COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

30 October 2023

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

Jake Lunness
Commodities
Emerging Markets

Sarah McDougall
General Fixed Income

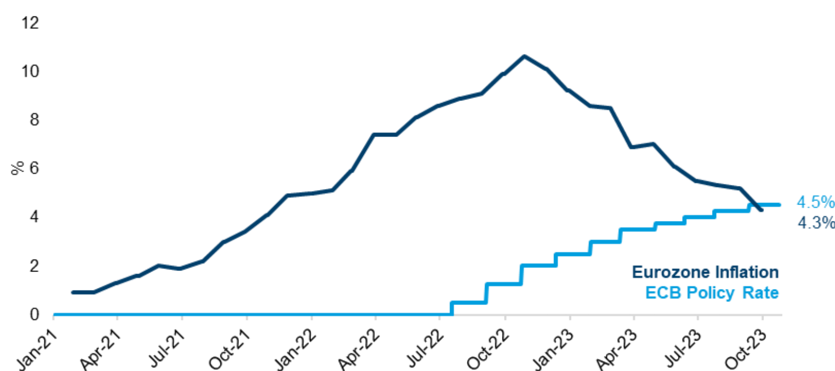
Keep calm and carry on

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.90%	-1 bps	-1.0%	-2.7%
German Bund 10 year	2.85%	-4 bps	0.1%	-1.1%
UK Gilt 10 year	4.60%	-5 bps	-0.7%	-5.3%
Japan 10 year	0.89%	5 bps	-1.2%	-1.6%
Global Investment Grade	140 bps	-2 bps	-0.9%	0.1%
Euro Investment Grade	160 bps	-2 bps	0.1%	2.4%
US Investment Grade	131 bps	-2 bps	-1.4%	-1.0%
UK Investment Grade	136 bps	-1 bps	-0.3%	0.8%
Asia Investment Grade	206 bps	5 bps	-0.7%	1.7%
Euro High Yield	508 bps	-2 bps	-0.7%	5.6%
US High Yield	453 bps	1 bps	-1.6%	4.3%
Asia High Yield	957 bps	11 bps	-1.2%	-5.8%
EM Sovereign	376 bps	-3 bps	-1.7%	-0.6%
EM Local	6.9%	-4 bps	-0.6%	3.6%
EM Corporate	348 bps	3 bps	-1.2%	2.2%
Bloomberg Barclays US Munis	4.5%	1 bps	-0.9%	-2.3%
Taxable Munis	5.8%	-6 bps	-2.4%	-2.5%
Bloomberg Barclays US MBS	77 bps	-3 bps	-1.9%	-4.1%
Bloomberg Commodity Index	239.27	-0.1%	1.2%	-2.3%
EUR	1.0589	-0.3%	-0.1%	-1.3%
JPY	149.83	0.1%	-0.2%	-12.4%
GBP	1.2129	-0.3%	-0.6%	0.3%

Source: Bloomberg, ICE Indices, as of 27 October 2023. *QTD denotes returns from 30/09/2023.

Chart of the week – ECB policy rate vs eurozone inflation



Source: Bloomberg, Columbia Threadneedle Investments, as of 28 October 2023.

Macro / government bonds

Fixed income markets remain nervy, with volatility encouraging 'gap and fill' activity from market participants who took advantage of any price weakness to add to positions. We are clearly within 'terminal rate' territory in core markets, but when is monetary policy likely to shift? Nobody in the market can approach this question with any confidence. In the US, annualised GDP for the third quarter came in at a stonking 4.9%, contrasting to the previous figure of 2.1% for the second quarter. Personal consumption also came in stronger than expected at 4%. The surprising resilience of the US economy has been attributed to the strength of the labour market, wage growth, and the running down of excess savings built up during the pandemic era. PMI data on the US economy, mirrored that of the GDP data, with both manufacturing and services remaining in expansionary territory. This has created a dilemma for the US Federal Reserve, as it cannot yet close the door on monetary tightening whilst the economy remains so buoyant. The other factor placing upward pressure on US treasury yields has been the increased level of treasury issuance, which appears likely to rise again when the US Treasury announces its financing schedule for the fourth quarter later this week. The Bank of Canada held tight on interest rates, keeping them at 5%. The market interpreted its actions as modesty bearish, while the central bank could not rule out further rate hikes.

In Europe, the European Central Bank met to determine interest rate policy. The market had not been expecting any change to interest rates and Christine Lagarde, President of the ECB, duly delivered. While she talked up the progress that had been made on inflation, she could not point to any turning point in monetary policy and emphasised the need for an extended period of monetary policy restriction if the central bank is to guide inflation successfully back to its 2% target (**see chart of the week**). She pointed out that whilst credit dynamics in the eurozone economy have deteriorated, the labour market remains too tight and has been one of the drivers of inflation. In the background, geopolitical tensions continued to percolate, although they failed to overwhelm market price action. Lagarde stated at the accompanying price conference that the ECB remained attentive to the risks posed to energy prices, and thereby eurozone inflation, from any escalation in geopolitical tensions. She also addressed the future operations of the Pandemic Emergency Purchase Programme, stating that it had not been discussed by the ECB in response to a direct question from a journalist. Prior to the meeting, there had been talk in the marketplace about potential adjustments to the programme, which continues to re-invest principal at maturity. At the margin, this was positive for peripheral eurozone bonds, as a price-insensitive buyer remains at the table for the time being.

Positioning in global rates mandates can be characterised by modest long duration positions and yield curve steepening positions across core markets. We believe we are getting closer to the inflection point in markets, as markets position for a shift to easier monetary policy even in a 'higher for longer' interest rate environment. Yield curve steepeners remain a key macro position. Fiscally expansionary policies in many countries have increased the need for greater sovereign issuance, while there is still debate over whether we will actually make it all the way back to 2% inflation targets or if we have shifted to a structurally higher inflation environment. Uncertainty around this issue has caused the market to demand higher term premia.

Investment grade credit

There was some marginal tightening in most investment grade areas last week except for Asia. Euro investment grade continues to outperform with 2.4% returns on the index year to date, versus a -1.0% return from US investment grade.

Issuance is seasonally low given the rise in rates with October issuance looking to end at around €250bn raised, according to Bloomberg. Previous October months raised far more than this and often north of €300bn.

Greece was upgraded to investment grade quality by S&P last week, the first of the three major rating agencies to upgrade the country. This follows Greece's improved budgetary conditions. GDP has expanded strongly over the past few years with 2024 GDP expected to rise by 3%, double that of the eurozone average.

High yield credit & leveraged loans

US high yield valuations ended the week largely unchanged amid elevated interest rate and equity volatility. The ICE BofA US HY CP Constrained Index returned 0.38% and spreads were unchanged. According to Lipper, retail high yield bond funds saw outflows totaling $942m, marking the seventh consecutive weekly withdrawal for a cumulative $10.9bn withdrawn. Meanwhile, the average price of the J.P. Morgan Leveraged Loan Index decreased $0.33 to $94.84. Retail loan funds saw $123m withdrawn for a fifth consecutive weekly outflow.

Inspite of a volatile week, European High Yield spreads finished almost flat for the period, tightening only 2bps to 508bps while yields fells 11bps, largely helped by the fall in underlying government bond yields. It was also another week of decompression with CCCs the only rating class to have negative returns (-34bps), strongly underperforming BBs and Bs (both returned +49bps each). This was even as flows were strongly negative (-€117m) with funds flowing out via ETFs and managed funds. The corporate primary market remained closed with the overall EHY market only being offered a small €200m from a Portuguese bank.

The reporting season is in full swing with certain themes already emerging: some looking good; some showing signs of cracks. In the leisure space, we are seeing great results – eg, British Airways (airlines) Accor (hotels) – beating expectations and improving guidance. In the packaging space, we are seeing misses on the back of destocking and weaker demand (eg, Ardagh), while in chemicals there are more signs of the deterioration mentioned earlier this year (eg, Chemours (US chemicals) that lowered its guidance for the 2023 full year by 7%).

In auto sector news, the UAW strike seems to be coming to a close with all three auto manufacturers having negotiated a deal worth 25% over four years. Just before the deal announcement (and with the posting of poor Q3 financial figures), Ford withdrew its 2023 guidance. More disposals were announced as companies shore up liquidity and look to reduce leverage (eg, AMS Osram, Virgin Media and Vodafone).

Structured credit

Some relief in interest rates gave the US Agency MBS sector a boost last week. With a return of +86bps, the sector was also buoyed by spreads retreating from recent wides. 30-year MBS outperformed 15s, as did lower coupon mortgages, with longer durations as the curve flattened.

In Non-agency, new issuance was light at $500m and secondary trading was also limited. Spreads widened by 20bps for Non-qualified and 10-20bps for CRTs. It was also quiet in CMBS with only one deal pricing last week, while spreads were mostly unchanged. The story continues on downgrades, with 49 bonds from 11 deals downgraded last week, while eight bonds from three deals were upgraded. An additional 54 loans reported appraisal value reductions as well.

Asian credit

In India, the National Financial Reporting Authority (NFRA) has started an inquiry on S.R.Batliboi (SRB), which is the statutory auditor of five listed Adani companies – Adani Power, Adani Green Energy, Adani Wilmar, Ambuja Cements and ACC Ltd. The inquiry will likely revolve around SRB's audit work on the accounting and disclosures of the Adani entities.

According to a notice by the bond trustee Citicorp International, the failure of Country Garden to pay a coupon of $15.4m within the 30-day grace period constitutes an event of default.

Emerging markets

There was at last a positive return over the week for the EM hard currency universe. While spreads continued to demonstrate resilience (3bps tighter to 376bps), the return from the treasury component finally contributed positively to returns: +0.71% for the index. Both the investment grade and high yield sub-sectors had positive weeks and African countries led returns, particularly Zambia after an agreement in principle with creditors to restructure its debt.

Turkey continued its newly found orthodox approach to monetary policy with a 500bps hike to 35% as inflation soared past 60%. Policy makers in Chile surprised markets with a hawkish cut of 50bps rather than the anticipated 75bps. This follows Indonesia's unexpected 25bps rate hike the week before, the first since January as both countries look to support their local currencies in light of higher oil and food prices. In Hungary, the Central Bank cut rates 75bps to 12.25%, which was higher than the 50bps expected.

In Venezuela bond prices continue to react favourably to the recent relaxation of sanctions in the energy sector, financial services sector and secondary market trading (not primary) by US investors. The nation's most widely traded 2027 maturity dollar bond alongside a 2026 maturity of state own energy company Petróleos de Venezuela have both seen their cash prices double since the easing of sanctions. We view the easing of secondary trading sanctions as more permanent given the lower impact on the Maduro government. The market has also become increasingly optimistic that the enhanced co-operation between the US and Venezuelan government could lead to debt restructuring agreement for government bonds.

Commodities

The BCOM index delivered total returns of -0.1% on the week with strength in industrial metals being offset by weakness in grains (-1.7%) and energy (-0.5%).

Oil declined on the week ahead of Israel's forces advancing into the Gaza strip. The operation isn't as large as feared, which is being taken as a positive as it reduces the probability of Iran being drawn into the conflict. Elsewhere we had some encouraging news from China. Domestic air traffic numbers were released for Q3, 180m passengers were carried, 2.6% ahead of pre pandemic levels (Q3, 2019). However Chinese international traffic is less than half of pre covid levels.

Base metals, led by copper (+2.3%) and aluminium (+1.7%), were supported by the news of $137bn worth of sovereign bond issuance by China, the proceeds for which are earmarked for improving flood damaged areas and improving urban infrastructure. Changes to China's budget are rare, with the budget deficit now at excepted at 3.8% up from 3.0% previously.

Fixed Income Asset Allocation Views

30th October 2023

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk	■ above 0 Under-weight -2 -1 0 +1 +2 Over-weight	▪ Valuations continue to be rich overall but have cheapened in the past month. Technicals seem stable; fundamentals show modest pockets of weakness but no thematic deterioration. **The Group stands neutral on Credit risk overall upgrading High Yield and Structured Credit.** ▪ The CTI Global Rates base case view is no cuts in 2023, with one more possible hike left in the hiking cycle. Focus remains on wages, labor market, financial conditions, and inflation expectations. ▪ Uncertainty remains elevated due to geopolitical tension, stricter lending, monetary policy tightening, persisting inflation, and weakening consumer profile.	▪ Upside risks: the Fed achieves a soft landing with no labour softening; consumer retains strength; end to Ukraine and Israel-Hamas wars. ▪ Downside risks: Fed is not done hiking and unemployment rises. Another banking crisis, this time from unrealised losses on securities and CRE, supply chain disruptions, inflation, volatility, commodity shocks re-emerge.
Duration (10-year) ('P' = Periphery)	¥ above -1, $ above +1 Short -2 -1 0 +1 +2 Long P below -1, € £ below +1	▪ 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$ above 0 Short -2 -1 0 +1 +2 Long ¥ € $ £ below 0	▪ 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 above +1 Under-weight -2 -1 0 +1 +2 Over-weight C below 0	▪ 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)	■ above -1 Under-weight -2 -1 0 +1 +2 Over-weight	▪ EMD spreads 30bps wider than last month, reversing the early summer rally. Technicals are slower, outflow and weak issuance. ▪ Conservatively positioned with most idiosyncratic opportunities in lower quality portion of index, focus on relval opportunities. ▪ Tailwinds: Central bank easing in less inflationary countries, 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.	▪ 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	■ above 0 Under-weight -2 -1 0 +1 +2 Over-weight	▪ US and EMEA spreads have widened since last month. Fundamentals are in focus as earnings report. Global portfolios prefer EUR IG over USD on relval basis. ▪ Fundamental concerns remain focused on commercial real estate and unrealised losses for banking sector, tight labor supply, changing consumer behaviour.	▪ Lending standards continue tightening, even after Fed pauses hiking cycle. ▪ Rate environment remains volatile ▪ Mass layoffs spike, worsening consumer profile. ▪ Geopolitical conflicts worsen operating environment globally
High Yield Bonds and Bank Loans	■ above 0 Under-weight -2 -1 0 +1 +2 Over-weight	▪ The group upgraded HY as prices have fallen, while technical and high-quality HY fundamentals remain stable. Financial conditions continue to punish destressed names. ▪ Conservatively positioned, but open to attractive buying opportunities in short HY, BBs and higher quality loans. ▪ US HY defaults remain below historic averages, with greater default expectations for 2024. ▪ Bank loan market has been more volatile in the past month. Themes: moderating retail fund outflows, delayed defaults, improving CLO issuance, increasing interest burden, credit concern in lower quality loans.	▪ 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	■ above +2 Under-weight -2 -1 0 +1 +2 Over-weight	▪ Mortgage index at similar lever to last month with spreads wide of historic medians, the group views agencies as attractive. ▪ Supply is manageable as higher rates and fall seasonals kick in. ▪ Performance has been driven by the Fed's hiking cycle, with MBS widening into a bear steepener. ▪ Place to add, prefer high coupon assets; constructive view 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	■ above +1 Under-weight -2 -1 0 +1 +2 Over-weight	▪ Upgraded outlook because of decent risk-adjusted valuations in select high quality Non-agency RMBS, CLOs and ABS. ▪ RMBS: September saw spreads widen, attractive risk-adjusted valuations. Home prices resilient despite headwinds. Delinquency, prepayment and foreclosure performance remains strong. Expect fundamentals to hold in as long as labor market strength remains. ▪ CMBS: The group is cautious, especially on office and multifamily, however non-office sectors perform as expected. Delinquencies increasing as maturities come due. Credit curve remains steep. ▪ CLOs: Spreads softer in past month. Defaults remain low but CCC buckets continue to rise slowly. ▪ ABS: Attractive relval in some senior positions. Higher quality borrowers remain stable, lower quality borrowers underperform. Student loan repayments restart, with 12 month ramp up period.	▪ 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, denting housing market strength. ▪ Cross sector contagion from CRE weakness.
Commodities	■ above 0 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

Important information: For use by Professional and/or Qualified Investors only (not to be used with or passed on to retail clients). Source for all data and information is Bloomberg as at 30.10.2023, unless otherwise stated.

This material in this publication is for information only and does not constitute an offer or solicitation of an order to buy or sell any securities or other financial instruments to anyone in any jurisdiction in which such offer is not authorised, or to provide investment advice or services. Offerings may be made only on the basis of the information disclosed in the relevant offering documents and the terms and conditions under the relevant application forms. Investment involves risk. You are advised to exercise caution in relation to this material. Please refer to the relevant offering documents for details and the risk factors. Past performance is not a guide to future performance. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. The analysis included in this publication has been produced by Columbia Threadneedle Investments for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice and should not be seen as investment advice. Information obtained from external sources is believed to be reliable, but its accuracy or completeness cannot be guaranteed. The mention of any specific shares or bonds should not be taken as a recommendation to deal. This document includes forward looking statements, including projections of future economic and financial conditions. None of Columbia Threadneedle Investments, its directors, officers or employees make any representation, warranty, guarantee, or other assurance that any of these forward-looking statements will prove to be accurate. This document may not be reproduced in any form or passed on to any third party in whole or in parts without the express written permission of Columbia Threadneedle Investments. This document is not investment, legal, tax, or accounting advice. Investors should consult with their own professional advisors for advice on any investment, legal, tax, or accounting issues relating an investment with Columbia Threadneedle Investments. This document and its contents have not been reviewed by any regulatory authority. **In the UK: issued by Threadneedle Asset Management Limited, registered in England and** Wales, No. 573204. Registered Office: Cannon Place, 78 Cannon Street, London EC4N 6AG. Authorised and regulated in the UK by the Financial Conduct Authority. **In Australia**: Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 (Cth) and relies on Class Order 03/1102 in respect of the financial services it provides to wholesale clients in Australia. This document should only be distributed in Australia to "wholesale clients" as defined in Section 761G of the Corporations Act. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws. **In Singapore**: Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore. **In Hong Kong**: Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058. **Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies**. columbiathreadneedle.com