

In Credit

9 September 2024



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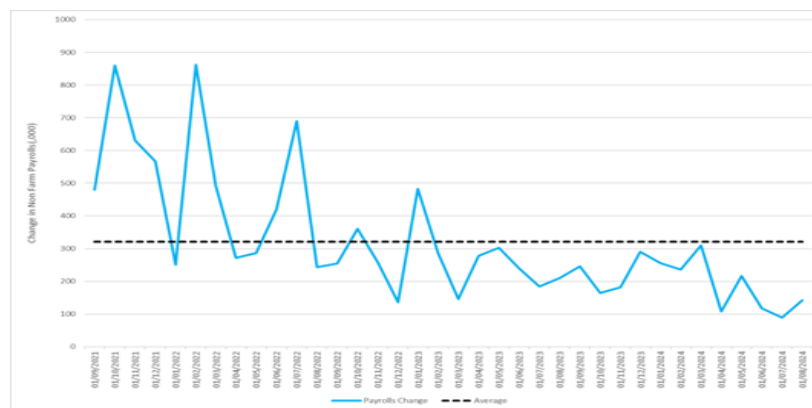
A quarter or a half?

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	3.73%	-18 bps	5.0%	4.2%
German Bund 10 year	2.20%	-10 bps	2.9%	0.7%
UK Gilt 10 year	3.90%	-12 bps	3.4%	0.4%
Japan 10 year	0.90%	0 bps	1.5%	-1.8%
Global Investment Grade	105 bps	3 bps	4.3%	4.6%
Euro Investment Grade	116 bps	2 bps	2.6%	3.1%
US Investment Grade	99 bps	4 bps	5.2%	5.3%
UK Investment Grade	99 bps	1 bps	2.6%	2.5%
Asia Investment Grade	161 bps	7 bps	3.5%	6.1%
Euro High Yield	376 bps	9 bps	2.5%	4.8%
US High Yield	339 bps	26 bps	3.8%	6.6%
Asia High Yield	562 bps	24 bps	2.1%	12.1%
EM Sovereign	348 bps	6 bps	4.6%	6.6%
EM Local	6.2%	-7 bps	6.1%	2.1%
EM Corporate	281 bps	12 bps	3.6%	7.6%
Bloomberg Barclays US Munis	3.4%	-7 bps	2.2%	1.8%
Taxable Munis	4.6%	-21 bps	6.4%	5.1%
Bloomberg Barclays US MBS	41 bps	2 bps	5.6%	4.6%
Bloomberg Commodity Index	223.81	-2.4%	-6.3%	-1.4%
EUR	1.1049	0.3%	3.5%	0.4%
JPY	142.89	2.7%	13.0%	-0.9%
GBP	1.3095	0.0%	3.8%	3.1%

Source: Bloomberg, ICE Indices, as of 6 September 2024. *QTD denotes returns from 30 June 2024.

Chart of the week – US job creation, 2021-2024



Source: Bloomberg, Columbia Threadneedle Investments, as of 9 September 2024.

Macro / government bonds

Last week saw a bull steepening yield curve in the US Treasury market, as we awaited potentially market-moving data on the state of the US labour market.

The context for market price action last week was concerns amongst traders that the US economy was in danger of slipping into recession and the Fed had fallen behind the curve in loosening monetary policy. For adherents of this view, the 'canary in the coal mine' was the US labour market. To justify the market pricing of four quarter point interest rate cuts by year end, traders needed to see a continuing deterioration in the US economy. First came manufacturing data from PMI and ISM. Both readings at the headline level pointed to continuing weakness in the manufacturing sector (with levels at sub 50) and softer employment growth. The relatively small share of manufacturing in the US economy, however, meant the data had a muted impact in pushing yields lower.

On the heels of this came reports about the Service sector from PMI and ISM. The PMI Services report edged a notch higher from 55.2 to 55.7, while the ISM Services Index remained unchanged at 51.5. Both reports pointed to strength in the services sector and an easing in inflation, which was indicative of a soft landing rather than outright recession. We also had the ADP employment number, which confirmed labour market cooling.

The Non-Farm Payroll data ([see Chart of the week](#)), when it came, disappointed markets. It failed to answer the question as to whether the US was entering a recession, and whether the next cut in US interest rates would be 25bps or 50bps. The number of new jobs created was 142k. This initially led to a sell-off until the market began to focus on the downward revision to the prior month's release from 114k to 89k. The data was insufficient to power the market rally further, as US Treasury valuations looked increasingly rich. Over the space of a week, the yields on the 10-year US Treasury fell 20bps to 3.71%, which left valuations looking rich, and vulnerable to any shift in market sentiment.

In terms of Fed speak, the two most important voices last week were those of New York Fed President John Williams, and Fed Governor Christopher Waller. Williams remarked that the data was consistent with a slowing economy and a cooling in the labour market and that it would be appropriate to start cutting rates. His remarks fell short of giving any indication on size and pace. Waller made the point that the time for patience was over and the time for action had come. One observation of Fed speakers was that their recent comments had focused to a much greater extent on the labour market rather than inflation, which increasingly seems to be on track to its 2% target.

In the UK, we had the Decision Maker's Panel, which the Bank of England views as an important source of data. Firms' plans to raise prices in the year to August fell to 3.4% from 3.7% in July, while pay growth grew 5.7% in the year to August. The relative strength of the UK economy was also highlighted by the Services PMI report, which remained unchanged at 53.7. Evidence of disinflation supported the decision to cut rates in August but pointed to the likelihood of a more cautious approach from the Bank. The main mover of the UK gilts market, as per other markets, was price action in the US Treasury market.

In the eurozone, we saw economic data mirror that of the UK and US with strength in services and weakness in manufacturing. There was broad unanimity on a September rate cut, with up to a further two cuts by year end.

Elsewhere, the Bank of Canada reduced its policy rate from 4.5% to 4.25%, amid slowing inflation and a cooling labour market.

Investment grade credit

Over the week, global credit spreads widened from 102bps to 105bps.

The month of September kicked off with a wall of new issuance globally. This follows the US Labour Day holiday, European summer recess and results season. Luckily, demand for the asset class remains strong, driven by higher yields rather than particularly attractive corporate bond spreads. This meant that there was only a minor bout of indigestion and spread widening last week. Indeed, markets are probably more concerned about the risk of a slowing economy than heightened levels of primary market activity. Interestingly, analysis from JP Morgan suggests that a significant portion of this (US dollar) issuance is coming from M&A (c13%), as well as being to pay dividends.

High yield credit & leveraged loans

US high yield bond total returns were assisted by lower interest rates as spreads widened amidst cooling labour market data, the resumption of primary issuance and small fund outflows. The ICE BofA US HY CP Constrained Index returned 0.25% and spreads were 25bps wider. The index yield-to-worst was unchanged at 7.27%, remaining around levels not seen in more than two years. According to Lipper, US high yield bond retail funds saw a \$48m outflow for the week, following \$3.2bn of inflows over the prior two weeks. In floating rates, the average price of the Credit Suisse Leveraged Loan Index was steady at \$95.6 in an environment of stable flows and light new issuance. Retail loan funds saw a sixth consecutive, albeit modest, weekly outflow with a \$38m withdrawal over the week.

European High Yield (EHY) showed resilience last week as spread widening (+16bps to 446bps) was offset by a fall in yields (-0.14% to 8.4%) due to the fall in underlying government bond yields. As a result, performance was basically flat for the week (+0.04%), with CCCs moderately outperforming higher-rated credits (+0.18% vs +0.02% for BBs and Bs). Demand for the asset class continued with another week of inflows (€232m) being added to the asset class across both ETFs and managed accounts though decisively stronger in the latter. The primary market continued the previous week's subdued nature with again only hybrid issues (€1bn), this time for SES, the satellite company.

In M&A news, Boparan announced that its European (Poland and Netherlands) poultry division will be sold to the Boparan private office for €200m with majority of the proceeds to go to debt reduction. On the Grifols' takeover story, Brookfields does not appear to be making much traction on getting sovereign wealth funds to join the bid as Qatar Investment Authority made clear its lack of interest.

In sector news, gaming continues to perform well with UK's 888 posting better than expected financial figures. This was the opposite for the auto sector where there seems to be a shift in outlook and strategy as firms re-consider the large capital requirements for conversion to EVs. Volvo was the poster child last week as it scaled back on its outlook for 100% EVs production, saying that there would be more of a mixture with hybrids. This comes on the back of lower than expected demand for EVs.

Under the Rising stars and Falling Angels, there was another departure from EHY as the National Bank of Greece was given a 2 notch upgrade to Baa2 by Moody's. YTD, the market is net up 6% for Rising Stars versus Falling Angels.

Word on the street is that the coming weeks will be busy with upcoming new issuance supply to be as much as €32bn, but this will be skewed to loans as corporate bond issuance is expected to be around €8bn.

Structured credit

The US Agency MBS sector posted a 1.26% gain last week with market participants all-in on the duration trade. The rate rally and re-inversion of the 2s-10s curve in over two years led to strong appetite for the sector overall. 30-year agency MBS outperformed 15-year and the belly of the coupon stack did best as investors picked their spots on the prepay curve. August speeds were up 3% for 30-year mortgages. September should be a bit slower given the shorter day count. There wasn't much specific news to note other than a slight uptick in mortgage applications led by purchases. In non-agency RMBS, spreads were mostly tighter 5-10bps across all sub-sectors. In CMBS, just one private label priced last week. We would expect a pick-up in the number of new loans and new deals issued on the improved refi market if rates continue to rally. Delinquencies 60+ days rose to 5.1% and 52 bonds (15 deals) were downgraded, while none were upgraded as stress continues in the office sector. It was a busy week in ABS. Five new issue ABS deals totalling \$4.4bn priced and approximately 18 new deals (c\$13bn) are currently marketing. YTD volumes are up 30% versus last year, a record versus comparable periods in all prior years. Spreads were mostly unchanged week-over-week with most still marginally above their 24-month lows.

Asian credit

In China, the PBOC indicated making further cuts to the RRR (reserve requirement ratio), which currently stands at 7% for financial institutions. PBOC had made similar comments in January 2024 and July 2023, before making subsequent cuts to the RRR ratio. This implies a high likelihood for RRR reduction over the near-term. The PBOC confirmed that 7-day reverse repo rate (1.7%) is now the official policy rate, in line with the PBOC's intent to simplify the existing policy rate framework and lower the reliance on the one-year policy rate (MLF – medium term lending facility).

The Caixin services PMI was softer in August, with a print of 51.6 (down 0.5 m/m) and coming somewhat below consensus. The services sector in China is still expanding albeit with a slower pace in August. The surveyed companies highlighted margin pressure in August on the back of higher input material, labour and transport costs. By contrast in India, the service sector growth was strong, coming at 60.9 (a 5-month high), thanks to solid payroll trend and positive business sentiment.

In Chinese properties, Country Garden continues to face a tight liquidity situation due to the ongoing pressure on home sales. The company plans to delay coupon and principal instalments payment on nine onshore CNY notes for six months. Additionally, Country Garden announced that PWC is resigning as its auditor. PWC has reportedly lost around two-thirds of its mainland clients after the fallout of its audit work with Evergrande, which remains the largest property defaulter so far.

Adani Green Energy Ltd (AGEL) has announced another JV with TotalEnergies, which would be the third 50/50 partnership between both companies. TotalEnergies also currently holds a 19.75% in AGEL. For the new JV, which has a portfolio of 1.15GW of solar projects, TotalEnergies will invest \$444m.

Emerging markets

The Emerging Market hard currency sovereign bonds posted positive returns (0.26%), helped by US Treasuries. Spreads were broadly unchanged at around 387bps, with high yield performing better, partly thanks to Ukraine bonds, which offset the wider investment grade bonds.

On 4 September, Ukraine announced the successful completion and settlement of its debt restructuring exercise, which effectively reduced Ukraine's debt by close to \$9bn. The old sovereign bonds with around \$20.5bn of outstanding principal amount (or \$25bn including accrued interest) were exchanged to eight new Eurobonds series with \$15.2bn in principal amount. The reconstitution of the Ukrainian debt was made to the JPM indices on 5 September.

In Mexico, the Lower House of Congress has approved the judicial overhaul proposed by President Andres Manuel Lopez Obrador (AMLO). This contentious proposal has raised tensions in Mexico over the politicization of the judiciary system to favour the ruling Morena Party (under President AMLO) and its allies. Next, the bill moves to the Senate where the governing coalition only requires one more vote to reach the supermajority required to pass it.

The US may impose new sanctions on Venezuelan government officials following the disputed re-election of President Maduro in July. Earlier in April, the Biden Administration had reinstated the sanctions on oil exports by Venezuela over the absence of a fair election.

The primary market was very active with numerous sovereign and corporates taking advantage of the demand for new paper. PIF (Saudi sovereign wealth fund) and Indonesia are the recurring issuers this year. In Latin America, the new issue pipeline was busy with Uruguay, Petrobras and Eletrobras in the market. Vedanta Resources PLC (low-B rated mining company) has launched a tender offer for its existing bonds (2027s and 2028s) in conjunction with a proposal to issue new bonds.

Fixed Income Asset Allocation Views

9th September 2024



Strategy and positioning (relative to risk free rate)	Views	Risks to our views
Overall Fixed Income Spread Risk 	<ul style="list-style-type: none"> Spreads have widened in recent macro volatility but remain on the tighter side of history. Credit fundamentals have remained stable despite rising volatility and early signs of slowing in macro data and issuer expectations. The group remains negative on credit risk overall, despite an upgrade to High Yield Credit to -1. The CTI Global Rates base case view is that the hiking cycle is over, and the start of the cutting cycle is expected to be the next Fed meeting. Uncertainty about the pace remains elevated due to sensitive monetary and fiscal policy schedules and US elections looming closer. 	<ul style="list-style-type: none"> 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) 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> 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) 	<ul style="list-style-type: none"> 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. 	<ul style="list-style-type: none"> 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)) 	<ul style="list-style-type: none"> Disinflation under threat but intact. EM central banks still in easing mode. Real yields remain high. Selected curves continue to hold attractive risk premium. 	<ul style="list-style-type: none"> Global carry trade unwinds intensify, hurting EMFX performance Stubborn services inflation aborts EM easing cycles Uptick in volatility Disorderly macro slowdown boosts USD on flight-to-safety fears
Emerging Markets Sovereign Credit (USD denominated) 	<ul style="list-style-type: none"> EMD spreads have also widened this month, following the escalation in potential risk. Especially given the ongoing geopolitical and economic uncertainties. Fundamentals have been downgraded after improvements in distressed areas. Investment Grade spreads are near historical tight while High Yield still offers idiosyncratic 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. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Spreads have widened, especially short and intermediate, but long IG spreads remain near record tight. 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 reval basis. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Spreads have widened but stabilised since last month. Spreads are still implying lower defaults than the Columbia Threadneedle research team. Anticipate credit selection will be the performance differentiator in 2024. Looking to avoid defaults/distress, focusing on credit recovery and deleveraging stories. 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. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Spreads are still 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. Fed's position on cuts, in relation to the recent CPI prints, is expected to be cautious. Constructive view on fundamentals over longer time horizon. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Neutral outlook because of decent fundamentals and reval in select high quality Non-Agency RMBS, and ABS. RMBS: Spreads remain tight. Delinquency, prepayment, and foreclosure performance remains. CMBS: There is ongoing pressure even on AAA securities. Outside of office and multifamily housing, however, performance has remained healthy. CLOs: Despite heavy 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 have deteriorated somewhat, while lower quality borrowers underperform. Federal student loan payments remain a key uncertainty with continued legal noise. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> o/w sugar o/w Zinc o/w Gasoline o/w Distillates o/w Cocoa o/w natural gas o/w corn o/w lead o/w silver o/w soybean meal 	<ul style="list-style-type: none"> Global Recession

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