

In Credit

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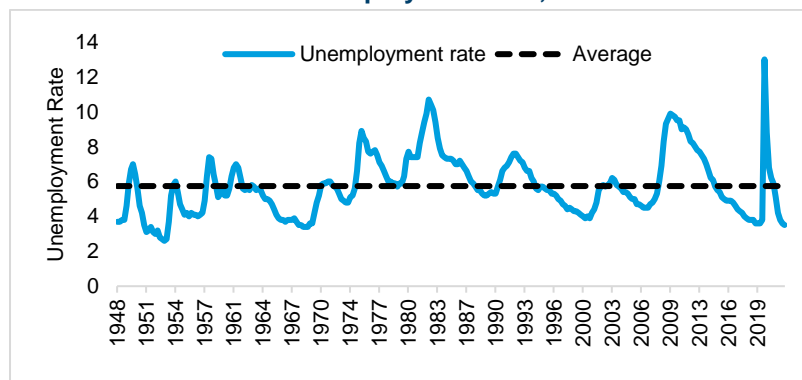
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As you were.... Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	3.88%	5 bps	-0.4%	-13.9%
German Bund 10 year	2.21%	11 bps	-0.5%	-15.8%
UK Gilt 10 year	4.41%	32 bps	-4.3%	-29.5%
Japan 10 year	0.25%	1 bps	1.4%	-3.3%
Global Investment Grade	174 bps	-6 bps	0.0%	-17.0%
Euro Investment Grade	216 bps	-5 bps	0.0%	-15.1%
US Investment Grade	160 bps	-7 bps	0.1%	-18.2%
UK Investment Grade	184 bps	-11 bps	-0.6%	-23.0%
Asia Investment Grade	228 bps	0 bps	-0.5%	-11.5%
Euro High Yield	614 bps	-26 bps	0.7%	-15.1%
US High Yield	502 bps	-41 bps	1.4%	-13.4%
Asia High Yield	1028 bps	8 bps	-0.3%	-23.3%
EM Sovereign	457 bps	-10 bps	0.4%	-21.9%
EM Local	7.3%	-2 bps	0.6%	-18.1%
EM Corporate	396 bps	-8 bps	0.4%	-15.9%
Bloomberg Barclays US Munis Taxable Munis	3.9%	-10 bps	0.8%	-11.4%
	5.3%	8 bps	-0.5%	-22.6%
Bloomberg Barclays US MBS	71 bps	2 bps	-0.3%	-13.9%
Bloomberg Commodity Index	254.68	5.1%	5.1%	19.4%
EUR	0.9700	-0.6%	-0.6%	-14.3%
JPY	145.60	-0.3%	-0.3%	-20.7%
GBP	1.1048	-0.8%	-0.8%	-18.1%

Source: Bloomberg, Merrill Lynch, as at 7 October 2022.

Chart of the week: US unemployment rate, 1948-2022



Source: Bloomberg Columbia Threadneedle Investments, as at 10 October 2022.

Macro / government bonds

After an all too short period of strength, government bonds once again revisited the downward trend they been on for most of this year. Yields in most markets are back close to the highest we have seen this year.

Meanwhile, expectations for interest rates this next year are back at the highs with expectations for US interest rates above 4% by December of this year and around 4.6% by March 2023.

The week ended with the US employment report. There were 263,000 jobs created, which was slightly in excess of expectations (255k). Meanwhile, the unemployment rate fell to 3.5% from 3.7% last month ([see chart of the week](#)). Earnings grew by 0.3% to 5.0% y/y. This week brings the all too important US consumer price inflation data set. The headline rate of inflation is expected to decline to 8.1% while the core rate, which excludes food and energy, is expected to come in around 6.5%. Additionally, we will get retail sales and producer price inflation data as well as the release of the minutes from the FOMC meeting and the University of Michigan consumer confidence data.

In geopolitical news, there was an attack on the Kerch bridge, which links Russian occupied Crimea with the Motherland. Russia was quick to respond to this action. This morning there were reports of missile attacks on Kiev and other Ukrainian cities. Lastly, the IMF and World Bank host their meetings this week in the US capital.

Investment grade credit

Credit markets struggled for real direction last week in a period of high volatility. The sterling market outperformed after weakness. It was also a busy five days for new issuance, some of which is coming with attractive new issue premia.

The global investment grade index spread ended last week at 176bps. This is close to the high for this year (which was 180bps) and a huge distance from the low of the year, which was 97bps in January.

This week brings the start of US quarter three earnings. In a busy period, JPMorgan, Citibank and Morgan Stanley will be amongst the highlights in the financial sector. In the corporate sector PepsiCo, Delta Airlines and Domino's Pizza will also release earnings.

In issuer specific news, Credit Suisse bond spreads 'gapped' tighter at the end of the week. The company's bonds had been very weak, as the business seeks to restructure and focus upon wealth management and banking and away from investment banking. It announced a tender (3bn) for some euro and US dollar 'opco' bonds, which forced bond prices much higher. Credit Suisse is also trying to sell its securitized assets business (around a quarter of the investment bank) to pay for the restructure, with a number of potential suitors mentioned in the press.

High yield credit & leveraged loans

US high yield bond prices rose over the week with outperformance up in quality following declines in six of the prior seven weeks.

The ICE BofA US HY CP Constrained Index returned 1.46% and spreads were 41bps lower. The largest retail inflows in two months surfaced (+\$1.87bn, YTD -\$52.6bn) following a 6-week stretch encompassing \$15.8bn of outflows. And the first new issue since September priced this week, with volumes of \$91bn YTD running 78% below prior year. Meanwhile, the average price of the J.P. Morgan Leveraged Loan index rose \$0.49 over the week to \$92.78,

which is \$0.77 above early July's low and down -\$1.88 since the beginning of September. Retail loan funds saw a \$1.6bn outflow for the week, moving YTD net flows to the negative side of the ledger at -\$962m.

European High Yield (EHY) had a positive return (0.70%) last week, its first week of positive performance seen since July. Higher quality credits outperformed with CCCs the only rating band to return a negative performance. Both spreads and yields fell, while outflows continued (€367m) but only from managed accounts as ETFs actually saw inflows last week. Trading in EHY remains challenging with pricing wide and liquidity poor, especially for lower rated and longer dated credits. The primary market was still subdued with only one new issue by Tendame, a Spanish retailer (€300m). Another much talked about issue, House of HR, was postponed as the issuer had hoped for a price in the mid 9s but market interest showed an expectation of a yield 100bps+ higher. In a commentary by JPMorgan, it was noted that the sharp fall in new issuance has resulted in the market duration moving from the range of 4.5-5.0 years to the lower end of 4.5 years.

In credit rating news, Casino, the French food retailer was cut to CCC+ by S&P citing the corporate's more difficult refinancing position given a more challenging retail environment.

Asian credit

The US Department of Commerce has implemented new controls on the exports of advanced computing and semiconductor manufacturing technologies to China. The intent is to restrict China's ability to purchase and manufacture certain high-end chips used in military applications. Some specific measures include the new license requirements for items going to semiconductor fabrication facilities in China.

There is also revision to the Unverified List (UVL) maintained by BIS (Bureau of Industry and Security under Dept of Commerce). 31 new entities are added to the UVL which could be moved to the Entity List if BIS is unable to verify the bona fides of the UVL entities (ie, the end-user check must be satisfied). Typically, on-site inspections are conducted for verification. The new additions to UVL include YMTC (Yantze Memory Technologies), the largest China memory chipmaker, which allegedly violated the US Foreign Direct Product Rule by selling NAND memory chips to Huawei.

Emerging markets

Emerging market debt enjoyed a week of positive returns last week, increasing 0.41% as measured by the JPM EMBI Global Index. Spreads were 10bps tighter with the high yield sub-component outperforming investment grade, mostly thanks to a rally in African names. The yield on the hard currency index ended the week at 8.6%.

There was finally some primary market activity with the Philippines coming to the market as well as Saudi Arabia's Public Investment Fund (PIF), which issued three green bonds, including a 100-year bond at 6.7%.

In Malaysia, prime minister Ismail Sabri Yaakob has dissolved parliament triggering a general election within 60 days. Yaakob's UNMO party are looking to capitalise on favourable sentiment to secure a bigger mandate and quash questions of legitimacy. The UNMO party ruled Malaysia for 60 years until they were ousted in 2018 following the 1MDB corruption scandal.

In central bank news, Peru hiked +25bps as expected but there were a couple of surprises from policy makers during the week; Ghana surprised markets with +250bps in an attempt to slow down inflation as the central bank indicated a rise in the country's fiscal deficit and a decline in FX reserves. In Poland it was the lack of any action that bothered investors; rates were left unchanged at 6.25% despite inflation rising to 17%.

In ratings, there was little to report but Pakistan was downgraded by Moody's to Caa1 due to higher debt sustainability risks, which have worsened since the devastating floods in summer.

Commodities

The commodity index resumed gains driven by a 10.9% rally in the energy complex. Brent rallied by \$10 to \$97 (+11.5%) while heating oil contracts rallied 24.7%, boosting refining margins.

The rally was driven by the OPEC+ announcement to cut production by 2m barrels per day from November. The cut is closer to 1m barrels in reality as many OPEC+ members are pumping below current quotas. The cuts were implemented despite US president Biden's recent visit to Saudi Arabia, in attempt to convince Saudi crown prince Mohammed bin Salman to boost production. To boost supplies, the US could loosen the 2019 sanctions on Venezuela, which is currently exporting just over 700,000 barrels a day (mainly to China). Morgan Stanley has raised their Q1, 2023 Brent price forecast \$5 to \$100/bbl.

In base metal news, the LME is considering banning Russian metal from its warehouses following an increasing number of consumers refusing to accept delivery. There are no outright sanctions on Russian metal but there is currently a ban on copper and zinc from Russia's UMMC. A ban, if imposed, would make it harder for Russian metal to reach the market. Base metals also rallied on the week with nickel (6.4%) and lead (9.9%) delivering the biggest gains.

Responsible investments

According to Bloomberg data, ESG issuance for Q3 was much weaker than this period last year. Approximately \$70bn came to the market, a further decline on the last two downward facing quarters. YTD supply is around 20% lower with sustainability bonds facing the worst of it. Interestingly, the percentage of ESG labelled issues in the sterling and euro markets have increased on 2021.

Summary of fixed income asset allocation views (as at 10 October 2022)

Fixed Income Asset Allocation Views 10th October 2022



Strategy and positioning (relative to risk free rate)	Views	Risks to our views
Overall Fixed Income Spread Risk 	<ul style="list-style-type: none"> Credit spreads have widened since the last meeting with volatility still high and a market-wide softening in technicals and fundamentals. This has kept the group negative on credit risk with no changes to sector outlooks. We are past the peak of economic growth with first few hikes done and expectations for more 75-100bp hikes through the end of 2022. Pullback in liquidity created opportunity for market volatility. Uncertainty remains elevated due to fears surrounding pace of central bank hiking, inflation, recession probabilities, weakening consumer profile and the Russian invasion of Ukraine. 	<ul style="list-style-type: none"> Upside risks: the Fed achieves a soft landing, Europe sees commodity pressure easing, consumer retains strength Downside risks: simultaneous low unemployment, high inflation, hiking, and slowing growth cause a recession. Russian invasion spills into broader global/ China turmoil. New Covid variants. Supply chain disruptions, inflation, commodity shocks persists to Q4 2022.
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 Hiking cycles may be curtailed by weakening growth, as risk of a policy error increases 	<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"> The invasion of Ukraine will hit global growth, hinder risk markets and lend a bid to the Dollar The repricing of the ECB has so far failed to boost the Euro as Eurozone growth expectations have underperformed the US 	<ul style="list-style-type: none"> End of zero-covid strategy in China normalises supply chains and raises global growth, to the detriment of the Dollar
Emerging Markets Local (rates (R) and currency (C)) 	<ul style="list-style-type: none"> Substantial monetary policy tightening now embedded into EM local rates Aggressive Fed pricing may now open the door to selective EMFX performance EM real interest rates relatively attractive, curves steep in places 	<ul style="list-style-type: none"> Negative sentiment shock to EM fund flows Central banks tighten aggressively to counter fx weakness EM inflation resurgence EM funding crises drive curves higher and steeper Tightening global financing conditions
Emerging Markets Sovereign Credit (USD denominated) 	<ul style="list-style-type: none"> EMD spreads unchanged from August, still seeing bifurcation in market with value in BBB and BB names Fundamental headwinds: elevated fiscal deficits, rising debt to GDP ratios, significant inflation, central bank tightening, China lockdown/growth, idiosyncratic political risks, increasing use of IMF programs Recent commodity price retracement has supported some names under pressure (India & Turkey). China real estate remains challenged with weaker data and growth forecast Technicals (outflows and supply) remain a headwind 	<ul style="list-style-type: none"> Chinese growth derails with less stimulus and uncertain zero covid policy after economy reopens Continued spillover 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 	<ul style="list-style-type: none"> US & EMEA spreads have widened since August. Stable fundamentals beat pessimistic expectations for Q2 earnings. Inflation, labor supply, low dispersion and monetary tightening remain headwinds pressuring margins and operating environment in 2H 2022 Technicals have continued to struggle with slow issuance, negative fund flows and poor liquidity 	<ul style="list-style-type: none"> Companies release materially lower Q4 outlook revisions Market indigestion as central banks sell EMEA corporates Rate environment remains volatile Russian invasion worsens operating environment globally
High Yield Bonds and Bank Loans 	<ul style="list-style-type: none"> Spreads have widened since August. Combined with greater downside risks, the group prefers conservative position while open to attractive buying opportunities. Technicals remains a headwind with light primary issuance, however August US fund flows were positive and default activity remains benign/idiosyncratic Bank loan market has moved lower with fewer new issues and low secondary trading volumes; concerns about recession and interest cost remain headwinds 	<ul style="list-style-type: none"> Default concerns are focused on demand destruction, margin pressure and macro risks Loan technicals & flows weaker Russian invasion & spillover rattles US bond loan/market as already seen in EMEA Commodity prices continue to retrace
Agency MBS 	<ul style="list-style-type: none"> Mortgages spreads have widened in the past month in sympathy with risk assets, supply continues to drop along with purchase activity and cash out refinancing Current coupon spreads near recent wides Headwinds as the Fed is reducing balance sheet position and bank demand has cooled as deposit growth slows 	<ul style="list-style-type: none"> Housing activity slows and rising rates move prepaids to normal levels without hurting mortgage servicing rates. Uncertainty with the Fed hiking and future balance sheet position
Structured Credit Non-Agency MBS & CMBS 	<ul style="list-style-type: none"> Our preference remains for Non-Agency RMBS RMBS: Increase in mortgage rate creates headwinds for prepaids and fundamentals. Delinquency performance remains strong, but housing is slowing. Reducing risk CMBS: Mostly solid fundamentals but weakening. Spreads flat MoM. Better relief in other sectors, continue to trim. CLOs: Default rate low but increasing. AAA spreads stable, supported by overseas investing. Mezz spreads worse as BB's 100 wider and manager tiering increasing ABS: Lower income, renters, lower fico borrowers continue to underperform. Higher quality borrowers' performance remains with expectations. Reducing exposure to inflation-sensitive borrowers 	<ul style="list-style-type: none"> Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening, consumer retail/travel behavior fails to return to pre-covid levels Work From Home continues full steam-ahead post-pandemic (positive for RMBS, negative for CMBS). SOFR deals slows CLO new issue Rising interest rates dent housing market strength
Commodities 	<ul style="list-style-type: none"> o/w Copper o/w Softs u/w Gold o/w Oil u/w Silver 	<ul style="list-style-type: none"> Global Recession



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