INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

Your success. Our priority.

In Credit

6 JUNE 2022

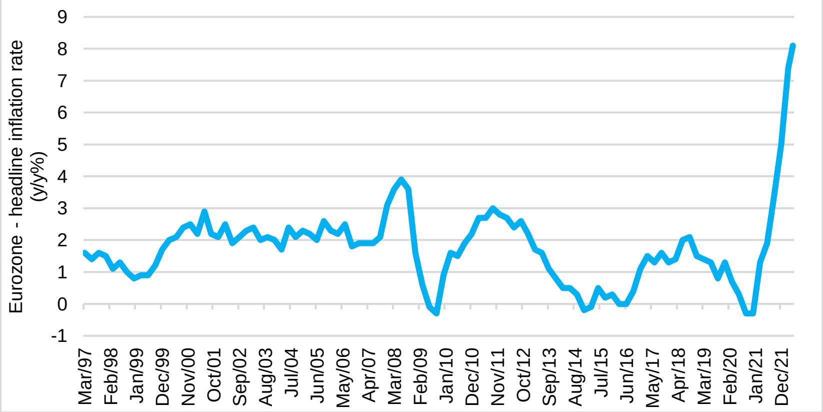
An inflated Europe

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	2.96%	22 bps	-3.7%	-9.1%
German Bund 10 year	1.29%	33 bps	-5.8%	-10.6%
UK Gilt 10 year	2.22%	30 bps	-6.1%	-13.1%
Japan 10 year	0.25%	1 bps	-0.4%	-2.0%
Global Investment Grade	144 bps	-4 bps	-4.6%	-11.2%
Euro Investment Grade	158 bps	-6 bps	-4.6%	-9.6%
US Investment Grade	138 bps	-3 bps	-5.0%	-12.3%
UK Investment Grade	138 bps	-2 bps	-4.2%	-10.1%
Asia Investment Grade	221 bps	-10 bps	-2.0%	-7.2%
Euro High Yield	478 bps	-28 bps	-4.2%	-8.7%
US High Yield	421 bps	2 bps	-3.8%	-8.1%
Asia High Yield	760 bps	-81 bps	-3.5%	-13.9%
EM Sovereign	383 bps	-7 bps	-5.7%	-14.4%
EM Local	6.8%	2 bps	-4.2%	-10.4%
EM Corporate	345 bps	-20 bps	-2.7%	-11.3%
Bloomberg Barclays US Munis	2.9%	-5 bps	-1.1%	-7.3%
Taxable Munis	4.2%	13 bps	-6.9%	-15.8%
Bloomberg Barclays US MBS	33 bps	-1 bps	-2.8%	-7.6%
Bloomberg Commodity Index	290.49	0.0%	7.7%	35.3%
EUR	1.0746	-0.1%	-3.1%	-5.7%
JPY	130.74	-2.8%	-7.0%	-12.0%
GBP	1.2570	-1.1%	-4.9%	-7.7%

Source: Bloomberg, Merrill Lynch, as at 6 June 2022.

Chart of the week: Eurozone inflation (CPI), 1996-2022



Source: Bloomberg, Columbia Threadneedle Investments, as at 6 June 2022

David Oliphant
Executive Director,
Fixed Income

Contributors

David Oliphant
Macro / Government bonds, Investment Grade Credit

Angelina Chueh
Euro High Yield Credit

Chris Jorel
US High Yield Credit, US Leveraged Loans

Katherine Nuss
US Investment Grade Credit

Kris Moreton
Structured Credit

Justin Ong
Asian Fixed Income

Doug Rangel
Municipals

Charlotte Edwards
Responsible Investments

Jake Lunness
Commodities
Emerging Markets

Macro / government bonds

After a couple of weeks of calm, government bonds resumed their downward spiral taking yields higher through the week and by around 20bps for the US 10-year government note. Again, it was fears of inflation (this time in the eurozone) that upset sentiment and prompted speculation of a swifter and larger monetary policy response.

Specifically, eurozone inflation came in at 8.1% y/y. This was a record **(see chart of the week).** The annual increase rose from 7.4% y/y in April and was well ahead of expectations. Energy inflation is running at nearly 40% y/y, while food, alcohol and tobacco increased by 7.5% y/y. This data provides monetary hawks in the ECB with plenty of reason to go for a 50bps increase in rates in July. However, it is not all plain sailing. German retail sales sank by 5.4% m/m in April with food sales especially weak. German government bond yields have risen by over 140bps this year and while inflation expectations have risen by around 60bps, it is real yields (driven by expectations of policy change) that have caused the greater damage.

Fears of the unwind of ultra-loose monetary policy in Europe have also dented confidence in non-German markets pushing spreads wider through the year. This has been more acutely evidenced in Spain and Italy where government spreads are over 50% wider than at the end of 2021.

In the US, the monthly employment report revealed a slowdown in payroll growth from last month and a moderation in wage gains. Specifically, May payrolls increased by 390k which was higher than expected (319k) though the net revision was -22k. The unemployment rate remained at 3.6% while average earnings increased by 0.3% m/m as was the case in April.

This week brings an ECB meeting where the market will be looking for clues as to whether the central bank will increase rates by 50bps in July. The market is priced for five hikes this year or around 125bps. In the US, we have CPI data which is expected to be around 8.3% y/y. In the UK we have a no-confidence vote in Prime Minister Boris Johnson.

Investment grade credit

Investment grade spreads tightened into the month-end and first few days of June but were wider in the month of May, nonetheless. In the last week, euro credit has modestly outperformed. Issuance was also a little lighter in May and the lowest volume May since 2012 in the US dollar market. ESG issuance remains healthy, however, and significantly higher than last year.

In specific news in both the widening and tightening, the real estate sector has underperformed as concern about property valuations and issuance weigh on this sector. Defensive sectors such as utilities and telecoms have outperformed this year, as has the energy sector given the strong rally in energy prices.

Finally, with credit curves having flattened the valuation of shorter-dated bonds looks appealing relative to longer-dated bonds. In the US dollar market, for example, 1–5-year debt has widened by twice the percentage of longer-dated (10-15 year) bonds.

High yield credit & leveraged loans

The historic tightening in US high yield bond spreads over the past six sessions stalled by week's end as a stronger than expected payroll report reinvigorated US Fed concerns. The ICE BofA US HY CP Constrained Index returned -0.39% and spreads were unchanged. According to Lipper, the asset class reported its largest weekly inflow since June 2020 totalling +$4.8bn. New issue activity also resurfaced over the week following May's $4.0bn of primary issuance, which was the third lightest month of issuance in the post-GFC era. In US leveraged loans, the average price of the J.P. Morgan Leveraged Loan Index increased $1.05 over the week to $95.13 as dip buyers waded in following the $3 price decline in May. Loan retail fund flows stabilized this week following three consecutive weekly outflows, albeit with a modest $33m inflow.

European High Yield continued to recover as spreads tightened in 12bps last week with single Bs outperforming BBs and CCCs. Yields were close to unchanged, having drifted higher only a couple of basis points on the back of underlying government yields also drifting higher. Fund flows returned to a positive print, led by ETFs as managed accounts still were experiencing outflows, albeit at a much slower pace than before. Given the shortened week with the UK out for the Platinum Jubilee, the primary market was closed last week.

It looks like part of the reason for the low new issuance is because banks are bypassing the primary market through private placement. Last year's LBO by Morrison's owners (CD&R) takeover financing, which they delayed, was finally partly raised (c £1.54bn), at an undisclosed price, via private placement.

In company specific news, Sani, the high-end luxury resorts firm) announced that its 2022 business is already 84% booked. Demand has been so strong that Russian bookings that were cancelled were easily replaced.

In M&A news, Vivendi, the second largest investor of Telecom Italia (owns 24%), announced it will not back the sale of the telecom's fixed network, valued between €17-€21bn, citing undervaluation.

In credit rating news, LKQ, an auto parts manufacturer, was upgraded to Baa3 by Moody's. This follow's S&P's April upgrade to BBB- and takes LKQ fully to investment grade across the rating agencies.

Structured credit

The US Agency MBS market struggled last week on higher rates coupled with a risk-on rally. While OAS tightened marginally the sector was down 84bps as rates sold off. A confluence of factors are mostly priced in at this point: the Fed's planned Agency MBS roll-off which launches this month, lower supply on higher rates and slower prepays and a liquidity risk premium on the part of investors. Perhaps the most noteworthy sector news is that the refinanceable universe of mortgaged households now stands at 1% vs nearly 100% two years ago with an average available 30-year mortgage rate of 5.5%. Equally incredible is a new high in-home price appreciation with the Case-Shiller index posting a 20.6% increase last week.

Asian credit

PBOC has required some banks to report on a weekly basis starting from June their exposure to 10 SOE developers, five developers without controlling shareholders (Vanke, Greenland, Greentown, Gemdale and Sino Ocean), as well as 50 private developers. This is to monitor the banks' exposure to the property sector and is part of the central bank's push to meet the reasonable financing needs of housing companies. According to CRIC, contracted sales of China's 100 largest developers fell 59% y/y in May, a decline similar to April. That said, sales in May rose 6% on an m/m basis. Sales of SOEs and stronger POEs recorded lower y/y declines, implying the developer's credit quality has become an important determinant of the sales performance.

Last week, Central China announced that a Henan SOE would be acquiring a 29% stake in the company. This came together with a shareholder loan and convertible bonds issued to the buyer. This should immediately enhance the company's liquidity. Moreover, the entry of an SOE as a significant shareholder should improve the company's access to financing.

Fantasia announced that it has been served with a winding-up petition filed by Flower SPV limited at the Grand Court of the Cayman Island, in connection to $149m loan. Modern Land filed for Chapter 15 Bankruptcy in New York.

Meituan's Q1, 22 revenue was at CNY 46.3b, +25% y/y. The revenue growth surpassed consensus estimates (CNY 45.3bn), but earnings were lower than expected (Adjusted net loss CNY 3.6bn, -7.8% y/y, vs estimate loss CNY 4.6bn). Business performance had been resilient in January and February before a severe impact from Covid-19 in March in many regions. Profitability decreased because of the company's initiatives to mitigate the impact of lockdowns on consumers. Reported EBITDA ameliorated to a loss of CNY 1.84bn, with a margin of -4.0% (Q1/22: CNY -2.38 bn; -6.4%), albeit this was still lower than the street's expectations. The credit profile remains underpinned by the company's dominant market position, with strong growth and sound liquidity. At end-March 2022, it had cash and cash equivalents of CNY 35.4bn and short-term treasury investments of CNY 68bn, totalling CNY 103bn.

Emerging markets

Emerging market spreads were a little tighter over the week, ending at +383bps over treasuries, the overall return for the index was, however, down owing to the rise in US treasury yields.

China has eased some restrictions following its zero-Covid policy. Schools are starting to reopen and public transport has resumed in many places. The Caixin manufacturing PMI rose to 48.1 in May; however, it was lower than market expectations.

El Salvador was downgraded to CCC+ by S&P, meaning it is now rated CCC by all three rating agencies. A lack of any clear plan from the government to address its financing gap continues to cause concern. Pakistan's outlook was lowered to negative by Moody's due to delays in securing a loan from the IMF. The government raised fuel prices over the weekend, part of the conditions to obtain further funding from the multilateral lender. Pakistan's FX reserves fell below $10bn as the current account deficit continues to widen. Ukraine was downgraded from B- to CCC+ by S&P due to increased risk to sovereign debt sustainability as the war continues. It is the second downgrade by the ratings agency since the war began at the end of February.

In central bank news, Ukraine more than doubled its interest rate, moving from 10% to 25%, the first interest rate move since the war began, as the government attempts to protect its currency and slow rising inflation as a result of the invasion.

Primary market activity remains subdued. Mexican oil and gas company Pemex surprised the market when it re-marketed its 2029 maturity bonds. The move raised questions about why Pemex is struggling with cash flow generation against a backdrop of higher oil prices and a pledge of unwavering support from the Mexican government.

Commodities

Even with a shortened week, the commodities index was still up 1.1%, mostly due to energy which was up 5%. Grains were down 2.2%.

In oil news, OPEC+ announced they would increase production by 648,000 barrels/day in July and August. This would bring the output cuts (initiated in 2020) to an end, earlier than originally agreed. However, this may be in word only as the oil producers currently have not been meeting their production targets and appear currently to have limited capacity to increase capacity. At the same time, the Saudis, one of the few who has spare capacity, appears hesitant to use up their spare capacity. This increased production also includes Russia, which is not likely to participate given sanction constraints.

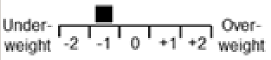
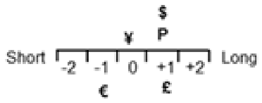
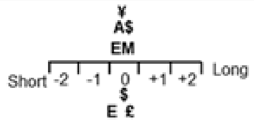
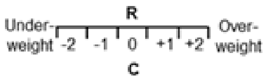
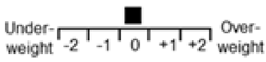
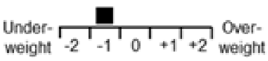
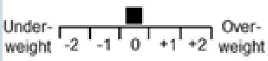
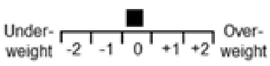
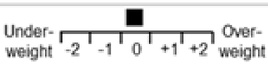
In grains, there is news that Russia and Turkey may have reached a deal to start again agricultural shipments from Ukraine from the port of Odessa. Ukraine is hesitant as there is concern that this could result in the Ukraine port being open to an attack from Russia. Turkey has offered to clear mines off the coast of Odessa.

Responsible investments

Market issuance for Green, social, sustainability and sustainability-linked bonds has continued a steady upward trend through Q2, 2022. The month of May saw total issuance of this kind at $89.1bn, making it the second highest month of issuance in 2022 so far, but we have some way to go to beat last year's levels. Interestingly in Green bond sales, the average issue size has almost doubled since last October, according to Bloomberg. For example, four issuers came to the market with $4bn each in May, accounting for 31% of total issuance in that month. Issuance year-to-date now stands at $422.7bn, with Green bonds still the dominating use of proceeds bonds. However, Moody's ESG solutions has heavily reduced its 2022 ESG issuance forecast to $1trn, down from $1.35trn, on the back of rising inflation, increased monetary policy and Russia's invasion of Ukraine.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views
6th June 2022

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk		▪ Credit spreads have widened from recent volatility- driven tightening, as we are seeing a market-wide softening in technicals fundamentals. This, along with rates-driven credit vulnerability, has moved the group negative on credit risk ▪ We are past the peak of economic growth, with first two hikes announced and expectations for more 50bp 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, and the Russian invasion of Ukraine.	▪ Upside risks: lowered volatility once expansionary environment is established as the new normal ▪ Downside risks: simultaneous low unemployment, high inflation, hiking, and slowing growth cause a recession. More spillover from Russian invasion, sanctions difficult to remove post-conflict. New Covid lockdowns. Supply chain disruptions, inflation, commodity shocks persist to H2 2022
Duration (10-year) ('P' = Periphery)		▪ 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)		▪ 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))		▪ Russia/Ukraine conflict cautions against aggressive positioning ▪ 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)		▪ Spreads have given back most of recent rally, technicals weaker with heavy EM outflows and little HY new issuance ▪ Fundamental headwinds: elevated fiscal deficits, rising debt to GDP ratios, significant inflation, Chinese growth, idiosyncratic political risks, increasing use of IMF programs ▪ Fundamental consequences of invasion are unevenly distributed via trade links and commodity exposure. Good for commodity producers, bad for resource importers ▪ Focus on buying strong relval opportunities as headwinds and volatility increase	▪ Chinese growth derails with softer policy stance after shutdowns ▪ Fundamental consequences of invasion are unevenly distributed via trade links and commodity exposure. Good for commodity producers, bad for resource importers ▪ A replay of 2013 occurs with a taper tantrum or swift appreciation of the USD ▪ Persisting COVID growth scars hurt economies & fiscal deficits ▪ Weaking technical with large fund outflows and slower supply
Investment Grade Credit		▪ US and EMEA spreads have widened since last month. Index last hung out at these yield levels in June 2010. ▪ Despite strength in fundamentals (leverage, debt service capacity, liquidity), we are past peak in credit quality for the cycle. Inflation, monetary tightening and technicals remain headwinds ▪ Liquidity remains very poor, with heightened volatility and wide new issue concessions taking focus away from secondaries.	▪ Supply dynamics remain a headwind ▪ Rate environment remains volatile ▪ Investors return to government bonds from IG as their risk/return preference for safe assets is changing in new rate environment ▪ Russian invasion worsens operating environment globally
High Yield Bonds and Bank Loans		▪ Spreads have widened since last month, still inside of long-term medians. New focus on higher quality & risk management, expect volatility to continue. ▪ In EMEA, spreads at previous recession points. Risks for EMEA HY are heightened because of proximity to and economic impact of Russian invasion. ▪ Primary market slow and weak liquidity in secondary ▪ Bank loan market drifted lower since April highs; overall sentiment more negative over slowing economy and higher interest cost, focus on de-risking ▪ Bonds & loan defaults set to remain near historic lows	▪ Default concerns are focused on demand destruction, margin pressure and macro risks ▪ Loan technical and flows ▪ Waves of ratings upgrade continue into this year. ▪ Russian invasion significantly rattles US bond loan/market as already seen in EMEA from commodities.
Agency MBS		▪ The risk/reward mix in Agencies is at fair value; MBS Basis spreads now look cheap to long-term averages. ▪ Higher Coupon securities are the most attractive in MBS Basis, as lower coupons appear vulnerable due to tight valuations, poor carry and upcoming Fed sales.	▪ Housing activity slows and rising rates move prepays to normal levels without hurting mortgage servicing rates. ▪ Uncertainty with the Fed hiking schedule and long-term position within the Fed balance sheet
Structured Credit Non-Agency MBS & CMBS		▪ Our preference remains for Non-Agency RMBS ▪ RMBS: Housing continues to perform well but expect normalization coming from heavy supply, extension concerns, and general risk off. Selectively reducing risk. ▪ CMBS: Most segments maintain strong fundamentals but widening has shifted relval preferences to other sectors. ▪ CLOs: Spreads have been widening in sympathy with structured product credit; new issue supply slowed by wider spreads ▪ ABS: US consumer looks well positioned, watching performance given inflation & rates.	▪ 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		▪ o/w Copper & Lead vs Zinc ▪ u/w Livestock ▪ u/w Gold ▪ o/w Oil	▪ Global Recession

Important information: For use by Professional and/or Qualified Investors only (not to be used with or passed on to retail clients). Source for all data and information is Bloomberg as at 06.06.2022, unless otherwise stated.

This material in this publication is for information only and does not constitute an offer or solicitation of an order to buy or sell any securities or other financial instruments to anyone in any jurisdiction in which such offer is not authorised, or to provide investment advice or services. Offerings may be made only on the basis of the information disclosed in the relevant offering documents and the terms and conditions under the relevant application forms. Investment involves risk. You are advised to exercise caution in relation to this material. Please refer to the relevant offering documents for details and the risk factors. Past performance is not a guide to future performance. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. The analysis included in this publication has been produced by Columbia Threadneedle Investments for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice and should not be seen as investment advice. Information obtained from external sources is believed to be reliable but its accuracy or completeness cannot be guaranteed. The mention of any specific shares or bonds should not be taken as a recommendation to deal. This document includes forward looking statements, including projections of future economic and financial conditions. None of Columbia Threadneedle Investments, its directors, officers or employees make any representation, warranty, guarantee, or other assurance that any of these forward looking statements will prove to be accurate. This document may not be reproduced in any form or passed on to any third party in whole or in parts without the express written permission of Columbia Threadneedle Investments. This document is not investment, legal, tax, or accounting advice. Investors should consult with their own professional advisors for advice on any investment, legal, tax, or accounting issues relating an investment with Columbia Threadneedle Investments. This document and its contents have not been reviewed by any regulatory authority.

Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act and relies on Class Order 03/1102 in marketing and providing financial services to Australian wholesale clients as defined in Section 761G of the Corporations Act 2001. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws. Issue by Threadneedle Investments Singapore (Pte.) Limited, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore. Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058. Issued by Threadneedle Asset Management Limited (TAML). Registered in England and Wales, Registered No. 573204, Cannon Place, 78 Cannon Street, London EC4N 6AG, United Kingdom. Authorised and regulated in the UK by the Financial Conduct Authority. In Japan: Issued by Columbia Threadneedle Investments Japan Co., Ltd. Financial Instruments Business Operator, The Director-General of Kanto Local Finance Bureau (FIBO) No.3281, and a member of Japan Investment Advisers Association. This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). For Distributors: This document is intended to provide distributors with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Marketing Counterparties and no other Person should act upon it.

Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies. columbiathreadneedle.com