COLUMBIA THREADNEEDLE INVESTMENTS

In Credit

22 July 2024

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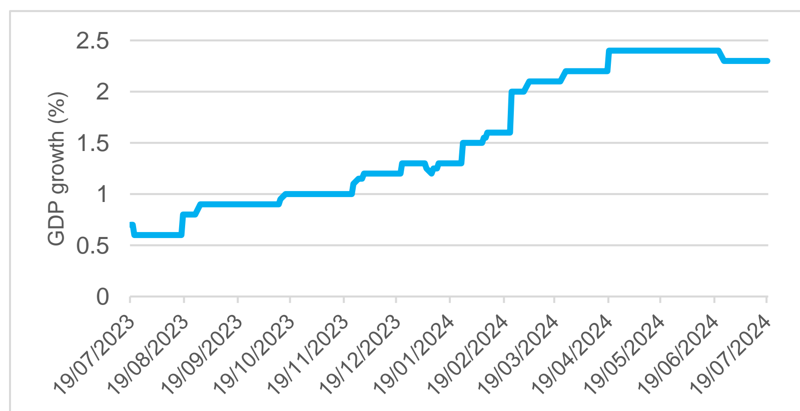
A week is a long time in politics.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.22%	4 bps	1.1%	0.2%
German Bund 10 year	2.47%	-3 bps	0.4%	-1.7%
UK Gilt 10 year	4.14%	3 bps	0.7%	-2.2%
Japan 10 year	1.06%	-1 bps	0.2%	-3.1%
Global Investment Grade	98 bps	1 bps	1.2%	1.5%
Euro Investment Grade	108 bps	1 bps	0.9%	1.4%
US Investment Grade	93 bps	1 bps	1.4%	1.4%
UK Investment Grade	95 bps	0 bps	0.9%	0.8%
Asia Investment Grade	149 bps	0 bps	0.9%	3.4%
Euro High Yield	361 bps	2 bps	0.8%	4.0%
US High Yield	309 bps	-10 bps	1.4%	4.1%
Asia High Yield	595 bps	-3 bps	1.4%	11.3%
EM Sovereign	346 bps	4 bps	1.1%	3.0%
EM Local	6.5%	5 bps	1.9%	-1.8%
EM Corporate	271 bps	-3 bps	1.0%	4.9%
Bloomberg Barclays US Munis	3.6%	-2 bps	0.7%	0.3%
Taxable Munis	5.1%	5 bps	1.3%	0.1%
Bloomberg Barclays US MBS	43 bps	1 bps	1.4%	0.4%
Bloomberg Commodity Index	231.39	-3.1%	-3.2%	1.8%
EUR	1.0890	-0.2%	1.6%	-1.4%
JPY	156.64	0.2%	2.2%	-10.4%
GBP	1.2929	-0.6%	2.1%	1.4%

Source: Bloomberg, ICE Indices, as of 19 July 2024. *QTD denotes returns from 30/06/2024.

Chart of the week – Consensus US GDP forecast for 2024 (2023/24)



Source: Bloomberg, Columbia Threadneedle Investments, as of 19 July 2024.

Macro / government bonds

During the last eight days we have seen an astonishing and unprecedented sequence of events in the US presidential race. Last weekend we saw the attempted assassination of Donald Trump, and (late Sunday night) the announcement from President Biden that he would not stand for re-election.

Although the Biden news occurred when markets were closed, and could of course trigger a reaction, we note that the US Treasury market remained remarkably stable last week, and that 10-year yields remained stuck around the 4.20% level. Does the US Treasury bond market know how to price the election at this stage?

It wasn't greatly different in Europe where political news (the re-election of Ursula von der Leyen as European Commission president) was ignored.

Perhaps the key for bond markets was that the pricing of rate cuts did not change meaningfully during the week. The US Federal Reserve is still priced for around 60bps of cuts in 2024, and the European Central Bank is still priced for 45bps. Economic data will be the key to changing these expectations. This week brings second quarter US GDP data: expectations for growth this year had been steadily rising and now stand at 2-2.5% for 2024 **(see Chart of the week).**

Our global rates desk remains long duration and express the position primarily in the US Treasury market.

Investment grade credit

It was a quiet week for investment grade bonds.

Global investment grade credit spreads were little changed last week at 98bps, which is only a few basis points wide of the year's tightest spreads (94bps) according to data from ICE indices.

There was little issuer specific news to report though European banks' results thus far point to decent return on equity, peaking margins and cost of risk (asset quality) that remains better than normal at a time of high levels of capital. Additionally, there was a report in the Financial Times that US media giant Warner Brothers Discover may seek to separate its legacy TV assets from its growth businesses (streaming and studio). This would mark a shift in strategy – this unconfirmed story pushed the company's bond spreads wider.

As we enter the summer period, the IG market is supported by strong technicals in the form of an expected reduction in net supply at a time of strong demand (driven by higher yields and steeper credit curves). Credit fundamentals remain robust with low levels of leverage for corporates and high levels of capital for banks. Against these supportive factors are valuations / spreads which are expensive. When we look at constant credit rating (BBB rated); global corporate spreads; and adjust for changes in index duration, the market is around 0.5 standard deviations rich to its long-term average. It is worth noting that over the last 25 years, however, the market has traded richer than this for over 60% of the time. In short spreads are tight – but not alarmingly so.

High yield credit & leveraged loans

US high yield bond valuations continued to tighten with support on both the spread and rate fronts amidst manageable new issuance and sizeable inflows.

The ICE BofA US HY CP Constrained Index returned 0.30% and spreads were 10bps tighter. The yield-to-worst of the index declined 11bps to 7.59%. According to Lipper, retail high yield funds reported a $3.3bn inflow for the week – the largest fund inflow for the asset class since January. Meanwhile, in floating rates the average price of the Credit Suisse Leveraged Loan Index was unchanged at $95.8. Retail loan flows continued for a third consecutive week with $634m contributed.

European high yield saw sideways trading overall, but still came with another positive return week (+0.13%), despite spread widening (+2bps to 361bps) as yields fell (6bps to 6.82%) on the back of macro weakness. Decompression returned as CCCs performed negatively (-0.10%) underperforming BBs and Bs. The primary market was busy with €2.8bn coming to the market in six new issues (largely refinancings), and generally coming inside of initial price talk. Issuers have been strongly encouraged to come to the market before the start of the summer lull and to avoid political volatility and possible market instability that might come in the autumn.

In M&A news, Fnac Darty (French retailer,BB+ but negative outlook) has offered to buy Unieuro (largest Italian consumer electronics retailer with €2.6bn in revenue per annum) for €249m in cash and stock.

On the LME (liability management exercise) front, an ad hoc group of shorter dated Intrum noteholders has sent the company a demand letter informing they have signed a cooperation agreement to oppose the group’s restructuring proposal. This group argues Intrum’s restructuring proposal, announced last month, violates the terms of the 2025 notes and is therefore cannot legally be implemented.

Asian credit

China’s Third Plenum concluded last week without any significant surprises in its initial communique. In essence, the Third Plenum continues to prioritize high quality economic development, the integration of urban-rural development, pushing innovation and tech development, supply chain resilience as well as improving national security. On another hand, there was little mention on the stimulus for domestic demand and consumption. Accordingly, we look towards the quarterly Politburo meeting in late July for more policy direction, if any, in boosting the domestic demand environment. Following the initial communique of the Third Plenum, the government will release a more comprehensive and detailed report shortly.

In a dovish move, the People’s Bank of China has reduced the 7-day OMO reverse repo rate by 10bps to 1.7% with a 10bps cut for both the 1-year and 5-year Loan Prime Rates. The policy easing is a response to the government’s expectation of near-term macro headwinds, as disclosed in the initial communique.

TSMC raised its FY’24 guidance for revenue growth to above mid-20% (US dollar terms), compared with its previous guidance of low-mid 20%. The company has benefited from the growth in AI-related demand and the structural demand for energy-efficient computing.

Emerging markets

EM hard currency sovereign bonds posted negative returns (-0.4%) last week owing to slightly wider spreads and a negative contribution from US Treasuries. Spreads now stand at 392bps and the 4bps widening came from high yield countries. The Middle East was the only region to register a positive return.

Investment grade rated Romania confirmed its plans to ask the European Commission to extend the period it needs to narrow its budget deficit toward the 3% GDP limit to seven years from the current three years, in order to accommodate record infrastructure spending. The request will not be viewed favourably by ratings agencies who could cut the country's current stable outlook to negative or even downgrade one notch to high yield.

There is news emerging that a $20bn debt restructuring deal has been reached between bond holders and Ukraine. A haircut of 37% has been accepted. At the time of writing, the Ukrainian bond curve was 2-3 points higher as a result of the positive news.

Moody's gave Turkey a 2-notch upgrade from B3 to B1, outlook positive. The ratings agency cited that the key driver of the upgrade was improvements in governance, more specifically the decisive and increasingly well-established return to orthodox monetary policy, which was yielding results in terms of reducing the country's major macroeconomic imbalances.

In terms of flows, positive momentum continued as EM bonds enjoyed net inflows over the week thanks to hard currency bonds while local currency continued to witness outflows.

In central bank news, policy makers in South Africa and Egypt opted to hold interest rates at all time highs of 8.25% and 27.25% respectively.

Responsible investments

The ESG labelled bond market has been relatively quiet in the last few weeks.

Year-to-date issuance is around $630bn, according to Bloomberg, and around 5.4% up on the same period last year. One bond issuance of note was a mega green bond deal from a Middle Eastern renewable energy company called Masdar: a $1bn issue came to market last week, the second from Masdar after a $750m deal last year. According to its Chief Financial Officer, more is to come and potentially at a larger size given the plans to target 100 gigawatts of clean energy projects by 2030.

Fixed Income Asset Allocation Views

22nd 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 have widened a bit but still remain at tight, unattractive levels. Economic data has weakened but hasn't yet translated into any significant spread widening. Current valuations limit the spread compression upside and are misaligned with potential market volatility. ■ **The group remains negative on credit risk overall, with an upgrade to Agency MBS to +2.** ■ 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 have remained stable this month, following the improvement in distressed credit and stability in GCC despite geopolitical risk amid changes after the 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 remained stable but 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. ■ 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: There is ongoing pressure, particularly on AAA securities. 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 corn ■ o/w lead ■ o/w silver ■ o/w soybean meal	■ Global Recession

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