

In Credit

21 August 2023



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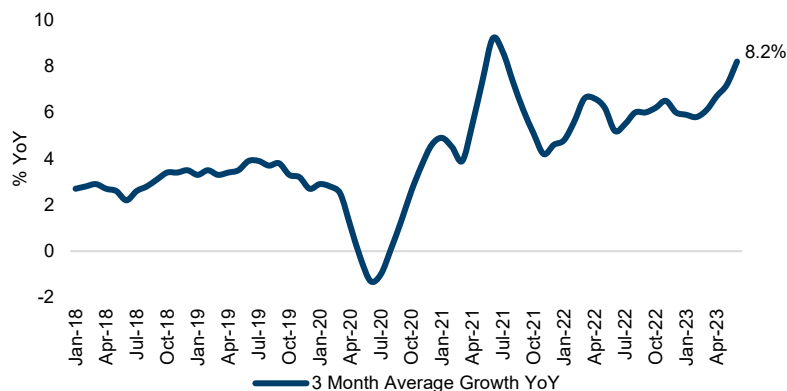
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Higher and higher Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	4.31%	16 bps	-2.0%	-0.4%
German Bund 10 year	2.69%	6 bps	-1.1%	0.0%
UK Gilt 10 year	4.70%	18 bps	-2.5%	-6.3%
Japan 10 year	0.65%	7 bps	-2.2%	0.4%
Global Investment Grade	135 bps	4 bps	-1.1%	1.6%
Euro Investment Grade	152 bps	3 bps	0.5%	2.5%
US Investment Grade	127 bps	5 bps	-1.8%	1.4%
UK Investment Grade	132 bps	3 bps	0.2%	-0.9%
Asia Investment Grade	206 bps	10 bps	-0.4%	2.6%
Euro High Yield	468 bps	13 bps	0.9%	5.3%
US High Yield	402 bps	19 bps	0.3%	5.7%
Asia High Yield	991 bps	78 bps	-5.1%	-5.3%
EM Sovereign	358 bps	22 bps	-1.3%	2.5%
EM Local	6.5%	15 bps	-0.8%	7.0%
EM Corporate	336 bps	12 bps	-0.1%	3.5%
Bloomberg Barclays US Munis	3.8%	10 bps	-1.0%	1.6%
Taxable Munis	5.4%	6 bps	-3.2%	1.6%
Bloomberg Barclays US MBS	56 bps	-1 bps	-2.2%	-0.3%
Bloomberg Commodity Index	236.42	-1.2%	3.5%	-4.6%
EUR	1.0893	-0.7%	-0.3%	1.6%
JPY	146.10	-0.3%	-0.8%	-9.8%
GBP	1.2748	0.3%	0.2%	5.4%

Source: Bloomberg, Merrill Lynch, as of 21 August 2023.

Chart of the week: UK average weekly earnings growth



Source: Bloomberg and Columbia Threadneedle Investments, as of 21 August 2023.

Macro / government bonds

In the quiet final month of summer there was little to excite fixed income minutes. We had the publication of the minutes of the last US Federal Reserve Meeting of July. These revealed that policy makers remained apprehensive about upside risks to inflation and they were in data dependant mode, just as Chair Jay Powell had communicated at the last Fed press conference. What did emerge was news that a small number of members had become increasingly concerned at the risk of overtightening monetary policy. The language focusing on upside inflation risks exerted upward pressure on US Treasury yields, although it was insufficient for Treasury yields to break out of their current trading range with support levels at the 10-year sector at around 4.3%. There was also little change in market expectations of where terminal rates were expected to finish, which is within a whisker of current rate levels of 5.5%.

This contrasted to the UK where news on the labour market continued to disappoint. Annualised average weekly earnings jumped from 6.9% to 8.2% for June ([see Chart of the Week](#)), while annualised earnings ex-bonus rose from 7.3% to 7.8%. The data challenged the narrative that the Bank of England might just have done enough to pause at its next sitting. One of the criteria for a pivot to easier policy is increasing economic slack in the UK, helped in part by a softer labour market. The earnings report instead hinted at tighter monetary policy if the Bank was to have any hope of putting the inflation genie back in the bottle. There was a parallel upwards shift along the UK sovereign curve of circa 10bps while the market also increased its pricing of terminal rates from 5.8% to 6%. The other big data release in the UK was inflation. Headline CPI to June fell from 7.9% to 6.8% while core CPI remained unchanged at 6.9%. The fall in headline inflation reflected falling gas and electricity prices, while core CPI saw a fall in goods inflation offset by a rise in services inflation. Whatever gloss could be put on goods disinflation and lower energy prices, the fact remains that the inflation numbers were still big and a long way away from the 2% target.

The eurozone bond market remained somnambulant. Beach holidays remain in progress.

Investment grade credit

After a few muted weeks we had some mild spread widening for investment grade last week, most notably in the US, but Europe and the UK followed suit. Spreads have been very much range bound all year.

The tail end of results season brings good results from some insurance names. Aviva reported its H1 numbers with premiums up 12% and operating profit up 8% year-on-year driven by the strength in their UK and Ireland General Insurance. Admiral published its H1 results with revenues up 21% and profit up 4% – unsurprising with the autos sector challenged in recent quarters. The ABI (Association of British Insurers) says that on average your motor insurance policy has risen by 46% in the past 12 months. The current average premium is 21% higher compared to Q2 2022 and is at its highest since data began in 2012. This is reflected by rising costs of labour and more expensive replacement parts.

High yield credit & leveraged loans

US high yield valuations widened sharply over the week as concerns around China and rapidly rising global bond yields led to a risk-off tone. The ICE BofA US HY CP Constrained Index returned -0.84% and spreads were 19bps wider. Per Lipper, the asset class reported a \$1 billion outflow, marking the fourth consecutive weekly outflow and largest since May. Meanwhile, the average price of the J.P. Morgan Leveraged Loan Index was resilient, rising \$0.10 to \$95.05. Retail loan funds reported a \$274 million inflow.

European HY had a quiet week though compression continued, especially for single Bs. The asset class returned -0.35% for the week with spreads widening 13bps back to 468 as yields rose 16bps to 7.9%. CCCs and BBs underperformed single Bs, with BBs the weakest. Flows were modest and negative (minus €27 million) largely due to managed accounts as ETFs still experienced small inflows. The primary market had another quiet week as the summer recess kept new issuance waiting in the wings.

In sector news, there was more volatility in the real estate sector as the CFO and deputy CEO, Eva-Lotta Stridh, of embattled Swedish real estate group SBB announced her resignation. Stocks and bonds traded sharply down on the news. In other worrisome real estate news, Medical Properties Trust, a landlord of medical facilities in the UK and US, also saw its bonds and stock prices hit when a law firm announced it was investigating claims that the company had failed to disclose information that the market might have expected to be reported.

Asian credit

China's central bank, the PBOC, lowered the rate on its one-year loans (medium-term lending facility) by 15bps to 2.5%, the second reduction since June. The surprise move came shortly before the release of disappointing economic activity data for July showing growth in consumer spending, industrial output and investment sliding across the board and unemployment rising.

Zhongzhi, a Chinese asset management company with interest in trust companies, private equity and wealth management, was reported to miss payments on at least 30 products since late July. The company has total assets under management of CNY 1 trillion, and the economic slowdown and property downturn have weighted on its operations. China's banking regulator, the National Financial Regulatory Administration, has set up of a task force to gauge the outstanding debt and risks. This highlights that Beijing will step in relatively quickly to ward off contagion risk

JD.com released positive Q2/23 results, but the marketing spend was higher to gain more user mindshare. The performance in supermarket category was softer due to a high prior-year base, while management expects a better trend in the second half of the year. Its balance sheet remains solid with net cash position. The operating profit was impacted by promotional activities (the 618 annual shopping festival) which included trade-in services, discounts and other complimentary services.

Lenovo released weak Q3 results. It is a challenging period for the company due to inventory clearance, soft demand for cloud solutions, and slower-than-expected transition to next-generation platforms by customers. Management expects the inventory digestion to clear out in one to two quarters leading to a better second half of the year. This may be optimistic given that demand dynamics could remain sluggish through the year.

Longfor released satisfactory half-yearly results with solid credit metrics and sufficient liquidity supported by positive operating cash flow with 15% year-on-year higher contracted sales. Longfor remains the most defensive private-owned developer in China. The company has manageable near-term maturities and a sizable unlevered investment portfolio as an additional layer of liquidity buffer.

Emerging markets

Emerging market hard currency assets struggled last week due to weakened risk sentiment; news from China continued to cause concern for investors, and higher US treasury yields resulted in a negative return of -1.79% for the index over the week. The main driver of this was from spreads rather than treasuries, particularly more vulnerable names in the high yield sub-component where they widened the most.

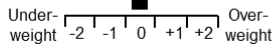
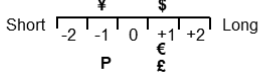
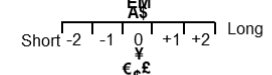
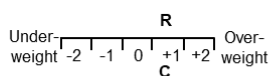
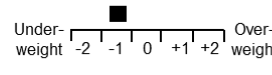
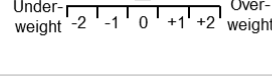
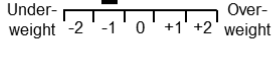
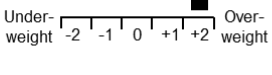

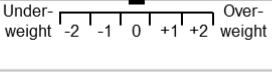
There were two elections in Latin America over the weekend: in Guatemala anti-corruption candidate Bernardo Arevalo looks set for a landslide win and the expectation is for policy continuation (ie, conservative economic policy, preserving the country's low debt levels and maintaining macroeconomic stability); while in Ecuador, early results points to a presidential run-off between the expected frontrunner, socialist candidate Luisa Gonzalez, and Daniel Noboa, who is an entrepreneur and viewed as a more market-friendly candidate who wants to encourage greater private sector involvement to lift the economy. Fitch downgraded Ecuador's credit rating last week to CCC+ citing heightened financial risks, which follows the assassination of a presidential candidate two weeks ago.

Please note, there will be no In Credit next week due to the UK bank holiday.



Fixed Income Asset Allocation Views

21st August 2023

Strategy and positioning (relative to risk free rate)	Views	Risks to our views
Overall Fixed Income Spread Risk 	<ul style="list-style-type: none"> Valuations have continued to tighten, some sectors their richest in over a year. Technicals seem stable; fundamentals show modest pockets of weakness, but no thematic deterioration. The Group stands neutral on Credit risk overall favouring higher quality credit. The CTI Global Rates base case view is no cuts in 2023, with one more hike before holding to end the year. Focus remains on wages, labor market, financial conditions, and inflation expectations. Uncertainty remains elevated due to stricter lending, monetary policy tightening, persisting inflation, weakening consumer profile and ongoing geopolitical tension. 	<ul style="list-style-type: none"> Upside risks: the Fed achieves a soft landing with no labour softening, no lasting changes fundamentals following banking crisis, consumer retains strength, end of Russian invasion of Ukraine Downside risks: Rising unemployment, especially if wage growth remains high and Fed continues hiking. Supply chain disruptions, inflation, volatility, commodity shocks reemerge.
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 	<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"> 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 	<ul style="list-style-type: none"> 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)) 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Severe US recession and/or financial crisis drives stronger US dollar and portfolio outflow 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) 	<ul style="list-style-type: none"> EMD spreads have widened in the last couple of weeks, however technical still remain balanced with limited supply over the last couple of months. Conservatively positioned with fewer idiosyncratic opportunities after market compression, prefer local to hard currency Tailwinds: Central bank easing in less inflationary countries, IMF program boost for distressed names Headwinds: higher debt to GDP ratios, wider fiscal deficits, geopolitical risks, domestic political uncertainty 	<ul style="list-style-type: none"> China/US relations deteriorate; China reopening stall Issuance slows Spill over from Russian invasion: local inflati (esp. food & commodity), slow global growth Persisting COVID growth scars hurt economies & fiscal deficits
Investment Grade Credit 	<ul style="list-style-type: none"> US and EMEA spreads have tightened since last month, with fundamentals showing resilience, minor exceptions in consumer facing names and some energy and utilities. EUR valuations are cheap, prefer USD and Euro to Sterling. YTD net issuance greater than last year, and expected to pick up in 2H23. Confidence from credit metrics amidst recession uncertainty. Fundamental concerns remain focused on commercial real estate for Banking sector, tight labour supply, weaker consumer, recession concerns 	<ul style="list-style-type: none"> Costlier funding and tighter lending standard from bank crisis Volatility remains high and 2023 supply is below expectations. Market indigestion as central banks sell EMI corporates Rate environment remains volatile Geopolitical conflicts worsen operating environment globally
High Yield Bonds and Bank Loans 	<ul style="list-style-type: none"> Spreads continue to tightening with valuations inside historic medians. Technicals strong and stable, fundamentals still solid but beginning to show small pockets of weakness. Prefer conservative position while open to attractive buying opportunities, especially in short HY & BB's and higher quality loans where increased financing costs are less of a headwind. US HY defaults higher than last year but still at reasonable levels, possibly normalising to historic trends. Bank loan market continuing May's rally, with overall market dispersion. Themes: retail fund outflows, delayed defaults, limited issuance, increasing interest burden, credit concern in lower quality loans. 	<ul style="list-style-type: none"> Costlier funding and tighter lending standard from bank crisis Default concerns are revised higher on great demand destruction, margin pressure and macro risks Rising stars continue to outpace fallen angels shrinking HY market Rally in distressed credits, leads to relative underperformance Pockets of weakness improve, HY spreads show resistance to widening that typically follow tightening policy.
Agency MBS 	<ul style="list-style-type: none"> Mortgage index unch or slightly wider than last month with spreads wide of historic medians, the group views agencies as opportunistic. Supply below expectations from rates but improving with seasonals. Liquidation of failed banks better than feared. Place to add, prefer high quality and higher coupon assets; constructive view over longer time horizon 	<ul style="list-style-type: none"> Costlier funding and tighter lending standard from bank crisis Housing activity slows and rising rates move prepaids to normal levels without hurting mortgage servicing rates Fed continues to shrink position Market volatility erodes value from carrying
Structured Credit Non-Agency MBS & CMBS 	<ul style="list-style-type: none"> Our preference remains for quality Non-Agency RMBS RMBS: Home prices resilient despite headwinds. Delinquency, prepayment, and foreclosure performance remains strong, need labor market weakness to see housing deterioration. CMBS: We feel cautious, especially on office and multifamily. Credit curve is very steep, non-office sectors remain stable. Delinquencies increasing as maturities come due. CLOs: Continued modest tightening. Downgrades outpacing upgrades. Prefer new issues, but supply is low. ABS: Attractive reval in some senior positions; higher quality borrowers remain stable. Market is active with decent valuations. 	<ul style="list-style-type: none"> Weakness in labour market Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening. Consumer (retail/travel) behavior fails to return to pre-covid levels Rising interest rates turn home prices negative, denting housing market strength. Cross sector contagion from CRE weakness
Commodities 	<ul style="list-style-type: none"> o/w Copper o/w Grains u/w Gold o/w Soybean Meal o/w Oil o/w Lead 	<ul style="list-style-type: none"> Global Recession



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