In Credit

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Investment Grade Credit

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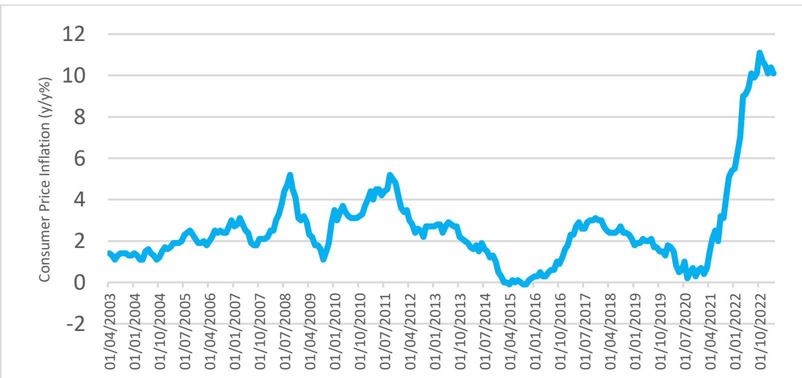
Inflationary in the UK.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	3.45%	-7 bps	-0.4%	2.7%
German Bund 10 year	2.43%	-1 bps	-1.1%	0.3%
UK Gilt 10 year	3.72%	6 bps	-2.1%	0.1%
Japan 10 year	0.48%	0 bps	-0.6%	1.7%
Global Investment Grade	144 bps	-3 bps	0.0%	2.9%
Euro Investment Grade	155 bps	-4 bps	0.0%	1.6%
US Investment Grade	138 bps	-1 bps	0.0%	3.4%
UK Investment Grade	146 bps	-6 bps	-0.4%	2.0%
Asia Investment Grade	222 bps	2 bps	0.9%	3.2%
Euro High Yield	476 bps	1 bps	0.3%	3.2%
US High Yield	448 bps	5 bps	0.4%	4.2%
Asia High Yield	762 bps	40 bps	-0.6%	2.3%
EM Sovereign	409 bps	17 bps	-0.4%	1.8%
EM Local	6.6%	0 bps	0.3%	5.5%
EM Corporate	372 bps	7 bps	0.6%	2.9%
Bloomberg Barclays US Munis	3.4%	28 bps	-0.3%	2.4%
Taxable Munis	4.8%	-1 bps	0.0%	5.4%
Bloomberg Barclays US MBS	61 bps	-4 bps	-0.2%	2.3%
Bloomberg Commodity Index	234.35	-2.0%	0.4%	-5.0%
EUR	1.1032	-0.1%	1.4%	2.6%
JPY	134.15	-0.3%	-1.0%	-2.3%
GBP	1.2464	0.2%	0.8%	2.9%

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

Chart of the week: UK Consumer Price Inflation (y/y %), 2003-23



Source: Bloomberg, Columbia Threadneedle Investments, as of 24 April 2023.

Macro / government bonds

After the sharp decline seen in government bond yields from mid-March to early April, it has been a more difficult period more recently for these markets. In part, that is because there has been a sharp recovery in 'risk-market' sentiment and performance and a lack of contagion post Credit Suisse and SVB and, in part, because policy conditions remain on a tightening trend.

There was a raft of 'disappointing' inflation news in the UK last week. Consumer Price Inflation (CPI) data showed a fall in inflation – but not as great a fall as expected – nor as much as has been the case in Europe or the US. UK CPI at a headline level remained in double digit territory as expected over the last twelve months and is growing at 6.2% y/y. The other 'bad' news for policy makers was a stronger employment report than expected that included a 5.9% y/y increase in wages (including bonuses). The unemployment rate remains low and indicative of tight labour market conditions (3.9%). The net effect of this data has been for forecasters to expect another 0.25% increase in interest rates at the Bank of England's next policy meeting and an increased likelihood of a further increase to 4.75% in June. Rates were as low as 0.1% in late 2021 for context. Economists suggest inflation will fall by a sharp degree for 'base effects' in coming months, which should enable policy holders to pause the pace or extent of rate rises.

This week brings Q1 GDP data from both the US and eurozone. This will be accompanied by PCE and Employment Cost data in the US and inflation data in Europe.

Investment grade credit

Positive sentiment has returned to credit markets.

After the sharp spike higher in spreads in mid-March, there has been a tightening in spreads. For context, global investment grade spreads were as tight as 127bps in February then widened to 170bps and are now at 144bps. This recovery has been led by banks and by COCOs/AT1s. The COCO index spread had moved wider from 259bps to 659bps before tightening to around 495bps by the end of last week.

This week brings a heavy load of corporate results including Big Tech in the US (eg, Microsoft, Alphabet and Meta) as well as the start of bank reporting in Europe including Credit Suisse, UBS and Santander.

High yield credit & leveraged loans

US high yield bond prices were slightly lower over the week as investors absorbed a mixed slate of economic data and corporate earnings. The ICE BofA US HY CP Constrained Index returned -0.29% and spreads were 4bps wider. According to Lipper, retail fund inflows totalled $3.1bn, the third weekly inflow over the last four weeks. Meanwhile, the average price of the J.P. Morgan Leveraged Loan index was $0.03 higher amidst low supply and modest CLO origination. Retail loan funds experienced $461m in outflows.

The primary market was the focus last week for European high yield. With five new issues (€3+bn equivalent), it was the week of the largest offerings seen start of the year with a focus on refinancings. Given the number and size of the new issues, market performance was muted though with still some decompression as CCCs underperformed higher-rated credits. There with a modest negative performance (-0.11%) as the credit spread tightened only 1bps to 474 but yields rose 5bps given the rise in underlying government bond yields. Sterling high yield had another week of underperformance vs European high yield. Real money experienced some outflows but not enough to offset the strong demand seen for ETFs resulting in net inflows for the asset class. The pressure point for sales continued to be in more duration sensitive credits.

In credit rating news, S&P upgraded Lufthansa to BB+ and downgraded some of Adler Group bonds to negative. In the case of the latter, the rating agency said it viewed the changes due to the restructuring plan as "tantamount to default". However, the SD rating were for some Adler bonds but not all as certain Adler bonds escaped the default rating as they will have funds put into escrow to fund those bond repayments.

In M&A news, United Group confirmed the tower sales to Saudi Telecom for €1.22bn with proceeds to be used toward deleveraging. In the same vein, it was announced that Virgin Media has started the process to sell part of its stake in Cornerstone, the mobile towers business. At Casino, more support is on the horizon as the firm announced it has received a proposal from billionaire Daniel Kretisnky (who currently owns 10%) to provide a capital increase of €1.1bn. This would likely constitute a change of control for the firm.

On the IPO front, Lottomatica announced an initial price talk of €9-11 / share with proceeds to be used to pay down debt.

Relative to the start of 2023 when European high yield spreads still looked cheap versus US dollar, given the spread tightening to early March followed by the subsequent widening of spreads of the two markets, Euro HY no longer looks cheap vs US dollar high yield.

Asian credit

TSMC expects to see further inventory adjustment by customers through Q2, which could extend into Q3, longer than initially guided. That said, management believes Q2 is the bottom and it expects some gradual improvement in H2, 23 for semiconductor demand (excluding memory chips). For FY23, management expects revenues to decline by low-to mid-single digit while gross margins will be impacted by lower capacity utilization, the ramp-up of overseas operations (N3 fabrication facility) and higher utility costs.

Adani Ports & SEZ (ADSEZ) has announced a tender offer of up to $130m for its '24s (amount outstanding: $650m) to reduce its near-term maturities and to demonstrate its comfortable liquidity position.

For the Macau gaming sector, based on the preliminary estimate from the Tourism Office, the Q1, 23 visitation volume to Macau has recovered to around five million or around 48% of the Q1, 19 level. The market-wide mass gaming revenue reached 67% of the Q1,19 level.

According to Las Vegas Sands (LVS) during its Q1 results update, Macau was impacted by labour constraints. The quotas for hiring non-residents and the willingness of ex-employees to return are limited. The major source of the non-resident work force is Mainland China, followed by Southeast Asian countries. During Q1,23, a daily average of around 3,800 rooms (or 31% of Sands China Ltd.'s rooms) was unavailable due to labour constraints. Only 69% of SCL's rooms were available.

Emerging markets

Emerging market hard currency sovereigns posted a negative return of -0.96% over the week, while spreads widened 12bps to 404bps. The decompression theme continues with high yield underperforming investment grade.

We had some supply last week from India's Renew Energy who issued a green bond and Mexico was also active in the primary market.

Bolivia was unsurprisingly downgraded one notch to B- by S&P as the country's FX reserves are very close to running out and bond prices have fallen considerably.

Central Bank meetings on the agenda this week include Turkey, Russia and Hungary where policy makers are expected to hold rates across the board

As Turkish presidential elections draw closer, President Erdogan has promised households a free one-year supply of natural gas in a bid to attract voters. While investors will be hoping the opposition wins, polls are looking tighter.

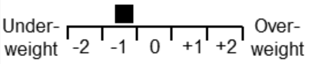
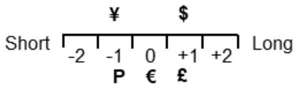
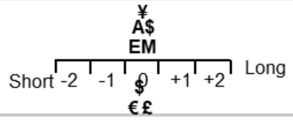
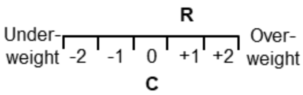
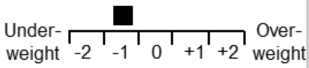
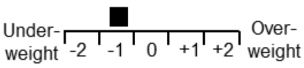
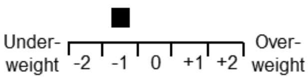
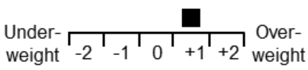
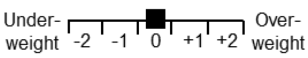
Responsible investments

It's been a strong start to Q2 for ESG labelled bond issuance. Although Q1 was a little shy of the same period last year, April is proving to take it up a gear with issuance currently just over $72bn, and we still have a week left of the month. The US is struggling somewhat to keep up the pace, as Republican political influence is having an impact on companies being encouraged to issue ESG related bonds. Florida's Governor, Ron DeSantis (a likely candidate for 2024), has recently said he's leading an alliance of 19 states intent on banning ESG investing outright.

The European Commission released some new, and rather late, guidance on the Article 9 classification under SFDR last week. Clarification has been made around funds that have an objective to reduce carbon emissions. According to Bloomberg, almost €175bn in funds classified as Article 9 were 'bumped down' to Article 8 (the lesser ESG rating) last year, with a skew towards passive funds. Now, funds that track Paris-aligned and climate-transition benchmarks could be promoted once again to Article 9 based on the new guidance, which is estimated to be half of the €175bn.

Fixed Income Asset Allocation Views

24th April 2023

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk		▪ Valuations remain cheap relative to Feb, but spreads have tightened in since March's banking-driven spike. Technicals and fundamentals are still worse than Feb. **The group remained negative on credit risk.** ▪ The Fed Funds market is pricing in a peak of 5.1% and rates being cut to 4.7% in 2023. This market has been volatile, with first cut now priced for July. ▪ The CTI Global Rates base case view is no cuts in 2023, with a best case of potentially one cut. They expect rates to peak between 5-5.25% in first half, with Fed holding steady in 2H 2023. Focus remains on wages. Financial conditions, and inflation expectations. ▪ Uncertainty remains elevated due to fears surrounding banking crisis spill over, monetary policy schedules, recession probabilities, persisting inflation, weakening consumer profile and ongoing geopolitical tension.	▪ Upside risks: the Fed achieves a soft landing with no labour softening, banking crisis eases with no lasting changes to fundamentals, strong China reopening, Europe sees commodity pressure easing, consumer retains strength, end of Russian Invasion of Ukraine ▪ Downside risks: simultaneous low unemployment, high inflation, hiking, and slowing growth cause a recession. Russian invasion spills into broader global/China turmoil. New Covid variant. Supply chain disruptions, inflation, volatility, commodity shocks persist re-emerge.
Duration (10-year) ('P' = Periphery)		▪ 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 to be curtailed by the impact of tighter credit conditions post SVB	▪ 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)		▪ 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	▪ 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))		▪ 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	▪ Severe US recession and/or financial crisis drives stronger US dollar and portfolio outflows 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)		▪ EMD spreads tightened since mid-March. Technicals weaker ▪ Moving into select relval opportunities while maintaining conservative positioning ▪ Tailwinds: China reopening optimism , central bank easing in countries with receding inflation. ▪ Headwinds: higher debt to GDP ratios, wider fiscal deficits, increasing use of IMF programs, geopolitical risks	▪ China/US relations deteriorate ▪ Issuance slows ▪ Chinese reopening paused ▪ Continued spill over 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		▪ US & EMEA spreads have widened from mid-March; fundamentals and technical are similarly weak as in March. EMEA valuations are cheap, GBP fair to USD ▪ Fundamentals had a strong starting point in 2023, however the banking crisis and growth/recession concerns are top-of-mind going into earnings ▪ Inflation, labor supply, sector dispersion and monetary tightening continue to pressure margins and operating environment. The group is looking to earnings commentary and 2023 outlooks for more clarity	▪ Additional bank failures with too little governmental intervention ▪ Volatility remains high and 2023 surplus below expectations. ▪ Market indigestion as central banks sell EMEA corporates ▪ Rate environment remains volatile ▪ Geopolitical conflicts worsen operating environment globally
High Yield Bonds and Bank Loans		▪ Spreads have tightened since mid – March's banking crisis, with fundatmentals and technical unchanged. Prefer conservative position while open to attractive buying opportunities, especially in short HY. ▪ CTI's US HY default forecast increased to 2.1% for 12m and 4.7%24m fwd. Drivers: global banking stress, recession probabilities, margin pressure, demand deterioration, and idiosyncratic sector risk ▪ Bank loan market has tightened in along with other credit sectors. Themes: retail fund outflow, limited issuance, credit concerns for lower quality segment	▪ Additional bank failures with too little governmental intervention. ▪ Default concerns are revised higher on greater demand destruction, margin pressure and macro risks ▪ Rally in distressed credits, leads to relative underperformance
Agency MBS		▪ Mortgage index has widened sinvce March. Since Feb, the group has modestly reduced exposure due to outperformance. Low net supply, but expected to pick up ▪ Performance remains stable. SVB/Signature liquidations expected to be orderly and spread over the next 12- 15 months. ▪ Place to add, prefer high quality and higher coupon assets; constructive view over longer time horizon	▪ Housing activity slows and rising rates move prepays to normal levels without hurting mortgage servicing rates ▪ Fed continues to shrink position even as hiking is paused in recessionary scenario
Structured Credit Non-Agency MBS & CMBS		▪ Our preference remains for quality Non-Agency RMBS ▪ RMBS: Home prices remain resilient despite headwinds. Delinquency, prepayment, and foreclosure performance remains strong; need labour market weakness to see housing deterioration. Risk premiums still cheap to LT avg. ▪ CMBS: Mostly solid fundamentals but weakening. Credit curve is very steep; non – office sectors remain stable.. ▪ CLOs: Spreads tighter since March. Downgrades outpacing upgrades. More tail risks for subordinate bonds ▪ ABS: Attractive relval in some senior positions; higher quality borrowers remain stable	▪ 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 ▪ WFH continues in 2023 (positive for RMBS, negative for CMBS). ▪ Rising interest rates dent housing market strength and turn home prices negative in 2023
Commodities		▪ o/w Copper, o/w Grains, u/w Gold, o/w Oil, u/w Silver, o/w Wheat, u/w Corn	▪ Global Recession