

In Credit

11 November 2024



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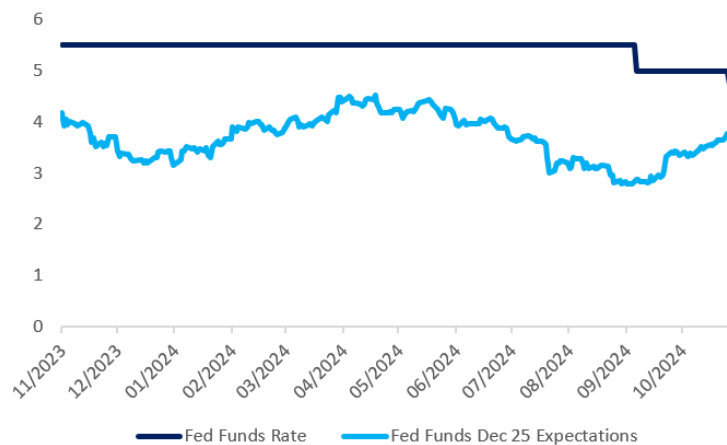
‘The winner takes it all’

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.30%	-8 bps	-2.5%	1.4%
German Bund 10 year	2.35%	-5 bps	-1.1%	0.0%
UK Gilt 10 year	4.45%	1 bps	-2.8%	-3.3%
Japan 10 year	1.00%	5 bps	-0.9%	-2.8%
Global Investment Grade	85 bps	-6 bps	-1.0%	4.0%
Euro Investment Grade	99 bps	-4 bps	0.2%	4.0%
US Investment Grade	77 bps	-9 bps	-1.6%	4.0%
UK Investment Grade	86 bps	-1 bps	-1.0%	1.2%
Asia Investment Grade	121 bps	-10 bps	-0.7%	5.8%
Euro High Yield	337 bps	3 bps	0.8%	7.7%
US High Yield	263 bps	-20 bps	0.2%	8.3%
Asia High Yield	496 bps	-3 bps	0.7%	15.2%
EM Sovereign	294 bps	-6 bps	-1.1%	6.8%
EM Local	6.3%	-9 bps	-4.3%	0.4%
EM Corporate	240 bps	0 bps	-0.6%	7.9%
Bloomberg Barclays US Munis	3.6%	-6 bps	-0.9%	1.3%
Taxable Munis	5.0%	-8 bps	-2.6%	2.0%
Bloomberg Barclays US MBS	40 bps	-7 bps	-2.3%	2.1%
Bloomberg Commodity Index	235.28	0.2%	-1.7%	4.0%
EUR	1.0659	-1.1%	-3.7%	-2.9%
JPY	153.79	0.2%	-5.9%	-7.6%
GBP	1.2886	0.0%	-3.4%	1.5%

Source: Bloomberg, ICE Indices, as of 8 November 2024. *QTD denotes returns from 30 September 2024

Chart of the week: Reality then expectations, Fed funds rates LTM



Source: Bloomberg, as of 11 November 2024

Macro/government bonds

A historic week! In a clear-cut result, Donald Trump was elected President of the United States and, at the time of writing, the Republicans look almost certain to achieve a clean sweep.

Most economists predicted that a Trump win would be positive for the dollar and negative for fiscal discipline in the future. Markets read the playbook and 10-year US Treasury yields jumped 12bps on the result, with the dollar rising by 1.2%.

Trump will be inaugurated as the 47th President on 20 January 2025. Between now and then, market speculation will focus on the precise form of his tariff policy, foreign policy initiatives in terms of Ukraine and Israel, and just how he will implement his immigrant deportation plans.

It is worth noting that, in contrast to 2016, the Trump team appears ready to proceed immediately upon inauguration. A Chief of Staff, Susie Wiles, has already been appointed.

In contrast to the new-found clarity in the US, the political situation in Germany has entered a crisis period. The coalition government, headed by SPD leader Olaf Scholz, collapsed last week, largely over government commitment to the legal “debt brake”. Early elections are almost certain. Estimates on timing range from January to March 2025. Current opinion polls put the CDU ahead, with the far-right AfD in second place. The next coalition will likely be some combination of CDU, SPD, and Greens – ie, not including the AfD. The law on the fiscal brake will probably be a key election issue. Reflecting the possibility of fiscal loosening in the future, the 10-year Bund yield moved above 10-year swaps.

Almost lost in the weeds was the news that the Federal Reserve cut rates by 25bps on Thursday, taking the target to 4.5%/4.75%. Unsurprisingly, Chair Jerome Powell argued that the Fed could not respond to possible Trump economic policy changes before they are implemented. However, the expected floor for US rates in 2025 has moved a little higher. Trump’s presidency brings with it a change in Fed rate cut expectations. As the **Chart of the week** shows – expectations for rate cuts at end-2025 have been revised. The expected floor has jumped 80bps in the past month.

The Bank of England (BoE) also cut rates by 25bps, taking the headline rate to 4.75%. This was expected, but as with the US expectations for the extent of cuts in 2025 has been revised to smaller numbers.

We should also note that the Standing Committee of the China’s National People’s Congress met. We await announcements but note that a reaction to Trump tariffs will not be likely until those tariffs are announced.

By the end of a roller coaster week for bonds, the 10-year US Treasury had clawed back the early week losses and ended at 4.3%.

Investment grade credit

Credit spreads, when measured as the difference between equivalent dated corporate and government bonds, are expensive – and as rich as has been the case since the global financial crisis (GFC), or before in the case of US dollar bonds. But are corporate bonds expensive or are government bonds cheap?

Another measure of spreads is a comparison between either government or corporate bond yields and similar maturity swap rates. The fear and reality of increased issuance of government debt appears to have made the spread between, for example, German government bonds and swap rates unusually tight – indeed inverted. So while the 10-year swap spread to Bunds was as wide as 100bps as recently as Q3 2022 it is now inverted, meaning the swap rate is richer than the government bond yield.

What does this all mean for credit markets? When measured against government bond yields they look rich but when compared to swap rates (so-called asset swap spreads) they look much more normal. The demand for income will continue and a catalyst for spread widening is anyone's guess!

High yield credit & leveraged loans

US high yield bond spreads continued to mark new post-GFC lows as the US election outcome resulted in a risk-on tone. The ICE BofA US HY CP Constrained Index returned 0.78%, while spreads were 20bps tighter ending at +288bps. The index yield-to-worst decreased 0.19% to 7.14%. According to Lipper, US high yield bond retail funds saw a \$455 million inflow for the week. The average price of the Credit Suisse Leveraged Loan Index increased slightly to \$96.3, a three-month high, as investors assessed a continued strong macro environment and expectations for less Fed easing. Retail loan funds saw \$488 million contributed, for a seventh consecutive weekly inflow.

European HY returned 0.17% last week, even as spreads widened 3 bps and yields remained basically unchanged at 6.33%. German government bond yields fell – 5 bps across the curve – unlike in the US, which finished with the Treasury yield curve flattening as yields of short maturities rose and long maturities fell.

It was a decompression week as BBs and Bs strongly outperformed CCCs, which was the only rating band to post a negative return. Net inflows were light, with only €24 million added to the asset class as ETFs experienced outflows, but were offset by inflows into managed accounts. The primary market was closed last week, unsurprisingly given the US presidential election and rate announcements from the Fed and BoE. With issuers waiting in the wings, the pause in the primary market will be short.

In credit rating news, cleaning and textile services company Elis became the latest rising star of 2024 as it was upgraded to BBB- by S&P. This will take out another €2.5 billion from the EHY universe. Within EHY there were a couple of downgrades: retailer Maxeda (MAXDIY), which was downgraded to Caa1 from B3, and Kongsberg Automotive (KOANO), which was cut to B2 by Moody's, as the issuer lowered guidance.

In sector news, chemicals remain weak. Kem One (KEMONE) reported a weak set of Q3 numbers, with sales down -12% on the back of a broad decline among all product lines (mostly price driven). Management, however, suggested the very weak results were due to supply/technical issues, which will likely continue into Q4. Reporting from the automotive sector, from Shaeffler, Goodyear and TI Automotive, showed a mixed set of numbers but overall largely weak, confirming a revised lower fiscal year guidance. The market will wait to see how potential Trump tariffs will affect this sector.

Structured credit

The US Agency MBS (mortgage-backed securities) sector rallied last week, up 96bps despite considerable volatility.

The re-election of Trump as president saw interest rates rise on Wednesday as the market digested potential implications of his proposed economic agenda. The following day, however, the Federal Open Market Committee stayed on track and unanimously decided to lower the Fed funds rate by 25bps, sending a clear message that policy remains restrictive and the easing cycle will continue. That message was welcome relief to the rates market and the 10-year Treasury rallied back to end the week closer to 4.3%. Most mortgage coupons performed well. The outlook for the sector is favourable as higher interest rates will curb prepayments and therefore supply, and the possibility for deregulation should improve bank appetite. Valuations have tightened but continue to represent good value.

Asian credit

The JACI index posted a positive week of returns, 30bps, with spread tightening (46bps) helping to compensate for the widening in core rates (-17bps).

In Thailand, both PTT Global Chemical (PTTGC) and Thai Oil reported weak Q3 results. For PTTGC, its refining business and performance chemicals businesses continued to face pressure in refining margins and the demand for specialty chemicals. Similarly, Thai Oil was impacted by a softer refining margin and reported stock losses (inventory) due to the decline in crude oil prices. Thai Oil will also provide further details on any potential impact to the timeline of commissioning its Clean Fuel Project later this week on the back of payment disputes between its main contractor consortium and subcontractors.

In Singapore, gaming business Genting was affected by lower VIP rolling volume and win rate. The VIP segment accounted for around a third of Genting Singapore's gross gaming revenue. There is currently a lack of near-term visibility on the recovery for the segment, which is highly dependent on the spending of Chinese tourists.

Emerging markets

Last week, emerging market bonds rallied after the US presidential election results. Despite concerns that Donald Trump's protectionist trade policies could hurt developing economies, emerging market bond spreads tightened by 6bps over the week, leaving spreads at the tight end of the five-year range. One of the top performers was Ukraine, as markets speculated that Trump could help accelerate the resolution of the war with Russia. However, China disappointed markets again by announcing economic measures that fell short of expectations, continuing a trend of modest policy changes.

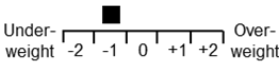
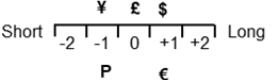
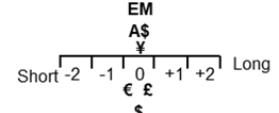
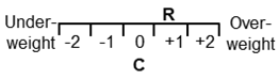
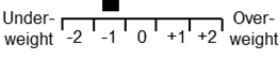
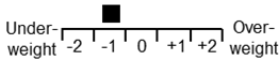
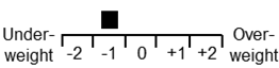
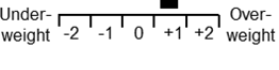
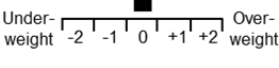
Overall, emerging markets proved resilient in the face of the election outcome and potential volatility. This resilience likely stems from the improving creditworthiness of many developing nations and their successful efforts to restructure defaulted debts in recent years. The rating upgrade trend continues, with Croatia the latest country to see an upgrade from BBB to A- by Moody's.

While the US election injects some uncertainty, and emerging market bonds remain expensive by historical standards, the asset class has demonstrated an ability to withstand shocks. However, a cautious stance is still warranted given tight valuations and the potential for trade disruptions under the new US administration.

Fixed Income Asset Allocation Views

11th November 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 are modestly tighter since last month and fundamentals remain stable, despite elevated volatility and slowing of macroeconomic data. The group remains negative on credit risk overall and downgraded Agency MBS to a modestly positive outlook. The Federal Reserve began the easing cycle in September with 50bp rate cut. The CTI Global Rates base case view is that the pace and magnitude of additional cuts is uncertain and dependant on inflation and labor market conditions. 	<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 depriving 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"> Index spreads are close to 5-year tightness while spread volatility remains elevated. The Group remains conservatively positioned and disciplined regarding valuations, reducing exposure where risk premium has compressed materially. Tailwinds: China stimulus, stronger growth, central bank easing, IMF programs. Headwinds: Escalating tensions in Middle East, higher debt to GDP ratios, wider fiscal deficits, US election, geopolitical uncertainty, slow restructurings. 	<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 tightened back near year-to-date tightness, are rich to long-run averages Results and commentary from issuers do not indicate fundamental deterioration. IG Analysts expect strong fundamentals and decade-low leverage for 2024/2025 Current valuations limit spread compression upside and provide little compensation for taking on additional risk. 	<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 continued tightening and are rich to long-term averages. Earnings season did not indicate broad deterioration; however, the group still has a cautious view of fundamentals given management guidance, CTI default forecasts and the increase in lender-on-lender violence and liability management exercises. Weaker outlook for cyclical industrial and consumer sectors The Group remains conservatively positioned given valuation backdrop but is open to attractive high quality revival opportunities. 	<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"> The Group downgraded Agency MBS because spreads are closer to fair value following the September FOMC and the housing market remains pressured. The Group remains positive on Agency MBS because the carry and convexity are still attractive, and prepayment risk is low because of elevated mortgage rates. Prefer call-protected Inverse IO CMOs, a large beneficiary of aggressive cutting cycle. Difficult to increase position sizing as few holders are willing to sell into the current rate environment. 	<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 revival in select high quality issues. RMBS: Spreads have continued to tighten. Fundamental metrics such as delinquencies, prepayments, and foreclosures, remain solid overall. CMBS: We are in the early stages of the office deterioration story. Outside of office and multifamily housing, however, performance has remained healthy. CLOs: Demand remains high given relative spread to other asset classes; active new issue market. Defaults remain low, but CCC buckets are rising with lower recoveries. ABS: 60+ Day delinquencies are rising. Spreads unchanged MoM, the group has been reducing positions in consumer and auto sectors. 	<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.

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