In Credit

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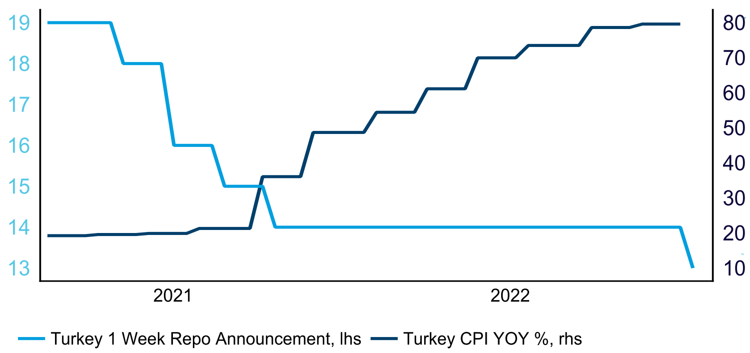
Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	2.99%	16 bps	-0.4%	-9.6%
German Bund 10 year	1.29%	31 bps	1.4%	-10.0%
UK Gilt 10 year	2.51%	40 bps	-1.6%	-16.1%
Japan 10 year	0.22%	3 bps	1.4%	-1.9%
Global Investment Grade	155 bps	2 bps	1.4%	-11.8%
Euro Investment Grade	184 bps	7 bps	2.4%	-10.0%
US Investment Grade	142 bps	1 bps	1.3%	-12.8%
UK Investment Grade	156 bps	4 bps	-0.3%	-12.7%
Asia Investment Grade	256 bps	-12 bps	-0.4%	-8.6%
Euro High Yield	541 bps	2 bps	5.9%	-10.1%
US High Yield	445 bps	20 bps	6.3%	-8.6%
Asia High Yield	933 bps	-23 bps	-1.3%	-20.2%
EM Sovereign	415 bps	11 bps	3.5%	-16.0%
EM Local	6.8%	17 bps	0.3%	-14.2%
EM Corporate	381 bps	-5 bps	1.9%	-12.3%
Bloomberg Barclays US Munis	3.1%	27 bps	1.2%	-7.9%
Taxable Munis	4.4%	8 bps	-0.2%	-16.3%
Bloomberg Barclays US MBS	33 bps	5 bps	1.2%	-7.7%
Bloomberg Commodity Index	263.84	-0.7%	4.8%	24.2%
EUR	1.0004	-2.2%	-4.3%	-11.7%
JPY	137.20	-2.6%	-0.9%	-16.0%
GBP	1.1815	-2.5%	-2.9%	-12.6%

Source: Bloomberg, Merrill Lynch, as of 19 August 2022.

Chart of the week: Turkish inflation & interest rates – LTM



Source: Macrobond, Columbia Threadneedle Investments, as of 12 August 2022.

Macro / government bonds

It was a very weak seven days in core government bond markets. Yields were higher across the board but particulary so in the UK, after a terrible inflation report, and Europe ahead of a looming energy crisis.

In the UK, there was another very "ugly" print for consumer price inflation. Consumer price index (CPI) inflation rose to 10.1% year-on-year in July (it was 9.4% last month and ahead of expectations of a 9.8% rise). Core CPI inflation rose to 6.2% from 5.8%, also above the expected 5.9% y/y rate. The Bank of England expects CPI to peak at 13.3% y/y in October. It was a similar inflation story in Europe where the HICP measure rose by 0.3% to a record 8.9% y/y. Core prices also rose to 4% from 3.7% y/y.

In the US there was more weakness evident in the housing market with a decline into contractionary territory for the NAHB survey and a decline in housing starts. 30-year mortgage rates are around 2% higher this year. Tightening US financial conditions were also evident in a renewed rally in the US dollar, which at the time of writing was trading at around parity.

The week brings flash PMI date from around the globe, where markets will be looking for more evidence of improvement as supply chain issues resolve themselves. There will also be PCE data from the US which will reveal if there is resilience in the consumer in the face of higher interest rates and slower economic growth. In Europe we expect to record another all-time low for consumer sentiment. Lastly, central bankers will be convening in Jackson Hole for their annual symposium. Speakers include US Federal Reserve chief, Jay Powell, and ECB executive board member Isabel Schnabel.

Investment grade credit

Global Investment Grade spreads widened last week in the first period of weakness in around a month-and-a-half. Weakness was more pronounced in derivative (CDS) markets and in Euro credit where spreads were around 7bps wider (USD only 1 bps wider).

New issuance exceeded expectations, especially so in the euro market where there was over €20 billion of primary activity. There was a similar amount of issuance in the USD market but clearly as a percent of market size this amount is more meaningful in Europe and hence caused a degree of indigestion. We are nearly through results season wherein revenues have risen, and earnings have been higher by around 2% in Europe and 8% in the USA.

Credit markets are caught in a tug of war between worsening inflation data and resulting expected tighter policy conditions on the one hand, and robust corporate earnings on the other.

High yield credit & leveraged loans

US high yield bond prices consolidated the prior six weeks' gains this week despite continued inflows. The ICE BofA US HY CP Constrained Index returned -1.22% and spreads were 21bps wider.[1]

According to Lipper, retail high yield funds posted their third billion-dollar plus inflow, $1.46 billion, in four weeks, totaling an aggregate $9.3 billion. Notably, $5.2 billion of bonds priced this week, which is the most active week since early June as capital markets tentatively reopen

[1]ICE BofA Indices.

following a sharp decline in yields and a decade-light stretch. Meanwhile, the average price of the JP Morgan Leveraged Loan Index ended the week at $95.24 – $0.13 below Tuesday's three-month high. The asset class reported its first retail fund inflow in 10 weeks totaling $123 million.

European high yield returned a negative performance last week, after six weeks of positive performance, dropping -0.91% with spreads wider by only a couple of basis points but yields higher by almost 30bps due to the sharp rise in underlying government bond yields on heightened inflation concerns. CCCs strongly outperformed BBs and Bs with the higher rated credits loosing 1% each. Markets experienced a second week of positive flows with €124 million coming in via both ETFs and managed accounts, in almost equal amounts. Market trading was quite mixed this week with little direction as the summer lull set in.

There were signs of market slowdowns as major chip manufacturers warned of weaker export orders. Demand for chips have been dropping over the past few months. This was followed by news of a fall in used car sales as the Mannheim Used Vehicle Index fell 4% versus July, in a mid-month update. Still, the leisure sector continues to look strong with Center Parcs posting sales up 42% y/y and solid liquidity. Expectations were maintained for a strong outlook. Labour inflation remains a headline issue as BA followed Lufthansa in announcing double-digit pay increases (+13%).

In issuer specific news, EDF announced it will soon introduce its new green financing framework aligned to EU taxonomy.

Following last week's story on private equity's move to grow direct lending to non-investment grade rated companies, the story this week is that major banks are retaliating by creating units to lend directly to HY corporates. This is as the banks, at the same time, pull back from underwriting deals – a business which is proving to be unprofitable given the rise in rates this year.

Asian credit

The Indonesia government may impose a tax on the exports of nickel pig iron (NPI) and ferronickel in 2022. This regulatory development, in addition to the ongoing restriction on the export of nickel ore, is aimed towards boosting investments in the downstream processing and value-added manufacturing of nickel-related products.

Melco Resorts and its subsidiary, Studio City, reported weak Q2 performance due to the Covid outbreak and travel restrictions. Melco Resorts reported negative consolidated 2Q EBITDA of $13.8 billion while Studio City posted negative EBITDA of $40.2 billion. On another hand, Melco's gaming operations outside of Macau are doing well. Its operations in the Philippines and Cyprus are improving with volume recovering towards pre-Covid levels.

Country Garden issued a profit warning that its 1H net profit could drop to CNY4.5-5 billion, down around 70% y/y. This is a negative read-across to other property peers given the drop in property sales and slowdown in property construction. Country Garden is reportedly looking to sell onshore bonds with a state-backed guarantee from China Bond Insurance Co. Longfor is also reportedly looking to issue a state-backed bond too. Azure Power has not provided much clarity on when the company will issue its audited F-20 for FYE March 2022. To avoid delisting it has six more months to fix this problem.

For illustrative purposes only. The mention of any specific shares or bonds should not be taken as a recommendation to deal. Past performance does not predict future returns.

Emerging markets

The combination of the treasury sell-off as well as spread widening in the high yield sub-sector resulted in a negative return of -1.63%, as measured by the JP Morgan EMBI Global index. African names, which had performed well recently, contributed most to the downturn. Spreads ended the week at 414bps above treasuries.

In China, the five-year and one-year prime loan rates, which are key lending reference rates, were lowered by 15bps and 5bps respectively. The cuts follow the news of "special loans" to restart stalled housing projects.

Elsewhere, Pakistan secured $4 billion in funding from Qatar, Saudi Arabia and UAE which was required to resume its IMF programme. However, there is concern the government will struggle to maintain the IMF-mandated austerity programmes.

In Egypt, Central Bank governor Tarek Amer resigned. His resignation is expected to accelerate IMF negotiations, despite the country already being one of the IMF's biggest borrowers. Meanwhile the credibility of the Turkish central bank was once again questioned as it surprised markets with a 100bps rate cut to 13%, despite inflation pushing 80% (**see Chart of the week)**.

Ratings agencies Fitch and S&P lifted their rating restrictions on Ukraine following last week's debt exchange[2]. The country's rating had been placed on "restricted default" but is now CCC+/CC after investors agreed to defer coupon payments until 2024. Oman was upgraded one notch to BB following a significant improvement in the country's fiscal metrics. It is now expected to post its first budget surplus since 2013. .

Mortgage-backed sercurities

With a back-up in rates, agency mortgage spreads unsurprisingly widened out over the week to the tune of about 20bps. As the calendar inches forward to September, the US Federal Reserve gets closer to doubling its planned run-off of agency MBS from $17.5 billion up to $35 billion. The potential for the Fed to outright sell agency MBS starting in the fall, combined with some large banks announcing plans to shrink their mortgage units, has reintroduced some uncertainty back to the MBS markets. On the credit side, non-agency residential MBS spreads continued tightening across most subsectors in both primary and secondary markets. Even with the recent tightening we've witnessed, certain sub-sectors still are offering historically attractive spread levels. The commercial mortgage-backed securities space has been relatively quiet with just one new private label deal pricing last week. Secondary trading was slightly stronger with the Single Asset Single Borrower (SASB) market trading a few bps tighter.

Commodities

The BCOM index was flat on the week with the recovery in energy markets being offset by losses in agriculture and metals. Commodities faced a headwind from the dollar which rallied as market expectations of a dovish federal reserve tilt were quashed, following the release of the Federal Open Market Committee (FOMC) minutes.

Agricultural markets were lower due to the Russia/Ukraine export deal, with 27 ships making the journey to the Mediterranean Sea successfully. Wheat was down 6.3% on the week.

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[2] Columbia Threadneedle, Standstill on Ukraine debt is right for both the country and our clients, 19 August 2022

Base metals were lower on the week with zinc down 2.6% despite surging 6% mid-week on the news that Nyrstar, one of Europe's largest smelters, was halting production due to rising energy costs. In a similar vein, Norwegian aluminium smelter Norsk Hydro announced it would shutter a smelter for the same reason. Despite lower expected supply, the market focussed on the lower demand implications, resulting in all base metals being down on the week.

Responsible investments

An unpopular type of environmental, social, and governance (ESG) bond could become the preferred way to fund environmentally focused projects, as well as help prevent greenwashing. This particular issuance combines a green bond with a sustainability linked bond (SLB) to provide a hybrid bond called a Green SLB. So far, very few issuers have brought bonds to the market this way, although Austrian electricity provider Verbund AG is an example. The construction of an SLB is to pay a certain level of interest if sustainability KPIs are met, and a higher interest payment if they aren't, by combining this with a green bond. The Institute for Energy Economic and Financial Analysis believe this could make it easier to assess performance of the green and sustainable projects, resulting in clarity on sustainability deliverables and thus avoiding greenwashing.

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Fixed Income Asset Allocation Views

22nd August 2022

COLUMBIA THREADNEEDLE INVESTMENTS

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk	■ (-1) Under-weight -2 -1 0 +1 +2 Over-weight	▪ Credit spreads have tightened 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.** ▪ We are past the peak of economic growth with first few hikes done and expectations for more 50-100bp 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.	▪ 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)	¥ P $ Short -2 -1 0 +1 +2 Long € £	▪ Carry offered by front end yields now attractive in UK ▪ 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	▪ 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 $ € £	▪ 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	▪ 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))	R Under-weight -2 -1 0 +1 +2 Over-weight C	▪ 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	▪ 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)	■ (-1) Under-weight -2 -1 0 +1 +2 Over-weight	▪ Strong month for EMD returns with tightening spreads and rallying in oversold names; still seeing bifurcation in market ▪ Fundamental headwinds: elevated fiscal deficits, rising debt to GDP ratios, significant inflation, Chinese lockdown/growth, idiosyncratic political risks, increasing use of IMF programs ▪ Recent commodity price retracement has refocused attention on underlying fiscal health; benefiting commodity importers and harming exporters; fundamental ▪ Techincals (outflows and supply) remain a headwind	▪ 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	■ (-1) Under-weight -2 -1 0 +1 +2 Over-weight	▪ US & EMEA spreads have tightened after hitting YTD wides in July, supported by positive economic data. ▪ Stable fundamentals beat pessimistic expectations for Q2 earnings. Inflation, labor supply and monetary tightening, however, remain headwinds pressuring margins and operating environment in Q3 2022. ▪ Technicals have improved with reopening new issue market, positive fund flows and better liquidity	▪ Remaining Q2 earnings show surprise weakness, materially lower Q3 outlooks ▪ Market indigestion as central banks sell EMEA corporates ▪ Rate environment remains volatile ▪ Russian invasion worsens operating environment globally
High Yield Bonds and Bank Loans	■ (-2) Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads have quickly tightened after hitting YTD wides in May/June. Combined with greater downside risks, the group prefers conservative positioning while remaining open to attractive buying opportunities ▪ Technicals remains a headwinds with light primary issuance, however fund flows are shifting positive and default activity remains benign/idiosyncratic ▪ Bank loan market has moved higher with more new issues and non-traditional loan investors; concerns about recession and interest cost remain headwinds	▪ Default concerns are focused on demand destruction, margin pressure and macro risks ▪ Loan technicals & flows weaken ▪ Russian invasion & spillover rattles US bond loan/market as already seen in EMEA ▪ Commodity prices continue to retrace
Agency MBS	■ (0) Under-weight -2 -1 0 +1 +2 Over-weight	▪ Mortgages recently outperformed as volatility dropped and spreads tightened. ▪ Prefer higher coupon because of more attractive valuations, carry, priority in Fed sales and sponsorship ▪ Mortgage spreads have stabilized in past month at historically wide levels, supply continues to drop along with purchase activity and cash out refinancing	▪ Housing activity slows and rising rates move prepays to normal levels without hurting mortgage servicing rates. ▪ Uncertainty with the Fed hiking and future balance sheet position ▪ Less bank holdings of MBS as deposit growth slows
Structured Credit Non-Agency MBS & CMBS	■ (0) Under-weight -2 -1 0 +1 +2 Over-weight	▪ Our preference remains for Non-Agency RMBS ▪ RMBS: Spread slightly better with stable fundamental performance , but expect normalization coming from heavy supply, extension concerns and general risk off. Prefer to move up in quality and seasoning ▪ CMBS: Mostly solid fundamentals but weakening. Spreads flat MoM. Better relval in other sectors, continue to trim. ▪ CLOs: Spreads tighter MoM but lagging competing products. AAA spreads over 200 are attractive from long-term perspective. ▪ ABS: US consumers are stable but with areas of weakness-trimming exposure to inflation-sensitive borrowers	▪ 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	■ (+1) Under-weight -2 -1 0 +1 +2 Over-weight	▪ o/w Copper & Lead vs Zinc ▪ o/w Softs ▪ o/w Grains ▪ u/w Gold ▪ o/w Oil ▪ u/w Silver	▪ Global Recession

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Source for all data and information is Bloomberg as at 04.07.2022, unless otherwise stated.