COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

20 November 2023

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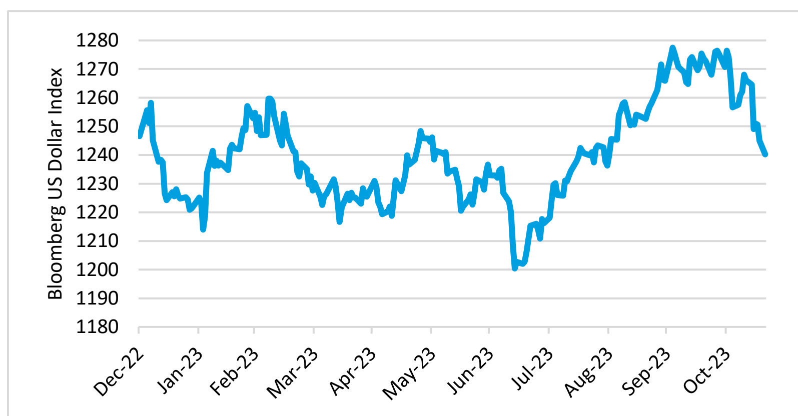
US dollar in decline.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.48%	-17 bps	1.4%	-0.4%
German Bund 10 year	2.63%	-9 bps	1.9%	0.7%
UK Gilt 10 year	4.15%	-19 bps	3.5%	-1.2%
Japan 10 year	0.75%	-10 bps	0.1%	-0.4%
Global Investment Grade	128 bps	-6 bps	2.0%	3.1%
Euro Investment Grade	147 bps	-4 bps	1.8%	4.2%
US Investment Grade	120 bps	-6 bps	2.1%	2.6%
UK Investment Grade	124 bps	-5 bps	2.9%	4.1%
Asia Investment Grade	196 bps	-4 bps	1.5%	3.9%
Euro High Yield	461 bps	-11 bps	1.5%	8.0%
US High Yield	399 bps	-4 bps	1.7%	7.8%
Asia High Yield	758 bps	-13 bps	1.7%	-3.0%
EM Sovereign	357 bps	-4 bps	2.1%	3.2%
EM Local	6.5%	-15 bps	4.3%	8.7%
EM Corporate	334 bps	0 bps	1.1%	4.5%
Bloomberg Barclays US Munis	3.9%	-20 bps	3.1%	1.7%
Taxable Munis	5.5%	-16 bps	1.7%	1.6%
Bloomberg Barclays US MBS	58 bps	-7 bps	2.0%	-0.3%
Bloomberg Commodity Index	232.85	0.4%	-2.1%	-5.4%
EUR	1.0926	2.1%	3.2%	2.0%
JPY	148.36	1.3%	-0.2%	-12.4%
GBP	1.2469	1.9%	2.2%	3.1%

Source: Bloomberg, ICE Indices, as of 17 November 2023. *QTD denotes returns from 30/09/2023.

Chart of the week – US dollar in decline – YTD



Source Bloomberg, Columbia Threadneedle Investments, as of 20 November 2023.

Macro / government bonds

Global sovereign debt, US dollar hedged, returned 1.00% in a week where economic data seemed to fit the narrative that we had reached terminal rates. US CPI came in weaker than the market had been expecting, while US PPI surprised to the downside and jobless claims rose. Market participants with long positions in interest rates benefited. The fall in yields though shone a light on the lack of consensus in the macro community over the future direction and timing of monetary policy with more tactical investors, such as macro hedge funds, using renewed market strength to re-establish short positions in anticipation of 'sticky' US inflation data. Fed policy makers tried to keep their options open, by talking up the prospect that rates could yet rise. However, the market took its cue from fundamental economic data. While investors kept one eye on the current resilience of the US economy, the increasing softness of US economic data seemed to justify arguments that the journey to lower rates had already begun. One victim of this backdrop has been the US dollar, which has weakened over the last few weeks **(see chart of the week).**

From a technical perspective, recent price action demonstrated that we had broken out of the up-channel trend in bond yields: US 10-year bond yields broke through their 50-day moving average to the downside; German 10-year bond yields broke through their 100-day moving average to the downside; while UK 10-year bond yields declined to reach their 200-day moving average. Technical indicators matter to market participants because they can help pinpoint when markets are entering momentum phases. The trinity of beneficial fundamental economic data, attractive valuations, and supportive technical conditions underpinned price strength in core interest rate markets last week.

Outside of the US, we saw better than expected CPI and retail sales data in the UK. The UK government felt vindicated by the decline in CPI to 4.6% having vowed to halve UK inflation. However, the fall largely reflected the impact of mechanistic base effects as past increases in inflation fell out of the year-on-year inflation comparison. The greater willingness of investors to hold interest rate risk was reflected in the syndication of the new 2043 gilt and a tap of the 2048 European Union issue. The order book for both of these bonds was oversubscribed by 13x. By the end of the week, the US and UK 10-year had fallen around 20bps to 4.4% and 4.1% respectively, while the German 10-year had fallen 13 bps to 2.6%

Investment grade credit

Credit market spreads continue to creep tighter and ended the week with a spread of 128bps for the global market according to data from ICE indices. This year the tightening has been led by media, autos and industrials with banks and insurance lagging the rally.

The market remains supported by client inflows at yields not seen for many years.

The strong performance and investor appetite has also prompted a deluge of primary issuance. In Europe, for example, levels of issuance are running at around double that of the prior month. With the US Thanksgiving holiday coming at the end of the week, we can expect a reduction in new issuance this week.

High yield credit & leveraged loans

US high yield bond valuations continued to tighten over the week amid softer than expected US CPI and continued fund inflows.

The ICE BofA US HY CP Constrained Index returned 0.91% and spreads were 4bps tighter. According to Lipper, retail high yield bond funds reported a $4.45bn inflow that was entirely ETF driven. The past two weekly inflows totalled $10.2bn, making it the second largest two-week inflow figure on record, trailing only June 2020's $12.1bn figure. Meanwhile, the average price of the J.P. Morgan Leveraged Loan Index increased $0.09 over the week. Retail loan funds saw a third consecutive weekly inflow with $288m contributed.

It was a strong week for European high yield, returning 0.73% as spreads tightened in -11bps to 461bps and yields fell even more (-16bps to 7.71%). Even in these markets, decompression continued as CCCs had another week of strong underperformance versus BBs and Bs while sterling again outperformed euros. Positive flows continued with +€535m returning to the asset class via both ETFs and managed accounts. ETF demand was so strong that pricing went to a premium. The primary market was robust with almost €3bn offered via six new corporate issues. New issues were mainly BBs but there were two single Bs offered as well.

There was lots of good news on the credit rating front as another rising star, Elis, the French hospitality company, was upgraded to BBB- from BB+, outlook stable. Vallourec, the French metals and mining company was also upgraded by S&P to BB from BB-. The agency cited "stronger US demand for Vallourec's products" and an expectation that conditions would likely continue into 2024. JaguarLandRover was also upgraded to BB, predicated on the company getting some cash support. Other companies had their outlook upgraded to positive (e.g. M&S) or up to stable (e.g. Boparan) on expectations of stronger trading performance and / or fallng leverage. It is not all rosy as Victoria, the UK flooring company, was downgraded to B+, outlook negative.

Earnings reports from last week were generally positive, in line or beating estimates. Some were seen benefiting from the fall from input costs.

Asian credit

The recent talks between US President Biden and China President Xi Jinping at the APEC summit in San Francisco made some progress in stabilizing the bilateral US-China relationship but, as expected, differences persist. During the talks, China agreed to crack down on the fentanyl trade, specifically manufacturers of the chemical substances for fentanyl. Both sides also agreed to resume military engagements and improve their communication channels as well as expand flight capacity between both countries.

Alibaba has terminated the plan to fully spin off its Cloud Intelligence Group (CIG). According to the company, the expanded control rules imposed by the US in October 2023 on advanced computing chips and semiconductor manufacturing tools will adversely affect CIG's ability to offer products and services, as well as to perform under existing contracts.

The restricted access to advanced computing chips is also impacting other Chinese companies. Tencent said that it has enough chips for at least a couple more generations to continue the development of Hunyuan (its proprietary foundation model). However, going forward, Tencent needs to look at potential domestic sources. With regards to domestic chip supply, Baidu has reportedly placed an order for Huawei's 910B Ascend chips.

Glencore has emerged as the successful bidder for a substantial stake in Teck Coal Business and this should ease the concerns that JSW Steel will risk stretching its balance sheet if it were to be the successful bidder instead.

In Indonesia, the talks between the government and Freeport Indonesia to extend the mining contract for another 20 years has entered the final stages and negotiations could be concluded by end November 2023.

Emerging markets

Declining US treasury yields and somewhat tighter EM spreads were supportive for the asset class this week and the index returned +1.47%.

Over the weekend it was confirmed that Javier Milei won the Argentinian presidential election with a higher share of the vote that expected. Some of his radical policies include replacing the nation's currency, the peso, with the US dollar as well as abolishing the central bank. However, he will have some governability issues due to his party having few seats in parliament.

We had encouraging news surrounding Egypt, as the IMF announced it was considering increasing its $3bn loan programme due to the difficulties posed by the Israel-Hamas war. Moreover, the trade ties between Egypt and Saudi Arabia have been strengthened following a visit from the Saudi Arabian Commerce Minister that will support Egypt's growth prospects.

The IMF reached a Staff Level Agreement with Kenya last week allowing the country to gain immediate access to a $682m tranche. Kenya's economy has been under pressure this year but the IMF has been encouraged by some progress made on implementing the necessary structural reforms to improve its position.

Commodities

The BCOM index delivered a 0.4% total return on the week with precious metals (+3.4%) and industrial metals (+1.3%) delivering the strongest returns.

Gold prices rallied by 2.4% on the week coinciding with the US 10-year treasury yield dropping by 22bps, lower treasury yields are typically positive for non-interest-bearing gold. Prices currently stand a $1,978 per oz against an all-time high close of $2,063 in August 2020.

In industrial metals, copper was the standout performer with a 3.9% rally. Prices have been rallying post hitting close to 2023's lowest levels back in mid-October.

Crude prices continued their decline, with the brent index now down 11.2% over the past 28 days (Brent at $81). The market turned its attention to this Sunday's OPEC meeting where there is speculation that Russia and Saudi will extend their voluntary cuts into early 2024. Reports on Friday also suggest that the broader OPEC+ group would consider a cut of 1MMbbls/d.

Responsible investments

Home to 60% of the Amazon Forest, Brazil issued it's first ESG bond in the form of a Sustainability Bond last week. The $2bn bond is set to mature in 2031 and will help fund projects under the sustainability framework that was recently approved. Projects will roughly be split 50/50 to green and social projects, including projects to help eradicate deforestation by 2028 and reduce Brazil's carbon emissions.

Fixed Income Asset Allocation Views

20th November 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 are within historic ranges, tightening back in over the past month. Technicals seem stable; fundamentals show modest pockets of weakness, but no thematic deterioration. **The group stands neutral on credit risk overall, with no changes to underlying sector views.** ▪ The CTI Global Rates base case view is no cuts in 2023, with one more possible hike left in the hiking cycle. Focus remains on wages, labor market, financial conditions, and inflation expectations. ▪ Uncertainty remains elevated due to geopolitical tension, stricter lending, monetary policy tightening, persisting inflation, and weakening consumer profile.	▪ Upside risks: the Fed achieves a soft landing with no labour softening; consumer retains strength; end to Ukraine and Israel-Hamas wars. ▪ Downside risks: Fed is not done hiking and unemployment rises. Another banking crisis, this time from unrealised losses on securities and CRE, supply chain disruptions, inflation, volatility, commodity shocks re-emerge.
Duration (10-year) ('P' = Periphery)	Short -2 -1 (¥, P) 0 +1 ($, €, £) +2 Long	▪ Longer yields to be captured by long-run structural downtrends in real yields ▪ Inflation likely to normalize over medium term, although some areas will see persistent pricing pressures	▪ Inflationary dynamics become structurally persistent ▪ Labour supply shortage persists; wage pressure becomes broad and sustained ▪ Fiscal expansion requires wider term premium ▪ Long run trend in safe asset demand reverses
Currency ('E' = European Economic Area)	Short -2 -1 0 (EM, A$, ¥, €, $, £) +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.	▪ 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))	Under-weight -2 -1 0 (C) +1 (R) +2 Over-weight	▪ Disinflation under threat but intact; EM central banks still in easing mode. ▪ Real yields remain high. ▪ Selected curves continue to hold attractive risk premium.	▪ Sustained high core rates thwart EM easing cycles. ▪ Energy persistence derails disinflation trend. ▪ US outperformance strengthens US dollar. ▪ 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 15bps tighter than last month, benefiting from lower global rates. Technicals are slower, outflow and weak issuance. ▪ Conservatively positioned with most idiosyncratic opportunities in lower quality portion of index, focus on relval opportunities. ▪ 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.	▪ China/US relations deteriorate. ▪ Issuance slows. ▪ Spill over from Russian invasion and Israel-Hamas war: local inflation (esp. food & commodity), slow global growth. ▪ Persisting COVID growth scars hurt economies & fiscal deficits.
Investment Grade Credit	Under-weight -2 -1 ■0 +1 +2 Over-weight	▪ US and EMEA spreads have tightened since last month. ▪ Fundamentals have proved resilient with decent earnings. Global portfolios prefer EUR IG over USD on relval basis. ▪ Fundamental concerns remain focused on commercial real estate, unrealised losses for banking sector, tight labor supply, and changing consumer behaviour.	▪ Lending standards continue tightening, even after Fed pauses hiking cycle. ▪ Rate environment remains volatile ▪ Mass layoffs spike, worsening consumer profile. ▪ Geopolitical conflicts worsen operating environment globally
High Yield Bonds and Bank Loans	Under-weight -2 -1 ■0 +1 +2 Over-weight	▪ Spreads have tightened over the past month, while technical and high – quality HY fundamentals remain stable. October brought more rising stars, but also more defaults. Financial conditions continue to punish destressed names. ▪ Conservatively positioned, but open to attractive buying opportunities in short HY, BBs and higher quality loans. ▪ US HY defaults remain below historic averages, with greater default expectations for 2024. ▪ Bank loan market volatility has improved in the past month. Themes: neutral retail fund flows, slow primary deal flow, improving CLO issuance, increasing burden, credit concern in lower quality loans. Market performance mostly reflects idiosyncratic credit stories, not wider industry themes.	▪ 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. ▪ Loans see retail fund outflows once Fed starts lowering rates.
Agency MBS	Under-weight -2 -1 0 +1 ■+2 Over-weight	▪ Mortgage index tightened in the past month; spreads still wide of historic medians. ▪ The group has reduced position sizing, but still overweight. Constructive view over longer time horizon. ▪ Supply is manageable as higher rates and fall seasonals kick in. ▪ Performance has been driven by the Fed's hiking cycle, with MBS widening into a bear steepener.	▪ Lending standards continue tightening even after Fed pauses hiking cycle. ▪ Prepayments normalise as rates rise without reducing mortgage servicing. ▪ Fed continues to shrink position. ▪ Market volatility erodes value from carrying.
Structured Credit Non-Agency MBS & CMBS	Under-weight -2 -1 0 ■+1 +2 Over-weight	▪ Positive outlook because of decent risk-adjusted valuations in select high quality Non-Agency RMBS, CLOs and ABS. ▪ RMBS: September saw spreads tighten. Home prices resilient, expect higher rates will slow growth. Delinquency, prepayment and foreclosure performance remains strong. We expect fundamentals to hold in as long as labor market strength remains. ▪ CMBS: The group is cautious, especially on office and multifamily, however non-office sectors perform as expected. Delinquencies increasing as maturities come due. Credit curve remains steep. ▪ CLOs: New issue steadily continues. Defaults remain low but CCC buckets continue to rise slowly with lower recoveries. ▪ ABS: Attractive relval in some senior positions. Higher quality borrowers remain stable, lower quality borrowers underperform. Fairly strong start to student loan repayment.	▪ 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. ▪ Rising interest rates turn home prices negative, denting housing market strength. ▪ Cross sector contagion from CRE weakness.
Commodities	Under-weight -2 -1 ■0 +1 +2 Over-weight	▪ o/w Copper ▪ o/w Grains ▪ u/w Gold ▪ o/w Soybean Meal ▪ o/w Oil ▪ o/w Lead ▪ o/w Zinc	▪ Global Recession

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