COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

5 June 2023

David Oliphant
Executive Director,
Fixed Income

Contributors

David Oliphant

Macro / Government bonds, Investment Grade Credit

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

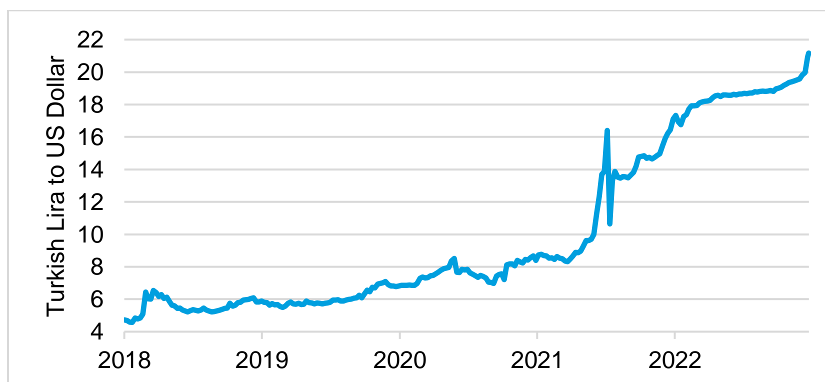
Turkish delight or disaster?

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	3.74%	-6 bps	-1.0%	2.0%
German Bund 10 year	2.36%	-18 bps	0.1%	1.6%
UK Gilt 10 year	4.22%	-12 bps	-5.2%	-3.1%
Japan 10 year	0.43%	1 bps	0.2%	2.5%
Global Investment Grade	147 bps	-1 bps	-0.3%	2.6%
Euro Investment Grade	167 bps	2 bps	0.7%	2.3%
US Investment Grade	139 bps	-2 bps	-0.6%	2.8%
UK Investment Grade	144 bps	2 bps	-2.0%	0.4%
Asia Investment Grade	209 bps	-6 bps	1.2%	3.5%
Euro High Yield	487 bps	15 bps	1.2%	4.2%
US High Yield	437 bps	-16 bps	0.8%	4.6%
Asia High Yield	821 bps	-57 bps	-3.9%	-1.1%
EM Sovereign	388 bps	-13 bps	0.1%	2.3%
EM Local	6.4%	-11 bps	0.4%	5.6%
EM Corporate	368 bps	-7 bps	0.5%	2.8%
Bloomberg Barclays US Munis	3.6%	-13 bps	-0.7%	2.0%
Taxable Munis	5.0%	-13 bps	-0.8%	4.6%
Bloomberg Barclays US MBS	57 bps	-7 bps	-0.6%	1.9%
Bloomberg Commodity Index	223.13	-0.2%	-4.5%	-9.7%
EUR	1.0688	-0.1%	-1.2%	0.0%
JPY	140.29	0.5%	-5.0%	-6.3%
GBP	1.2402	0.9%	0.9%	3.1%

Source: Bloomberg, Merrill Lynch, as of 2 June 2023.

Chart of the week: Turkish lira to US dollar – last five years.



Source: Bloomberg, Columbia Threadneedle Investments, as of 5 June 2023.

Macro / government bonds

It was a better week for government bond markets with yields lower in most areas but led by the German market where yields were nearly 20bps lower at the 10-year part of the yield curve.

At the weekend, the US debt ceiling crisis was finally resolved and put into law – albeit at the last minute as is usually the case. Meanwhile, there was encouraging inflation data out of Europe. The week also saw more evidence of strength in labour markets, with a rise in the four-week average for jobless claims in the US and the lowest unemployment rate (6.5%) since the inception of the single currency in Europe. The week ended with a very robust non-Farm payroll report in the US wherein there were 339k jobs created last month, plus a revision higher to previous month's data of nearly 100k. Delving deeper, however, and there is some confusion. Hours worked fell, wages dipped to a rate of 4.3% y/y (from 4.4%) and the unemployment rate jumped three tenths to 3.7%. This leaves us with a market implied one in three chance of a rate hike next week in the US and no rate cuts discounted for the year as a whole. Central banks in Australia and Canada also meet this week.

Investment grade credit

Global credit spreads were little changed last week with spreads ending the period at around 147bps. The US dollar market outperformed and tightened by two basis points.

May was another month of modest change in the credit market. The amplitude of spreads was meagre and around 10bps in the month and the same as in April for the global investment grade market. This contrasts to the wilder market conditions seen in March during the mini banking crisis. Coincident with these calmer times, and after a fairly benign earnings season, primary activity skyrocketed with the largest month of new issuance for May in years. That said, fund flows are positive with higher yields seemingly attracting buyers to the market.

The outlook for spreads is supported by positive credit fundamentals (eg, low leverage and high interest cover) in the US and in Europe coupled to reasonable / attractive valuations or spreads in the euro and sterling markets especially. Economic expectations have also climbed modestly higher from an expectation of recession in late 2022 to low but positive growth today. Present and expected monetary policy conditions remain the most obvious hurdle to spread tightening. With inflation still too high for central bank comfort and employment markets tight, the possibility of easier monetary conditions this year appears to be an ever-increasing pipe dream.

High yield credit & leveraged loans

US high yield bond valuations tightened over the week amidst fading US debt ceiling risks and strong labour market data. The ICE BofA US HY CP Constrained Index returned 1.19% and spreads were 15bps tighter. According to Lipper, the asset class experienced a $2.2bn outflow, the fourth outflow in five weeks, leaving YTD outflows at $13.3bn. Meanwhile, the average price

of the J.P. Morgan Leveraged Loan Index declined $0.06 alongside the forward curve. Retail loan funds experienced their 40th outflow in 41 weeks with $926m withdrawn, leaving YTD outflows at $17.7bn.

Structured credit

Agency MBS had a strong week, up 1.29%, outperforming other high quality fixed income assets. The rate rally supported longer maturity and lower coupon bonds given more duration and overall spreads tightened about 20bps. Home prices were reported as broadly 'flat to rising' with FHFA signalling higher prices in eight out of nine regions last week. In non-agency, trading was light given the shortened week and spreads were mostly flat on light volumes. In CMBS, we had three new private label deals last week and most tranches priced wider than guidance. There was only one new ABS deal, while secondary spreads were mostly unchanged. The end of the federal student loan payment pause is nearing, which is a marker we are closely watching.

Asian credit

The Chinese government is reportedly considering the launch of a comprehensive support package for the property sector, according to Bloomberg. Measures may include the reduction of down payments in non-core neighbourhoods of major cities, easing restrictions for residential purchases and lower agent commissions on transactions. Additionally, there could be a refinement and extension of some policies in the 16-point rescue package from late 2022.

For the Macau gaming sector, gross gaming revenue (GGR) rose 366% y/y to MOP15.6bn, helped by the Labour Day holidays. The GGR for the five first months of 2023 (5M 2023) increased 173% y/y to MOP64.9bn, equivalent to 51.7% of the 5M 2019 level.

Adani Ports reported a set of operationally solid performance for FYE March 2023. FY revenue rose 26% y/y to INR208.5bn, with an EBITDA of INR128bn (+25.5% y/y). The main drawback continues to be the governance issues with its auditor (Deloitte Haskins & Sells LLP) issuing a qualified opinion. According to the auditor, there are concerns about certain transactions with three unrelated entities. Given that the Adani Group has declined to obtain an independent external assessment, the auditor was unable to certify that the parties were unrelated in the following transactions: (1) Myanmar divestment; (2) financing deals that include equity; and (3) an Engineering, Procurement and Construction [EPC] contract.

Emerging markets

Emerging market hard currency sovereign spreads tightened 13bps to 388bps over the week leading to a positive return of +1.29% for the asset class. The high yield sub-component outperformed investment grade with notably strong performance coming from Africa, in particular Angola, following the government's announcement that fuel subsidies would be cut: a policy which Nigeria's new President also recently implemented.

A faster than expected reduction in inflation led to the central bank of Sri Lanka reducing the standing lending facility rate from 16.5% to 14%, the first cut in almost three years. In Thailand, policy makers hiked rates 25bps.

In EM FX news, the Turkish lira declined 4.6% against the US dollar to all-time lows (**see chart of the week**). This follows a lack of FX support by state banks and the news of the appointment of Mehmet Simsek as finance minister. Simsek is seen as market friendly and an advocate of conventional economics. While news of the appointment has been interpreted as positive overall, as indicated by sharply tightening US dollar bond spreads, the market expects some FX pain. Simsek's vow of ensuring "consistency and comparability to international norms" could signal the loosening of FX controls that have propped up the Turkish lira despite deteriorating fundamentals. Example of such controls include, forcing exporters to convert their income into lira, and providing financial incentives to encourage holding the Turkish currency.

Commodities

Commodity markets fell modestly with a 0.2% decline on aggregate.

Energy markets declined by 3.1% on aggregate led by US natural gas, with the other major sub-sectors delivering slim positive returns.

In base metals, copper rallied by 1.2% (-2.9% YTD) with zinc prices declining by 1.6% (-22.2%). In further disappointing news for the sector, China's manufacturing PMI printed below expectations at 48.8, and weaker than April's print of 49.2.

Crude prices were flat on the week but rallied by around a $1 to $77 on Monday morning. Prices were supported by the news of Saudi Arabia announcing a 1m barrels per day production cut from July. Furthermore, OPEC+ as a whole agreed to extend previously announced cuts of 3.66m barrels per day for an additional year to the end of 2024.

5719339 Issued June 2023 | Valid to end August 2023

Fixed Income Asset Allocation Views

5th June 2023

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	▪ Valuations have widened since the last meeting: still cheap relative to Feb but tighter than March's highs. Technicals and fundamentals are still worse than Feb. The group remained negative on credit risk but upgraded investment grade credit to neutral. ▪ The Fed Funds market is pricing in a peak of 5.1% and rates being cut to 4.4% in 2023. This market has been volatile, with the first full cut now priced for Sep. ▪ The CTI Global Rates base case view is no cuts in 2023, with a best case of potentially one cut. Expect rates to peak between 5-5.25% in first half, with Fed holding steady in 2H 2023. Focus remains on wages, financial conditions, and inflation expectations. ▪ Uncertainty remains elevated due to fears surrounding banking crisis spill over, monetary policy schedules, recession probabilities, persisting inflation, weakening consumer profile and ongoing geopolitical tension.	▪ Upside risks: the Fed achieves a soft landing with no labour softening, banking crisis eases with no lasting changes to fundamentals, strong China reopening, Europe sees commodity pressure easing, consumer retains strength, end of Russian Invasion of Ukraine ▪ Downside risks: simultaneous low unemployment, high inflation, hiking, and slowing growth cause a recession. Russian invasion spills into broader global/China turmoil. New Covid variant. Supply chain disruptions, inflation, volatility, commodity shocks persist re-emerge.
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 ▪ Hiking cycles to be curtailed by the impact of tighter credit conditions post SVB	▪ 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 $ €£	▪ 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 ▪ EM real rates relatively attractive, curves still steep in places	▪ 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	▪ EM central banks slowing or terminating hike cycles ▪ Sharply reduced Fed expectations may permit EMFX strength ▪ EM real interest rates relatively attractive, curves steep in places	▪ Severe US recession and/or financial crisis drives stronger US dollar and portfolio outflows from EMD ▪ Sticky global inflation or wage/ price spiral keeps EM interest rates higher for longer ▪ Structurally higher global real rate environment subdues risk assets
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ EMD spreads unch since mid-March. Technicals weaker ▪ Moving into select relval opportunities while maintaining conservative positioning ▪ Tailwinds: China reopening optimism , central bank easing in countries with receding inflation. ▪ Headwinds: higher debt to GDP ratios, wider fiscal deficits, increasing use of IMF programs, geopolitical risks	▪ China/US relations deteriorate ▪ Issuance slows ▪ Chinese reopening paused ▪ Continued spill over from Russian invasion: local inflation (esp. food & commodity), slowing growth in trade partners, supply chains ▪ Persisting COVID growth scars hurt economies & fiscal deficits
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ US & EMEA spreads have widened in the past month; fundamentals and technicals still weak to pre-covid. EUR valuations are cheap, GBP vals fair to USD. ▪ Earnings season confirmed the theme of resilient corporate balance sheets, with low leverage and stable margins. The fundamental concerns remain focused on elevated macro risks from the US banking crisis, commercial real estate, tight labor supply, weaker consumer, and elevated recession concerns	▪ Additional bank failures with too little governmental intervention ▪ Volatility remains high and 2023 suppluis below expectations. ▪ Market indigestion as central banks sell EMEA corporates ▪ Rate environment remains volatile ▪ Geopolitical conflicts worsen operating environment globally
High Yield Bonds and Bank Loans	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads have widened since mid-April, fundamentals and technicals remain unchanged. Prefer conservative position while open to attractive buying opportunities, especially in short HY.US HY default forecast increased, driven by global banking stress, recession fears, margin pressure, demand deterioration and idiosyncratic sector risk ▪ Bank loan market has widened along with other credit sectors. Themes: retail fund outflows, rising defaults, limited issuance, credit concern in lower quality loans	▪ Additional bank failures with too little governmental intervention. ▪ Default concerns are revised higher on greater demand destruction, margin pressure and macro risks ▪ Rally in distressed credits, leads to relative underperformance
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Mortgage index has continued to widen. Since Feb, the group has reduced exposure due to outperformance. Mortgage index has continued to widen. Since Feb, the group has reduced exposure due to outperformance. ▪ Supply picking up due to seasonals, still below expectations. FDIC liquidations from SVB/Signature beginning with lists trading better than expectations ▪ Place to add, prefer high quality and higher coupon assets; constructive view over longer time horizon	▪ Additional bank failures ▪ Housing activity slows and rising rates move prepays to normal levels without hurting mortgage servicing rates ▪ Fed continues to shrink position even as hiking is paused
Structured Credit Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Our preference remains for quality Non-Agency RMBS RMBS: Home prices remain resilient despite headwinds. Delinquency, prepayment, and foreclosure performance remains strong; need labor market weakness to see housing deterioration. Risk premiums still cheap to LT avg. ▪ CMBS: Investors cautious, especially on office. Credit curve is very steep; non-office sectors remain stable. ▪ CLOs: Spreads unch since April. Downgrades outpacing upgrades. More tail risks for subordinate bonds ▪ ABS: Attractive relval in some senior positions; higher quality borrowers remain stable. Market is active	▪ 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 ▪ WFH continues in 2023 (positive for RMBS, negative for CMBS). ▪ Rising interest rates dent housing market strength and turn home prices negative in 2023
Commodities	Under-weight -2 -1 0 +1 +2 Over-weight	▪ o/w Copper ▪ o/w Grains ▪ u/w Gold ▪ o/w Oil ▪ u/w Silver ▪ u/w Wheat ▪ o/w Corn	▪ 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 05.06.2023, 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 Australia**: Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414 and/or Columbia Threadneedle (EM) Investments Limited ["CTEM"], ARBN 651 237 044. TIS and CTEM are exempt from the requirement to hold an Australian financial services licence under the Corporations Act and relies on Class Order 03/1102 and 03/1099 respectively in marketing and providing financial services to Australian wholesale clients as defined in Section 761G of the Corporations Act 2001. 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.
Issued by Threadneedle Investments Singapore (Pte.) Limited, 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. 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. Issued by Threadneedle Asset Management Limited (TAML). Registered in England and Wales, Registered No. 573204, Cannon Place, 78 Cannon Street, London EC4N 6AG, United Kingdom. Authorised and regulated in the UK by the Financial Conduct Authority. **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. This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). For Distributors: This document is intended to provide distributors with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Marketing Counterparties and no other Person should act upon it. **Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies.** columbiathreadneedle.com