In Credit

28 October 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

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

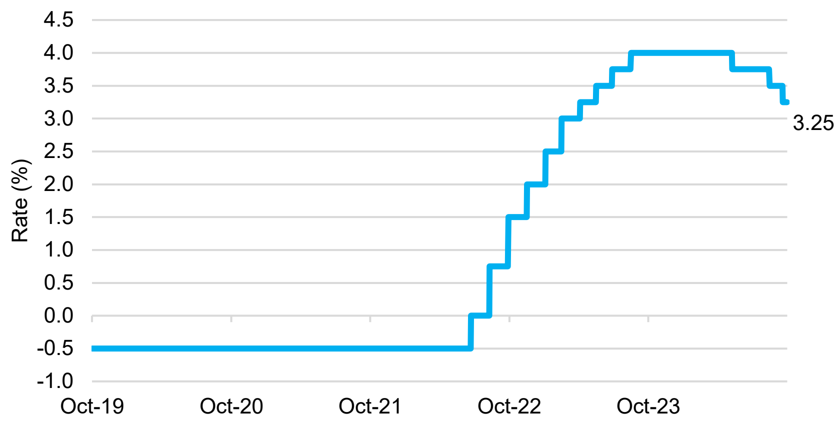
What goes up, must come down

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.25%	17 bps	-2.4%	1.5%
German Bund 10 year	2.27%	9 bps	-0.8%	0.3%
UK Gilt 10 year	4.22%	16 bps	-1.1%	-1.7%
Japan 10 year	0.98%	0 bps	-0.5%	-2.4%
Global Investment Grade	91 bps	1 bps	-1.3%	3.7%
Euro Investment Grade	102 bps	-3 bps	0.2%	4.1%
US Investment Grade	85 bps	2 bps	-2.1%	3.5%
UK Investment Grade	87 bps	-1 bps	-0.1%	2.1%
Asia Investment Grade	132 bps	-4 bps	-0.8%	5.7%
Euro High Yield	339 bps	-4 bps	0.6%	7.5%
US High Yield	289 bps	1 bps	-0.5%	7.5%
Asia High Yield	501 bps	-2 bps	0.7%	15.3%
EM Sovereign	304 bps	-1 bps	-1.6%	6.3%
EM Local	6.4%	7 bps	-4.0%	0.7%
EM Corporate	246 bps	-4 bps	-0.7%	7.7%
Bloomberg Barclays US Munis	3.6%	21 bps	-1.4%	0.8%
Taxable Munis	5.0%	14 bps	-2.9%	1.6%
Bloomberg Barclays US MBS	48 bps	5 bps	-2.6%	1.8%
Bloomberg Commodity Index	235.70	2.1%	0.2%	6.1%
EUR	1.0825	-0.7%	-3.0%	-2.2%
JPY	152.52	-1.8%	-5.7%	-7.4%
GBP	1.2995	-0.7%	-3.1%	1.8%

Source: Bloomberg, ICE Indices, as of 25 October 2024. *QTD denotes returns from 30 September 2024.

Chart of the week – European Central Bank Rate



Source: Bloomberg, as of 28 October 2024

Macro/government bonds

Last week was negative for core fixed income markets, which all generated negative returns as interest rates rose.

The worst performing market was the UK, followed by the US. The common thread linking these markets is political uncertainty. In the US a presidential election is about to take place, which is statistically too close to call. However, there is broad agreement in the market that regardless of whether a Democrat or Republican occupies the White House, it is likely to prove fiscally expansionary.

The state of the US economy was another factor putting upward pressure on bond yields. PMIs – survey-based indicators of business activity – indicated solid growth in the US. The political and economic backdrop has created a quandry for the market: could the Federal Reserve justify much in the way of future interest rate cuts if economic strength were to endure and fiscal spending to rise? If the disinflationary process were to reverse, the Fed could even find itself in the position of having to tighten fiscal policy. Reflecting the repricing of interest rate expectations, the yield on the two-year US Treasury rose 16bps over the course of last week to 4.1%.

Across the border, the Bank of Canada (BoC) cut interest rates by a jumbo 50bps from 4.25% to 3.75%. BoC policymakers justified their decision on a fall in inflation (CPI) from 2.7% in June to 1.6% in September, while viewing the rate cut as an insurance policy against any weakening in the labour market.

In the UK, political uncertainty was at its height as the country neared the publication of an era-defining budget for the new Labour government. Labour has promised a painful budget as it seeks to increase day-to-day spending and investment on public services. Part of Chancellor Rachel Reeve's proposal is to amend the fiscal rules, by replacing the current measure of debt with a broader measure, Public Sector Net Financial Liabilities, which takes into account all assets and liabilities. This redefinition of debt stands to open fiscal headroom for another £50 billion-£70 billion. In such an uncertain environment for gilt issuance, investors in the UK market preferred to take risk off the table. The yield on the two-year gilt rose by 17bps to 4.2%.

In continental Europe, PMIs reported a picture of a deteriorating eurozone economy. Manufacturing remained below 50, the point which indicates recession, while services hovered just above 50. In addition, input costs increased at their slowest pace since November 2020. President of the European Central Bank (ECB), Christine Lagarde, addressed these factors at the IMF conference last week in Washington, pointing to downside surprises in economic activity and a disinflationary process that remains on track. The debate in the market has been to ask the question as to whether the ECB should opt for a 50bps move just as the Fed and the BoC have done. There was no hint from Lagarde as to the pace of rate cuts and the market remains split. Pricing in the swaps market currently points to another quarter point rate cut in December, with a 40% probability of an additional quarter point rate cut by year end.

Investment grade credit

Unlike in government bonds, there was little move in credit spreads last week, which remain at tight levels. For context, when compared to government bond yields, US dollar spreads are at the tightest level since the global financial crisis. However, when one adjusts for changing credit quality and index duration, global IG spreads are "only" around 0.5 standard deviations rich. Indeed, over the past couple of decades spreads have traded tighter than this level in one out of three occurences. Recently, euro spreads have outperformed as swap spreads have narrowed more acutely than elsewhere.

In issuer-specific news, reports suggest that Boeing is likely to announce a $15 billion capital raise this week. This is designed to shore up its IG rating while the company deals with a crippling strike and its effect on cashflow.

High yield credit & leveraged loans

US high yield bond spreads were unchanged with initial second quarter earnings reports generally in-line with expectations and macroeconomic data reports resilient. The ICE BofA US HY CP Constrained Index returned -0.40% while spreads were unchanged at +312bps. The index yield to worst increased 0.15% to 7.21%. According to Lipper, US high yield bond retail funds saw a negligible $34 million inflow for the week. The average price of the Credit Suisse Leveraged Loan Index declined $0.1 to $96.2 amid an active primary market. Retail loan funds saw $528 million contributed, primarily to ETFs, for a fifth consecutive weekly inflow.

It was a sideways week for European HY even as it outperformed the US. The asset class returned 0.02% as spreads tightened 4bps to 339, but yields rose 2bps to 6.25%. In this environment, higher rated credit outperformed CCCs, which saw spreads widening over the period. After the bumper €1.5 billion inflow the previous week, inflows returned to more typical levels at €240 million with ETFs still dominating. New issuance was the highlight of last week with €6 billion issued via six new offerings, not all of which were refinancings. There were two M&A/LBO-related deals as well as a number of green bonds within the six new issues. This takes the amount of GSS (green, social and sustainability) issuance year-to-date to €21 billion, twice the amount seen in 2023. While gross year-to-date issuance has reached reached €106 billion, net issuance year-to-date is now at €20 billion, exceeding the total net issuance of 2019.

In credit rating news, Victoria, the flooring company, was downgraded a notch to B3 on weak operating performance and expectations of further re-leveraging and weak free cash flow. Intrum, the debt collector firm, was downgraded to Ca by Moody's and C by Fitch on announcement of Chapter 11 as the company launches the solicitation process for debt restructuring, which was initially announced in July.

In M&A news, Auchan announced that they are looking to sell their Russian assets. This is long overdue but it will be interesting to see how they get the cash out of the market.

In stock-specific news, Constellium, the manufacturer of aluminum products, issued a profit warning and restated their guidance for 2024. This is due to their exposure to cyclical sectors which are showing weakness, specifically in autos and aerospace.

Last week, Italian police also raided the office of a Telecom Italia executive on an alleged procurement bribery.

Asian credit

The JACI index posted negative returns of 29bps over the week, weighed down by unfavourable Treasuries returns (-0.42%).

Adani Green Energy may consider the private placement route in its long-term debt financing option. While the company withdrew its recent 20-year bond issuance due to tepid demand, it remains open to accessing the bond market over the near term. For JSW Steel, its second quarter results were affected by soft price realisation due to the pressure of China steel exports. During 9M CY24, China steel exports rose 21% year-on-year to 84mt. In JSW Steel's view, India steel pries bottomed out in September and the company has seen an uptick in global steel prices following the announcement of China's stimulus.

PT Freeport Indonesia (PTFI) provided an update about its new smelter which was damaged by fire. The original plan was to ramp up the operations of the new smelter by the end of 2024. However, the timing will be pushed back to the second quarter of 2025 due to the fire damage and PTFI will seek government approval to export copper concentrates.

Moody's upgraded Vedanta Resources Limited to B3 from Caa1, and lifted the senior unsecured bonds to Caa1 from Caa2, following Vedanta's successful tap of $300 million.

Vedanta has demonstrated that it continues to retain access to funding and its liability management exercises have eased its liquidity constraints.

Fitch downgraded Longfor Group Holdings from BB+ to BB- with a negative outlook. It said Longfor's liquidity buffer has weakened given the drop in sales and cash flow generation.

Emerging markets

Emerging market hard currency sovereign bonds delivered negative returns (-0.77%), largely due to the drag in US Treasuries (-0.97%), which offset the positive spread returns.

EM flow dynamics were negative with an outflow of $642 million – higher than the prior week of $147 million. The hard currency bond outflow eased to $374 million, down from $397 million, but local currency outflow rose to $268 million from $250 million.

The National People's Congress (NPC) and its Standing Committee (NPCSC) sessions will be held from 4-8 November. The NPCSC has the legislative authority to approve additional fiscal budget and the expansion of the government bond issuance quota. The timing of the sessions, originally expected to be held in October, has now been pushed to the same week as the US presidential election (5 November). This implies that the outcome of the election could be an important factor in China's calculus for the scale of its fiscal policies and stimulus framework. The key specifics to monitor from the upcoming session would be: the issuance of the special government bonds; potentially raising the fiscal deficit ratio above 3% GDP; swapping out the local government bonds and hidden debt; and recapitalisation of the quasi banks.

With regards to sovereign ratings action, S&P has revised Costa Rica's outlook to Positive and affirms the BB- ratings. This reflects stronger external buffers, lower current account deficits and stronger foreign direct investments.

Responsible investments

The water mark keeps rising for labelled bonds as green bond sales so far this year reached $500 billion last week. This is the fastest that amount has ever been raised in a calendar year.

Back in the first quarter of 2024 it was expected we would see labelled bond issuers front load their annual capital raising before the majority of elections were underway. But as the months have passed and numerous elections have happened, the pace of new issuance hasn't slowed as much as expected. Refinancing could be the driver to the continued level of new issuance, as the market's age reaches late teenage years certain projects are still ongoing and require more funding, however the market is far more aware of how ringfencing use of proceeds can attract investors from across the investing spectrum.

Fixed Income Asset Allocation Views

28th October 2024

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	▪ 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.	▪ 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)	¥ £ $ Short -2 -1 0 +1 +2 Long P €	▪ 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$ ¥ Short -2 -1 0 +1 +2 Long € £ $	▪ 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.	▪ 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	▪ Disinflation under threat but intact; EM central banks still in easing mode. ▪ Real yields remain high. ▪ Selected curves continue to hold attractive risk premium.	▪ 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)	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ Index spreads are close to 5-year tights 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.	▪ 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	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads have tightened back near year-to-date tights, 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.	▪ 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	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ 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 relval opportunities.	▪ 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	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ 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.	▪ 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	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ Neutral outlook because of decent fundamentals and relval 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.	▪ 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	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ 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	▪ 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 21.10.2024, 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. **In Japan:** Issued by Columbia Threadneedle Investments Japan Co., Ltd. Financial Instruments Business Operator, The Director-General of Kanto Local Finance Bureau (FIBO) No.3281, and a member of Japan Investment Advisers Association and Type II Financial Instruments Firms Association. **Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies**. columbiathreadneedle.com