In Credit

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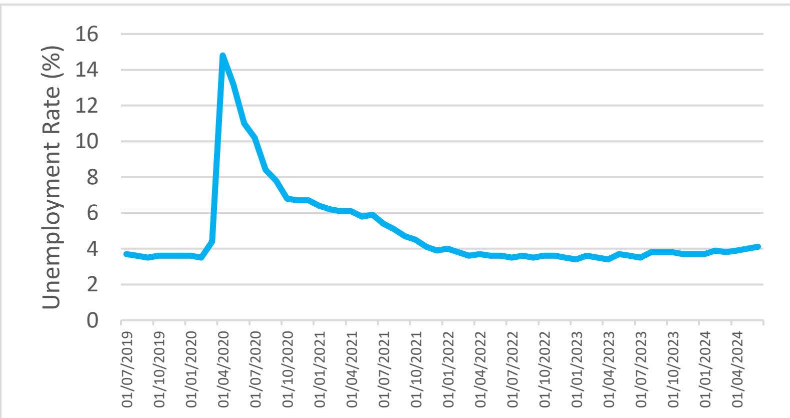
All change.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.30%	-10 bps	0.6%	-0.2%
German Bund 10 year	2.57%	7 bps	-0.3%	-2.4%
UK Gilt 10 year	4.13%	-4 bps	0.5%	-2.5%
Japan 10 year	1.10%	4 bps	-0.2%	-3.4%
Global Investment Grade	97 bps	-5 bps	0.7%	1.0%
Euro Investment Grade	106 bps	-11 bps	0.3%	0.9%
US Investment Grade	92 bps	-4 bps	0.9%	0.9%
UK Investment Grade	95 bps	-3 bps	0.5%	0.5%
Asia Investment Grade	151 bps	1 bps	0.2%	2.7%
Euro High Yield	359 bps	-9 bps	0.3%	3.6%
US High Yield	327 bps	9 bps	0.2%	2.8%
Asia High Yield	601 bps	-1 bps	0.4%	10.2%
EM Sovereign	345 bps	1 bps	0.6%	2.4%
EM Local	6.6%	-3 bps	1.0%	-2.8%
EM Corporate	274 bps	7 bps	0.3%	4.2%
Bloomberg Barclays US Munis	3.7%	0 bps	0.1%	-0.3%
Taxable Munis	5.1%	-8 bps	0.6%	-0.6%
Bloomberg Barclays US MBS	46 bps	-2 bps	0.7%	-0.3%
Bloomberg Commodity Index	240.78	1.6%	1.6%	6.8%
EUR	1.0839	1.2%	1.2%	-1.8%
JPY	160.80	0.1%	0.1%	-12.3%
GBP	1.2837	1.3%	1.3%	0.7%

Source: Bloomberg, ICE Indices, as of 5 July 2024. *QTD denotes returns from 30/06/2024.

Chart of the week – US Unemployment rate – last five years.



Source: Bloomberg, Columbia Threadneedle Investments, as of 8 July 2024.

Macro / government bonds

It was a better week for government bond markets with yields falling in most areas.

Last week's data highlight was the release of US employment statistics on Friday. The headline number on non-farm payrolls was close to market expectations, but as often is the case, the 'devil was in the detail' – namely the revisions to previous data releases. The net result was a perception of a weak report, and a rally in US treasury 10-year bonds which took the yield down by 5bps to 4.30%.

The UK election on Thursday delivered as expected a very large majority for the Labour party. However, what was a surprise was that this was achieved with a similar number of votes for Labour as when losing the 2019 General Election. The peculiarities of the UK's 'first past the post' voting system were the explanation for this, accompanied by a fracturing of the Conservative vote in favour of the Reform and Liberal Democrat parties, and the collapse in support for the SNP in Scotland. Has the UK swung to the left? Not really. Adding votes for Reform and the Conservatives together equals 38% of the total vote, against the 34% won by Labour.

The first round of the French elections last weekend raised the spectre of a win for the right-wing RN party. However, a flurry of political manoeuvring and construction of temporary election alliances amongst left and centrist parties have stymied the right-wing RN. Results from the second round of the election on 8 July reveal the RN finished in third place, behind both a left-wing alliance and the centrist group. The bottom line, however, is that no group will have a parliamentary majority, and an unstable coalition is the likely outcome. Expect fresh parliamentary elections to be called in June 2025.

The week ahead will be dominated by analysis of Fed Governor Powell's appearance in Washington DC on Tuesday and Wednesday; by on-going analysis of President Biden's intentions in terms of his candidacy; and by the US CPI release on Thursday.

Investment grade credit

After the spread widening seen in the last couple of weeks markets have rebounded pulling valuations back closer to the year's tights – as can be seen in **'Markets at a glance'** spreads and most materially in Europe. By the end of the week, Global IG spreads reached 97bps over government bonds according to data from ICE Indices. This is only three basis points wide of the recent tight spreads.

The market remains supported by ongoing investor demand and inflows. Some notable interest was seen for property company Grand City (estimated seven time oversubsribed) and for Deutsche Bank's social bond (with even higher demand).

There was little specific news to focus on last week and the surprise result in the French election last weekend, which seems to rule out a majority for either of the more 'extreme' political parties, has soothed some of the fears from a couple of weeks ago. The widely expected landslide victory for the opposition Labour Party in the UK last week passed without any market impact (see more above in the Macro / government bonds section).

The market's attention will now focus on the results season which kicks off this week as a number of major banks report earnings (e.g. DNB, JP Morgan, Citibank and Wells Fargo).

High yield credit & leveraged loans

European high yield started Q3 with a solid +37bps increase for the week as spreads tightened 9bps while yields remained more or less unchanged at 7%.

Market decompression continued as CCCs were again the weakest performers and the only rating band with a negative return for the week (-19bps). Outflows continued for the second week in a row, this time from both ETFs and managed accounts. The primary market remained busy with €2.7bn brought to the market over five issuers.

In credit rating news, SBB the Swedish real estate group was cut to selective default by S&P. This came with the news that the group had initiated a bond exchange, swapping its bonds for new ones but with a deep discount.

Another short seller target is in the news, with Muddy Waters questioning certain accounting issues of Eurofins, the testing company for farmers and food. In response, Eurofins has hired EY to conduct an accounting review. In other issuer news, Altice France's plan of selling its XpFibre unit is stalling. Valuations from prospective buyers are coming in at €6-$7bn, lower than the €8bn that Patrick Drahi was expecting. At Grifols, there was more drama with the announcement that members of the Grifols family are in talks with Brookfield, the alternative investment management firm, to take over the company (the family currently owns 30%).

Asian credit

The PBOC has reportedly made arrangements with major domestic financial institutions to borrow Chinese Government Bonds for the purpose of potentially short selling these CGBs to curb the short-term rally in yields. The PBOC has expressed concern on what it views as the excessive decline in the long-term CGB yield, which could pose downside risk to financial stability should the market reverses. Accordingly, the PBOC is looking to set a floor for the yield of the long-term CGBs via the short-selling arrangements.

The PBOC has also announced further open market operations as well as the tightening of the interest rate corridor of short-term rates. Specifically, it will conduct bond repurchase or reverse repurchase operations in the afternoon, where necessary. The repurchases will be based on the 7-day reverse repurchase rate and reflects the gradual shift away from the reliance on the one-year policy rate (Medium Term Lending Facility) as the benchmark rate.

Honhai reported its June revenue and Q2 revenue (+17% q/q +19% y/y), which were strong despite the off-peak seasonality in Q2. The company provided a confident guidance for the second half of 2024 with expectations for further q/q and y/y growth in Q3. The key drivers are the ramp-up of AI servers, the recovery in the demand for non-AI servers and new product launches of PCs and smartphones.

Emerging markets

A quiet week in emerging markets was in part owing to the US holiday on Thursday. Emerging market hard currency sovereigns took some relief following Friday's softer US data and ended the week +0.60% with the majority of returns coming from the US treasury rally. Spreads were unchanged at 392bps. High yield names outperformed investment grade with Africa the best performing region.

Chile launched a €1.6bn 7-year social bond as the A2/A/A- rated country looks to diversify its bond offerings. EM sovereigns have issued $119bn new bonds so far this year with the last couple of weeks seeing higher activity as issuers look to issue before the summer. EM corporates have experienced more primary market activity with $204bn YTD.

As expected, the Polish central bank held interest rates at 5.75% for the ninth consecutive month, as inflationary pressures continue. In Turkey, annual inflation came in lower than expected at 71.6%, down from 75.5% the previous month. The government's inflation target for this year is 33%.

Responsible investments

It was a fairly quiet first week in July for the ESG bond market, although a new issue from Deutsche Bank did make the headlines.

A brand new social bond from Deutsche Bank came to the market last week with incredible popularity at over 13 times oversubscribed. The bank aims to have €500bn in labelled bonds issued by the end of 2025, and is on track to achieve this with over €200bn already in issue. Proceeds from this new €500m issue – its first social bond issue – will fund projects outlined in its sustainability framework such as “development and provisioning of adequate and affordable housing for disadvantaged populations or communities, or to the promotion and enhancement of access to senior housing with special care”.

Fixed Income Asset Allocation Views

8th July 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 remain at historically tight, unattractive levels. Technicals and fundamentals are relatively unchanged with no thematic deterioration. Current valuations limit the spread compression upside and are misaligned with potential market volatility. **The group remains negative on credit risk overall, with no changes to the scorecard.** ▪ The CTI Global Rates base case view is that the hiking cycle is over, and the start of the cutting cycle is uncertain. With the recent CPI prints, the impetus is on the fed to bring the timing and the magnitude of cuts forward. ▪ Uncertainty remains elevated due to sensitive monetary and fiscal policy schedules and elections in various countries.	▪ 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)	A$ EM ¥ 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 real rate reversal challenges EM easing cycles. ▪ Geopolitical strife rekindles inflation ▪ US macro-outperformance strengthens US dollar.
Emerging Markets Sovereign Credit (USD denominated)	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ EMD spreads tightened this month, supported by improvement in distressed credit and stability in GCC despite geopolitical risk amid changes after elections. ▪ Investment Grade spreads are at historical tights while High Yield still offers some 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.	▪ 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 continued to move tighter and are near record lows. The group is taking down credit risk because of flat spread curves and less spread compression upside. ▪ 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 relval basis.	▪ 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 remained stable but tight since last month. ▪ Anticipate credit selection will be the performance differentiator in 2024. Looking to avoid defaults/distress, focusing on credit recovery and deleveraging theses. ▪ 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.	▪ 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	▪ Spreads are still flat to 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, however the recent increase following hotter than expected CPI has started to undo this process. ▪ Constructive view on fundamentals over longer time horizon.	▪ 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 Non-Agency RMBS, and ABS. ▪ RMBS: MoM spreads remain tight. Delinquency, prepayment, and foreclosure performance remains strong for prime borrowers; seeing small increase in delinquencies for non-prime borrowers. ▪ CMBS: The group is cautious, especially on office, floating rate, and near-term maturities. Non-office sectors, however, perform as expected with the overall market sentiment improving. ▪ CLOs: Despite 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 stable, lower quality borrowers underperform. Federal student loan payments near '18 / '19 levels with ~75% of borrowers 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 ▪ 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 crude oil ▪ u/w corn ▪ u/w live cattle	▪ Global Recession