely to take place after the annual “Shunto” wage negotiations in March and April, in which labour unions seek wage rises across sectors. Maintaining the theme of a watchful eye on disinflationary pressures, the Bank of Canada kept rates on hold at 5.5%.

While the January correction reflects how far the rally came in Q4, 2024, we remain constructive on interest rate markets. This is reflected through a long duration view, which we continue to manage tactically. We have paired this view with a steepening bias across portfolios.

We also retain a short rates view on Japan where we expect the elevated degree of inflation to prompt the BoJ to tighten monetary policy later this year by lifting short term rates or by altering the upper level of its yield curve control policy.

Investment grade credit

Investment grade bonds continue to perform well with spreads under pressure **(see Chart of the week)** across markets year to date. This has seen global IG spreads compress from around 170bps in mid-March 2023 to less than 110bps at the end of last week.

The chief reason for such strength has been significant demand / flows for both US dollar and euro markets and indications of offers wanted in the secondary market. In terms of markets both euro and US dollar have seen spreads tighten by 6-7% leading the sterling market, which is only 3% better. Sector wise banks and insurers have been the strongest and outperformed industrials and utilities in January.

Compared to government bonds, IG markets look expensive by around 0.7 standard deviations (SDs) for the global and US dollar markets. Compared to swaps that number looks less extreme and more like 0.1 SDs. Euro bonds look cheaper than their US dollar cousins at -0.1 SDs.

The reporting season continues with banks in Europe showing peaking margins and normalising asset quality: similar to that recorded from the US market a week or so ago.

High yield credit & leveraged loans

US high yield bond spreads re-tested 1-year lows amid improving investor sentiment and the most active primary market since November 2021.

The ICE BofA US HY CP Constrained Index returned 0.64% and spreads were 15bps tighter. 11 new bonds were priced for a total of $10bn par value. According to Lipper, retail high yield funds saw a small $72m inflow for the week with actively managed funds seeing their highest inflow ($436m) since April. The average price of the Credit Suisse Leveraged Loan Index remained unchanged at $95.6 amid a surge of repricing and refinancing activity. 50 loans were syndicated over the week for a total par value of $50.7bn, the most active week since January 2020. Retail loan funds saw a $213m inflow, the 10th inflow over the last 13 weeks.

European high yield was back on track last week returning a solid positive return (+70bps) as spreads tightened in -10bps to 384bps and yields fell 12bps to 6.79%. Lower rated credits shone as CCCs outperformed higher rated credits by more than 2x for the week. The primary market was still somewhat subdued with only two issuers (United Group, cable, and ZFF, autoparts) last week. There were strong inflows into the asset class with a net €508m via both ETFs and managed accounts.

On credit rating news, ATOS the beleaguered technology company was hit with more rating downgrades, this time by S&P. The credit rating company dropped the firm’s rating by three notches to B-. This was followed by Moodys’ downgrade of INEOS Group to Ba3 reflecting Moody's expectation that INEOS' earnings will continue to be pressured, for some time, in line with the broader chemical sector Though it acknowledged INEOS’ upcoming $700m acquisition of the oxide business from LyondellBasell Industries N.V. has given value to the purchasing assets during a cyclical downturn, and also mentioned the benefits of the oxide assets being located close to INEOS' existing facilities. Moody’s noted that this transaction is aggressive given its timing in the business cycle, the company's current high leverage and its ongoing investments.

Given the paucity of new offerings and the strengthening inflow into the asset class, technicals remain strongly supportive for European high yield.

Structured credit

Agency MBS squeaked out a positive return of 9bps last week on a stabilization in interest rates. Spreads were relatively unchanged on Agencies but 10-50 bps tighter in non-agency. New home sales data was released and came in stronger than expected at +8% for December vs -12% in November. Mortgage rates about 1% lower towards the end of the year helped support new homebuyers. In CMBS, spreads gapped tighter. Most notably investors added risk in secondary markets, while new issues were multiple times over-subscribed. Current spread levels are bringing interest back to the sector as indicated by the generally sanguine mood at a recent CMBS conference. Commercial Real Estate CLO AAAs have also been party to the broader market rally across CMBS. Volumes in new issue AAA have ramped to nearly 4x the average level last year to meet demand from money managers at the top of the stack.

Asian credit

The Hong Kong Court has issued a liquidation order on China Evergrande Group after the company was unable to reach a restructuring deal with its creditors. The Hong Kong Court has reportedly appointed Alvarez & Marsal as the liquidator to take over Evergrande's parent company which is listed in Hong Kong. The next focus would be the extent to which the liquidator can effectively push forward with the winding-down order for Evergrande's subsidiaries and assets in mainland China.

The Indian steel companies reported satisfactory Q3 results (quarter ended December 2023). JSW steel expects the domestic demand in India to be well supported by the government's focus on infrastructure, manufacturing and energy transition. With respect to funding options for its near-term bond maturity ($500m in April 2024), management highlighted that the onshore market continues to be more competitive compared with offshore US dollar borrowings. For Tata Steel, the near-term focus would be on the implementation of its restructuring plan for its UK operations which entails the upcoming closure of the blast furnaces at Port Talbot in 2024 and the development of an electric arc furnace for commissioning by 2027.

Bharti Airtel has made another prepayment (INR83.25bn) of its spectrum liabilities to the Dept. of Telecoms. This is an ongoing initiative by the company to pay down the high-cost spectrum liabilities (interest cost of 10%) by using lower-cost borrowings and operating cash flow.

Emerging markets

Emerging market hard currency returns were flat on the week. EM spreads have held up well despite rising concerns in the Middle East and a mixed technical picture of large new issuance and overall asset class outflows. The return on the index for the week was +0.10% and spreads remained at 400bps over US treasuries. Lower rated countries including Ecuador and Pakistan performed the best.

Activity continued in the primary market with Romania and Brazil both coming with dual tranche deals. In Sub-Sahara Africa we saw a high yield name gaining market access as Ivory Coast issued two new bonds totally $2.6bn.

In ratings news, Qatar was upgraded by Moody's to Aa2 as the increased global demand for liquified natural gas continues to bolster government revenue and exports.

In China, the PBOC said it will cut the RRR rate for the banking sector by 50bps, which should release $139bn in long term liquidity into the market. This represents the biggest cut in two years and follows increasing pessimism on Chinese equities. Hong Kong's Hang Seng index recently hit the lowest level since the financial crisis, China has also now imposed limits on short selling. Looking forward the market expects more stimulus on top of the RRR cut.

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Fixed Income Asset Allocation Views

29th 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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