

In Credit

23 September 2024



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

Gary Smith
General Fixed Income

Sarah McDougall
General Fixed Income

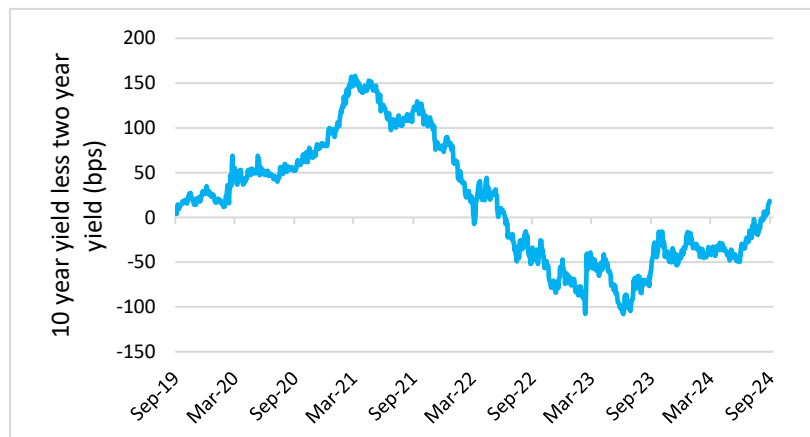
Deeper cut, steeper curve...

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	3.75%	10 bps	5.1%	4.3%
German Bund 10 year	2.17%	2 bps	2.5%	0.4%
UK Gilt 10 year	3.91%	15 bps	3.2%	0.2%
Japan 10 year	0.85%	0 bps	1.3%	-2.0%
Global Investment Grade	99 bps	-6 bps	4.8%	5.1%
Euro Investment Grade	112 bps	-6 bps	2.7%	3.3%
US Investment Grade	93 bps	-6 bps	5.9%	5.9%
UK Investment Grade	98 bps	-3 bps	2.6%	2.5%
Asia Investment Grade	153 bps	-7 bps	3.9%	6.5%
Euro High Yield	358 bps	-18 bps	3.2%	6.5%
US High Yield	315 bps	-22 bps	5.1%	7.9%
Asia High Yield	555 bps	-18 bps	2.8%	12.8%
EM Sovereign	330 bps	-14 bps	6.0%	7.9%
EM Local	6.1%	-3 bps	8.3%	4.3%
EM Corporate	273 bps	-11 bps	4.2%	8.2%
Bloomberg Barclays US Munis	3.3%	-2 bps	2.6%	2.2%
Taxable Munis	4.6%	4 bps	6.4%	5.2%
Bloomberg Barclays US MBS	41 bps	3 bps	5.9%	4.8%
Bloomberg Commodity Index	235.34	2.1%	-1.6%	3.4%
EUR	1.1123	0.8%	4.2%	1.1%
JPY	143.57	-2.1%	11.8%	-1.9%
GBP	1.3314	1.5%	5.3%	4.6%

Source: Bloomberg, ICE Indices, as of 20 September 2024. *QTD denotes returns from 30 June 2024.

Chart of the week – US yield curve, 2019-2024



Source: Bloomberg & Columbia Threadneedle Investments, as of 23 September 2024.

Macro / government bonds

It was US interest rate week, and the US Federal Reserve did not disappoint. As was widely expected, the Fed reduced rates by 50bps to 4.75-5% in the first move since Q3,2023 when it last tightened policy conditions. The FOMC voted 11:1 for the cut but stressed that the size of the move should not be seen as a new norm. One can presume a return to 25bps cuts in future and the Fed indicated its forecast for a further 0.5% loosening in monetary conditions through the rest of this year.

The Fed 'tweaked' its economic forecasts – reducing inflation next year by two tenths but increasing its expectations for unemployment by a similar amount.

In the UK there was less to celebrate as the Bank of England left rates unchanged – as expected. Meanwhile, Government borrowing figures were pretty terrible ahead of the new Labour Government's first budget in October.

This week began with disappointing composite PMI data from Europe, which indicated the eurozone economy is contracting. Similar data from the UK was less weak but lower than market expectations denting some of the recent strength in sterling.

Longer-dated bonds ended the week with higher yields though shorter-dated notes were better supported. The US yield curve between the two- and 10-year points is the steepest since 2022. The curve had been inverted from June 2022 to early this month, reaching a peak inversion of -108bps. It ended the week around +17bps ([see chart of the week](#)).

Investment grade credit

After that much anticipated but meaningful rate cut in the US (and in Europe the prior week), investment grade credit markets enjoyed a period of strength last week. Global spreads tightened around 6bps in the last five days of trading, ending the week at a spread of 99bps over government bonds. Year-to-date, spreads are some 16bps or 14% tighter. Euro spreads have been the best performer and are around 18% narrower, while the US dollar market is 'only' 11% inside the level at the end of last year.

The market remains attractive to investors seeking income with some degree of safety as it still offers a yield in excess of the historical average – though it is worth noting that the yield has declined from around 5.9% in October of last year to close to 4.3% today. The long run average is around 4% according to data from ICE indices.

There remains, however, some degree of dispersion of returns. The much unloved (last year) real estate sector along with banks in the financials sector have outperformed this year. Meanwhile media, healthcare and more recently autos have underperformed. Indeed, in company specific news, Mercedes followed rival BMW with a profit warning towards the end of the week citing competition and slower demand in a reduction of margin expectations.

High yield credit & leveraged loans

US high yield bonds also continued to rally as the Fed delivered its 50bps cut, a strong risk-on tone remained, and retail funds saw strong inflows. The ICE BofA US HY CP Constrained Index returned 0.79% and spreads were 21bps tighter. The index yield-to-worst declined to 6.99%, dropping below 7% for the first time since May 2022. According to Lipper, US high yield bond retail funds saw a \$1.8bn inflow for the week, primarily ETF driven. Despite the 50bps US Fed Funds cut, the average price of the Credit Suisse Leveraged Loan Index rose \$0.1 over the week to \$95.7 amidst receding growth concerns, manageable fund outflows, and still-elevated coupons. Retail loan funds saw an eighth consecutive, albeit small, weekly outflow with a \$116m withdrawal over the week.

European high yield had a strong week as spread contraction resumed with spreads narrowing 18bps to 358bps as yields fell 11bps to 6.45%. This resulted in a solid 0.54% return for the week with CCCs once again outperforming higher-rated credits. Technicals were strong as inflows (€258m) picked up from the previous week, via both ETFs and managed accounts. The corporate primary market was robust with €2.65bn issuance from four issuers (one a newcomer to the market) with a good mix of BB and single B rated names. There was strong demand from the market especially for CPI Property Group, which was more than 6x oversubscribed. This comes as the outlook for the real estate sector improves with the fall in interest rates.

In credit rating news, Fitch upgraded Teva from BB- to BB flat, outlook positive. Most of Teva's ratings predate opioid settlement so this is definitely part of the rationale, alongside debt reduction, shift towards innovation and the sale of the API business to be concluded in H1,25. There was good news in the consumer sector as Coty was upgraded to BB+ by S&P. The rating agency said that this reflected "its overall scale, diversity of brands, and products in both prestige and mass beauty and improved operating efficiency." Emeria, a real estate services company, was downgraded by Moodys & Fitch to B3 and B-, respectively. The ratings downgrade does not come as a surprise considering the elevated leverage, which has been ramped up for a few quarters now.

Recent announcements show that M&A business is finally on an upward swing. In the healthcare sector, Organon announced an acquisition of Dermavant (immuno-derma product only approved in '22), paying \$1.2bn. S&P put Organon's rating on negative as this move will delay deleveraging. In gaming, Flutter (FLTR) announced the acquisition of Playtech's (PLTC) Snaitech for an €2.3bn. This comes post last week's announcement last week that Flutter is buying 56% of NSX Group (a Brazilian business).

Asian credit

In China, the PBOC conducted two open market operations (OMO) to ensure sufficient liquidity in the banking system. The PBOC lowered the 14-day reverse repo rate by 10bps to 1.85%, and it also used the operations to inject CNY74.5bn (c.\$10.6bn) of liquidity. It conducted the 7-day reverse repurchase operations in the amount of CNY160.1bn while keeping the 7-day rate unchanged at 1.7%. Such liquidity injections via OMO have previously taken place ahead of extended holidays. This round of liquidity management comes ahead of the upcoming week-long Golden Week holidays (1 – 7 October 2024). Interestingly too, the PBOC governor (Pan

Gongsheng) will be holding a press conference on 24 September 2024 with the heads of National Financial Regulatory Administration and China Securities Regulatory Commission. The focus will likely be on any further financial support for the economy.

In India, the long-running plea by the telecom mobile operators to Supreme Court to review the calculation of the AGR (Adjusted Gross Revenue) dues has been dismissed. As background, the operators had been ordered to pay the AGR dues in October 2019. The operators were subsequently given a 10-year payment period, effective from March 2021 albeit with a 4-year moratorium. Given that the Supreme Court has dismissed the plea for recalculation, the operators must start paying the AGR dues from 2025 (after the 4-year moratorium) and complete the payment by March 2031.

With regards to ratings updates, Fitch has revised the outlook on PTT Global Chemical PCL (PTTGC) from negative to stable to reflect PTTGC's position as a leading petrochemical company in Thailand, its cost-competitive feedstock supply and product offtake agreements with the parent company, PTT PCL. S&P has lowered the ratings outlook of PT Krakatau Posco's BBB- to negative (previous: stable) due to its weak operating performance through 2024 amid sales volume decline and price pressure from steel imports in Indonesia.

Emerging markets

EM debt enjoyed the broader Fed-induced rally in risk assets last week, tightening by 14bps led by high yield which ended 29bps tighter. The EMBIG posted a 0.56% total return, which was bested by the EM Local index returning over 1.1% as EM fx was a clear beneficiary of the 50bps rate cut from the Fed.

The biggest outperformer on the week was El Salvador, where President Bukele's promise of a zero deficit budget saw index-level total returns over 6% as markets reprice higher odds of the country agreeing to terms with the IMF for a financing programme.

Most newsworthy was an agreement in principle between Sri Lanka and bondholders on the terms of its eurobond restructuring, which was announced just days before the weekend's Presidential elections. In the event, the leftist and anti-establishment party won in the second round. With campaign promises to renegotiate the IMF programme and extract greater debt relief from creditors, last week's agreement is very much in doubt with bonds trading 5-6% weaker on Monday morning.

The Fed's 50bps rate cut opens space for many EM central banks to begin or continue cutting rates, as we saw with both Indonesia and South Africa kicking off their easing cycles with 25bps cuts last week. Counter to the global easing narrative was Brazil, which hiked rates 25bps a few hours after the FOMC on the back of overheating domestic demand, tight labour markets, rising inflation expectations, and elevated fiscal risks. It is noteworthy that Brazilian monetary policy settings have been about one year ahead of the Fed throughout the global cycle post-Covid, so will be an interesting watchpoint for global macro investors.

Fixed Income Asset Allocation Views

23rd 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 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, with no changes to underlying sector views. The CTI Global Rates base case view is that cutting cycle will start at the September FOMC. 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"> Spreads are within 10bps of historical average; spread volatility has increased. Investment Grade credit demand remains strong from crossover investors, which absorbed the post-summer issuance. Waiting for High Yield issuance to see how market digests lower quality credit. Tailwinds: Stronger growth forecasts, Central bank easing, IMF program boost for distressed names. Headwinds: higher debt to GDP ratios, wider fiscal deficits, US election, geopolitical and domestic political uncertainty (especially Venezuela & Mexico), 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"> Earnings season saw solid results from IG issuers, no fundamental deterioration. Spreads have tightened back near year-to-date tight, are rich to long-run averages. Issuance has been strong (80 deals in first two week of September totalling ~\$100b) and is expected to be a tailwind for the market until the November election. 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 widened so far in September but are still rich in 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 	<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 at the year-to-date tight but still wide of historical long-term averages. Prefer call-protected Inverse IO CMOs, large beneficiary of aggressive cutting cycle. 30-year MBS outperforming the shorter (15 year and below) MBS The decline in interest rate volatility since the Fed signalled a definite end to the hiking cycle has been a tailwind for MBS. 	<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 RMBS. RMBS: Spreads have continued to tighten. Fundamental metrics such as delinquencies, prepayments, and foreclosures, remain solid. 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 wider 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.
Commodities 	<ul style="list-style-type: none"> o/w sugar o/w Zinc o/w Gasoline o/w Distillates o/w Cocoa u/w natural gas u/w corn o/w lead o/w silver o/w soybean meal 	<ul style="list-style-type: none"> 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 23.09.2024, 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