COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

30 January 2023

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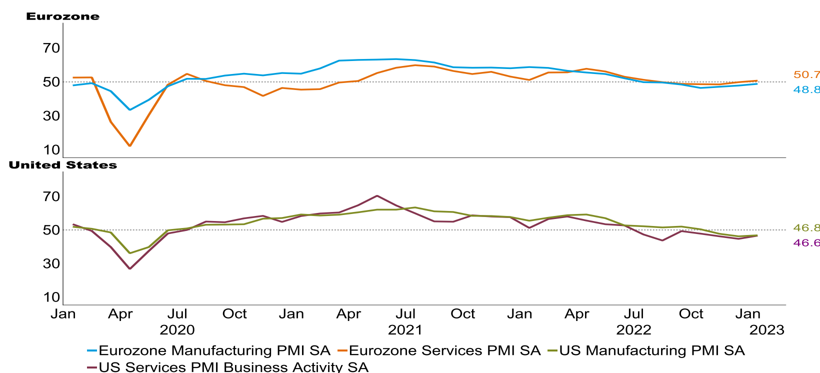
Markets at a glance

	Price / Yield / Spread	Change 1 week	Index YTD return	Index 1 year return
US Treasury 10 year	3.54%	6 bps	2.4%	-8.9%
German Bund 10 year	2.29%	11 bps	2.0%	-15.4%
UK Gilt 10 year	3.34%	-3 bps	2.8%	-20.6%
Japan 10 year	0.48%	10 bps	1.4%	-5.0%
Global Investment Grade	133 bps	-5 bps	3.2%	-9.8%
Euro Investment Grade	149 bps	-4 bps	2.2%	-11.3%
US Investment Grade	125 bps	-4 bps	3.7%	-9.6%
UK Investment Grade	141 bps	-6 bps	3.6%	-13.0%
Asia Investment Grade	202 bps	-6 bps	2.3%	-6.0%
Euro High Yield	460 bps	-8 bps	3.3%	-7.8%
US High Yield	423 bps	-12 bps	4.0%	-5.4%
Asia High Yield	626 bps	-13 bps	7.0%	-4.6%
EM Sovereign	366 bps	-3 bps	3.6%	-10.9%
EM Local	6.6%	-1 bps	4.7%	-7.2%
EM Corporate	330 bps	-9 bps	3.1%	-8.1%
Bloomberg Barclays US Munis	3.1%	1 bps	2.8%	-3.8%
Taxable Munis	4.7%	-2 bps	5.8%	-13.6%
Bloomberg Barclays US MBS	36 bps	-3 bps	3.5%	-7.2%
Bloomberg Commodity Index	243.55	-0.4%	-0.7%	7.6%
EUR	1.0882	0.1%	1.5%	-2.5%
JPY	130.30	-0.2%	0.9%	-11.2%
GBP	1.2373	-0.1%	2.5%	-7.5%

Source: Bloomberg, Merrill Lynch, as at 27 January 2023.

Chart of the week: S&P Purchasing Manager's Index, Eurozone and United States



Source: Bloomberg, Columbia Threadneedle Investments, as at 23 January 2023.

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Macro / government bonds

Government bonds returns were mixed. We saw modest sell offs in the US and Germany with a slight rally in UK gilts. The three major central banks meet this week with the US Federal Reserve strongly priced in for a 25bps hike and the eurozone priced in for 50bps as previously telegraphed by Lagarde. The market is expecting a 50bps hike from the Bank of England to 4%, with peak rates priced for 4.5%.

In the US, Q4 GDP grew by 2.9%, beating expectations of 2.6%, but at a slower clip than Q3's 3.2%. While the print looked attractive at the headline level, growth was driven by inventories and foreign trade, neither of which are sustainable sources of growth. The consumption component (a sustainable source of growth) was weak as evidenced by personal consumption registering negative growth in the last two months.

Elsewhere in the US initial jobless claims continued to creep down, printing at 186k, thanks to favourable seasonal patterns. Despite the apparent strength in the jobs market claims have yet to reflect the recent surge in lay-off announcements in finance and technology.

Last week was also global PMI week **(see chart of the week)**, there was weakness in these measures (which are forward looking measures unlike GDP) but to varying degrees. In the US both manufacturing and services PMIs printed above expectations but still in contractionary territory. In Europe, the Eurozone Composite PMI printed at 50.2 in expansionary territory and ahead of expectations. Both the services and manufacturing component improved, with the services component printing above 50. European activity has been supported by the easing of natural gas prices and strong government support alongside the easing of supply chain issues.

Investment grade credit

Investment grade spreads had yet another week of tightening in a busy week of economic data releases, corporate results and issuance. Sterling IG spreads are still top of the leader board now at 15% tighter YTD, followed by global and European at around 10% tighter with US spreads just under 10%.

Issuance in Europe broke records in the early part of last week, as new debt sales reached €240bn in what is now currently the busiest ever January since 2020. As mentioned in last week's report, issuance has now calmed down somewhat whilst we take note of important corporate results and economic data.

High yield credit & leveraged loans

The US high yield bond market continued to grind tighter over the week, albeit to a more modest degree, as the supportive technical and constructive market sentiment remained in place. The ICE BofA US HY CP Constrained Index returned 0.38% and spreads were 11bps tighter. According to Lipper, the asset class saw a $1.3bn outflow, the first outflow in three weeks. Meanwhile the average price of the J.P. Morgan Leveraged Loan Index increased another $0.20 to $94.44 with stable CLO demand and moderating retail fund outflows supporting the asset class. Retail loan funds saw $288m withdrawn over the week following the first weekly inflow in 22 weeks during the prior week.

European High Yield (EHY) provided another week of positive returns showing more compression as CCCs strongly outperformed high rated credits and sterling HY outperformed EHY. Again, performance came from another bout of spread tightening (-8bps to 460bps) as government yields rose marginally over the week. Overall, the first month of 2023 has been the strongest start for a calendar year since 2019 with CCC performance the best for start of a year since 2012. The asset class continued to experience solid inflows, this time into both ETFs and managed accounts. Supporting the positive tone for high yield was the strong primary market, which saw €4.8bn of new issuance, this week from nine deals (all refinancings). Unlike the previous week, most of the bonds were single B rated, with only two BB rated deals (Telefonica hybrid and ZF green bond). The new bonds were generally well received by the market, with

final pricing coming in from initial price talk and well over subscriptions. It was a resilient market with good two-way flow.

Trading updates continued to show weakness in specialty chemicals with poor Q4 results (eg, Trinseo, Ashland) on the back of customer destocking and lower underlying demand resulting in earnings and cash generation coming in much lower than expected. More positively, transportation, (eg, WizzAir, GetLink), continued to show strong sales figures, even coming ahead of pre-Covid numbers in some cases.

In credit rating news, Allwyn, the Czech gaming company, was upgrade to BB from BB- by S&P. This was on the back of strengthened diversification of ownership and increased scale. On the downside, Telepizza was downgraded to Ca from Caa3 by Moodys, with negative outlook.
In sector news, real estate was hit, again, by short seller, Viceroy. Their target, this time was the health care real estate group, Medical Properties.

Structured credit

The US MBS market generated a positive total return of 17bps last week, beating the broad bond market but underperforming IG corporates. With yields largely unchanged, it was a week of longer maturity and lower coupon bonds, both with higher durations. Spreads were marginally tighter and 30-year bonds remain in relatively cheap territory. Investors can still enjoy a higher spread on current product Agency MBS vs IG corporates, a relationship we rarely see. Non-agency spread risk was better bid. Spreads tightened 10-50bps.

Current remittance reports indicate credit performance is holding up with a stable level of delinquencies. In CMBS, there were no new issues and the forward pipeline is lacklustre. Trading in the secondary market was elevated with approximately $1.3bn BWICs. Spreads tightened with outperformance in the belly of the stack.

In ABS, nine deals priced last week across Autos, Equipment, and Consumer Loans. Spreads were also mostly tighter in that sector but earnings expectations have weakened with further credit deterioration expected in 2023.

Asian fixed income

Adani Group has released its formal rebuttal of the allegations by Hindenburg Research (short-seller). Adani Enterprises Ltd (AEL) is in the midst of its FPO (follow-on public offering) to raise $2.5bn. The risk of an unsuccessful FPO is high given the sharp drop in share price. Despite the formal rebuttal by management, both equities and bonds of Adani entities remain under pressure. The subscription by anchor investors was completed on 24 January 2023, which raised around INR59.85bn ($730m). For retail investors, the FPO subscription is opened from 27-31 January 2023, priced at INR3,112 to INR3,276/share. Today, AEL's share price closed at around INR2,900/share (below the floor price of the FPO). That said, according to Bloomberg, International Holding Company (IHC, Abu-Dhabi investment company) is reportedly planning to invest around $400m in the FPO.

JG Summit announced a solid recovery in its Cebu Air (CEB) business. The passenger volume at CEB rose to 15 million in 2022 (2021: 3.3 million) and the company expects to achieve full capacity in March 2023.

For context, before the pandemic, CEB accounted for around 28% of JG Summit's revenue and around 20% of net profit. In Q3, 2022, CEB revenue contribution rose y/y to 16% of group revenue and its net loss narrowed. Its systemwide seats reached approximately 80% of pre-pandemic capacity with a domestic market share of around 56%.

Emerging markets

Emerging market hard currency posted a positive return of 0.22% with high yield performing stronger than the investment grade sector.

Central bank action this week came from Colombia who hiked interest rates 75bps to 12.75% and Nigeria who increased 100bps to 17.50%. Hungary kept rates unchanged at 13%. Nigeria and Hungary also saw ratings action last week: both were downgraded, with Moody's downgrading Nigeria to Caa1 due to its worsening fiscal position. S&P lowered Hungary's rating one notch to BBB-, keeping it investment grade, on external balance sheet pressures.

In Peru, protests demanding the resignation of newly minted president Boluarte continue with the death toll rising to over 50, following the first reported death in the capital of Lima. Law makers have rejected calls for an early election despite Boluarte supporting this. Continued unrest risks around 30% of Peru's copper supply.

In South Africa, the central bank hiked interest rates 25bps (50bps expected) to 7.25%. The bank's 2023 GDP growth expectations was also cut to 0.3% from 1.1% previously, a consequence of persistent power outages implemented by state owned utility Eskom, this will shave an estimated 2% off growth this year. The central bank now expects 250 days of rolling blackouts in 2023.

Commodities

The commodity index finished the week down 0.4% with energy markets the worst performer declining -3.4%, while industrial metals were flat on the week (0.1%).

US and European natural gas prices continued to slide facing downward pressure from warmer weather in the northern hemisphere allowing both regions to boost storage levels. The EIA expects US gas production to outstrip supply for the next couple of years thanks to increases in production, declining domestic and industrial power demand alongside flat LNG exports.
In more bullish news the Freeport LNG export terminal (which has been closed since an explosion in June) is now repaired and has received regulatory approval to restart some operations, with a full restart expected from late February or early March. The terminal accounts for around 20% of US LNG export capacity with a restart likely to be supportive for prices through opening the US market increased export demand.

Gold was flat on the week but is trading at a nine-month high. Prices have been supported by recessionary concerns following weaker data from the US alongside a weaker US dollar following the Federal Reserve's move to a slower pace of rate hikes.

Responsible investments

The government in the UK is rumoured to soon agree on a budget of £300m to assist British Steel in preventing job losses alongside cutting its carbon emissions. The Chinese owned steel manufacturer, based in the north of England, is currently using high carbon emitting furnaces in its production line and needs to replace them with more eco-friendly versions. In the recent high inflation environment, 4,000 jobs at the company are at risk as factories risk being idle due to low demand and rising energy costs.

The European Union is expected to launch a new initiative that will require companies to provide scientific back up to any product claiming to be environmentally friendly. Stricter measures around greenwashing are required as, according to a survey in 2020 stated in the draft proposal, over half of the product environmental claims studied contained "vague, misleading or unfounded information". EU member states would be able to penalise those companies that fail to provide scientific proof to their claims.

Fixed Income Asset Allocation Views

30th January 2023

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	▪ Valuations are less attractive relative to December, technicals and fundamentals stable to improving. **The group remained negative on credit risk, upgrading Investment Grade to neutral and downgrading Structured Products to neutral.** ▪ The Fed Funds market is pricing in a peak of 5% and rates being cut to 4.5% in 2023 ▪ The CTI global Rates base case view is no cuts in 2023, with a best case of potentially one cut. They expect rates to peak between 5 – 5.25% in first half, with Fed holding steady through the second half. ▪ Uncertainty remains elevated due to fears surrounding recession probabilities, schedule of central bank hiking/easing, persisting inflation, weakening consumer profile and the Russian invasion of Ukraine.	▪ Upside risks: the Fed achieves a soft landing, strong China reopening, Europe sees commodity pressure easing, consumer retains strength, end of Russian Invasion of Ukraine ▪ Downside risks: simultaneous low unemployment, high inflation, hiking, and slowing growth cause a recession. Russian invasion spills into broader global/China turmoil. New Covid variant. Supply chain disruptions, inflation, volatility, commodity shocks persist to 2023.
Duration (10-year) ('P' = Periphery)	¥ P $ Short -2 -1 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 ▪ Hiking cycles may be curtailed by weakening growth, as risk of a policy error increases ▪ change in UK fiscal position to contractionary is a positive for the front end	▪ 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 $ € £	▪ Rising expectations around a soft landing and peak Central Bank rates have weakened the dollar ▪ China reopening has amplified this by boosting growth expectations helping risk markets ▪ A material weakening of the dollar from here will need to see growth expectations move significantly higher	▪ 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	▪ Substantial monetary policy tightening now embedded into EM local rates; inflation peaking in some places ▪ Aggressive Fed pricing may now open the door to selective EMFX performance ▪ EM real interest rates relatively attractive, curves steep in places	▪ Negative sentiment shock to EM fund flows ▪ Central banks tighten aggressively to counter fx weakness ▪ EM inflation peaks higher and later ▪ EM funding crises drive curves higher and steeper ▪ Further rises in DM yields
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ EMD spreads unchanged since last meeting, following strong Q4 spread compression and performance. ▪ China reopening story is huge turnaround since November. ▪ Fundamental headwinds: elevated fiscal deficits, rising debt to GDP ratios, significant inflation, central bank tightening, idiosyncratic political risks, difficult global financing conditions (US rates and USD strength), increasing use of IMF programs, geopolitical risks ▪ Technicals improving with higher new year issuance	▪ Chinese reopening paused – weakened property market and confidence drag on growth ▪ Continued spillover from Russian invasion: local inflation (esp. food & commodity), slowing growth in trade partners, supply chains ▪ Persisting COVID growth scars hurt economies & fiscal deficits
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ US & EMEA spreads have continued tightening to less attractive valuations as fundamentals remain stable and technicals remain soft. ▪ Fundamentals remain stable, with strong starting point – expected deterioration may be a 2023 story. ▪ Inflation, labor supply, low dispersion and monetary tightening continue to pressure margins and operating environment. All eyes on Q4 results and '23 outlooks.	▪ Supply remains low. ▪ M&A expected to slow; cash flow prioritizing shareholder payouts ▪ Market indigestion as central banks sell EMEA corporates ▪ Rate environment remains volatile ▪ Russian invasion worsens operating environment globally
High Yield Bonds and Bank Loans	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads have moved tighter. Prefer conservative position while open to attractive buying opportunities. ▪ Technicals have started to improve with positive fund flows and no defaults in December; more rising stars than fallen angels in 2022. Fundamentals still stable. ▪ Expect 2023 performance will be driven by credit selection amidst fundamental dispersion and distress. ▪ Bank loan market has tightened: market is in equilibrium with fund outflows offset by stable CLO formation and lower new supply.. Concerns about recession and interest cost remain headwinds.	▪ Default concerns are revised higher on greater demand destruction, margin pressure and macro risks ▪ Loan technicals & flows weaken ▪ Global consumer health weakens ▪ Russian invasion & spillover ▪ Commodity prices retrace
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Mortgage index has tightened along with other risk assets. Despite outperformance, valuations still attractive from historic perspective and volatility remain elevated. ▪ Headwinds as money manager demand is small relative to Fed, bank, REIT and overseas selling pressure ▪ Place to add as preference shifts to high quality assets and sentiment is constructive over longer time horizon	▪ Housing activity slows and rising rates move prepays to normal levels without hurting mortgage servicing rates. ▪ Fed continues to shrink position even as hiking is paused in recessionary scenario
Structured Credit Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Our preference remains for Non-Agency RMBS ▪ RMBS: Higher mortgage rate is headwind for prepays, fundamentals and transaction activity. Delinquency performance remains strong, but housing is slowing. Risk premiums still cheap to historical averages but tightening. ▪ CMBS: Mostly solid fundamentals but weakening. Spreads attractive for historical CMBS, but better relval elsewhere. ▪ CLOs: Spreads tighter since December. Default rate increasing and slow new issue supply to start the year ▪ ABS: Lower income, renters, lower fico borrowers continue to underperform, higher quality borrowers remain stable.	▪ Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening, Consumer retail/travel behavior fails to return to pre-covid levels ▪ WFH continues in 2023(positive for RMBS, negative for CMBS). ▪ Rising interest rates dent housing market strength and turn home prices negative in 2023
Commodities	Under-weight -2 -1 0 +1 +2 Over-weight	▪ o/w Copper ▪ o/w Grains ▪ u/w Gold ▪ o/w Oil ▪ u/w Silver	▪ Global Recession

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