COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

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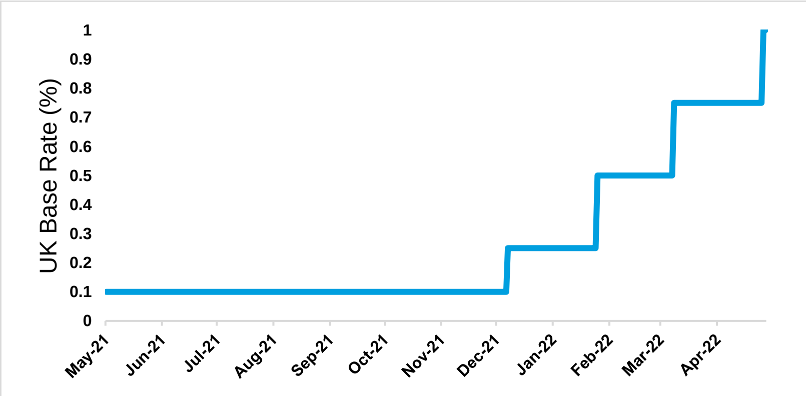
Rates rose and markets fell.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	3.17%	24 bps	-4.6%	-9.9%
German Bund 10 year	1.14%	20 bps	-4.4%	-9.3%
UK Gilt 10 year	2.03%	12 bps	-4.3%	-11.4%
Japan 10 year	0.25%	2 bps	-0.6%	-2.1%
Global Investment Grade	145 bps	3 bps	-5.4%	-11.9%
Euro Investment Grade	157 bps	9 bps	-4.0%	-9.1%
US Investment Grade	140 bps	1 bps	-6.4%	-13.6%
UK Investment Grade	138 bps	6 bps	-3.6%	-9.5%
Asia Investment Grade	211 bps	-1 bps	-2.4%	-7.6%
Euro High Yield	497 bps	33 bps	-4.6%	-4.7%
US High Yield	418 bps	25 bps	-4.9%	-9.2%
Asia High Yield	746 bps	6 bps	-1.3%	-12.0%
EM Sovereign	382 bps	4 bps	-6.9%	-15.5%
EM Local	6.9%	16 bps	-7.1%	-13.1%
EM Corporate	328 bps	2 bps	-2.9%	-11.4%
Bloomberg Barclays US Munis	3.3%	14 bps	-3.5%	-9.5%
Taxable Munis	4.3%	22 bps	-8.6%	-17.4%
Bloomberg Barclays US MBS	40 bps	0 bps	-4.4%	-9.1%
Bloomberg Commodity Index	277.78	0.7%	4.9%	31.6%
EUR	1.0512	0.1%	-4.7%	-7.2%
JPY	131.10	-0.6%	-6.8%	-11.8%
GBP	1.2300	-1.8%	-6.0%	-8.7%

Source: Bloomberg, Merrill Lynch, as at 9 May 2022.

Chart of the week: UK Interest rates continue upwards



Source: Macrobond, Columbia Threadneedle Investments, as at 9 May 2022.

Macro / government bonds

It was a week of rising interest rate changes and a week of declining asset market prices. There was little safety to be found with equity, core bond and credit market prices all lower.

As widely anticipated, and by a unanimous vote, the US Federal Reserve delivered a 0.5% increase in interest rates and announced that the balance sheet run-off would begin in June at a pace of $47.5 billion per month. This run-off will be increased to $60bn of US government bonds and $30bn of mortgage-backed securities over the next three months. The Fed noted that household spending and business investment are robust, job creation is strong, and that inflation remains heightened. It appears that another couple of 50bps increases should be expected but that the Fed is not considering a larger increase in rates (ie, 75bps). The rejection of a sharper tightening cycle benefited shorter-dated bonds, which rallied on the news. It is also likely that inflation, though well above target, is peaking in the US. Futures markets are estimating that US rates will be around 3.25% in a year's time, which would be well into contractionary territory. A neutral rate of interest is often estimated as being between 2-3%. The week ended with a modestly stronger employment report detailing a gain of 481k jobs but an unchanged unemployment rate of 3.6%.

The Bank of England (BoE) also increased interest rates last week, though the decision was not unanimous (three policy makers wanted a 50bps hike). The move higher is the fourth in this cycle of tightening, which began in December last year **(see chart of the week)** and takes UK base rates to 1%; this is the highest level since 2009. Rates are expected (by markets) to peak at around 5% over the next two years. Growth in the UK has been more muted than in the US, while inflation has also been well above target and is anticipated by the BoE to reach 10%. Ironically, despite tightening policy conditions the BoE foresees a modest contraction in the UK economy in 2023. This forecast helped UK gilt yields and sterling to fall after the meeting.

Investment grade credit

Credit spreads continued on a widening trend last week. The global investment grade index spread has now widened from around 120bps to 145bps in the space of a month and by around 45bps this year thus far. Though investment grade spreads are wider, they are still not wide of long-term averages. Meanwhile the average credit quality of the index has worsened, and the duration increased over recent years. Market valuations could best be described as neutral at present.

Credit markets remain concerned about the rising interest rates described earlier and the risk of policy error, which might lead to recession. Meanwhile in the UK, the BoE will start to actively sell the corporate bonds they acquired in recent years. These sales are expected to begin in mid-September and end in late 2023. The BoE owns £20bn of corporate bonds.

High yield credit & leveraged loans

US high yield spreads continued to widen, and lower-quality credits underperformed over the week as investors debate the potential ramifications from elevated inflation and rapidly adjusting Fed policy. The ICE BofA US HY CP Constrained Index returned -1.24% and spreads were 25bps wider. The average yield-to-worst increased around 25bps as well, ending at 7.20%. According to Lipper, retail fund outflows continued with a $1.10bn withdrawal for the week, leaving YTD outflows at $35bn. Meanwhile, the average price of the J.P. Morgan Leveraged Loan Index suffered its largest w/w decline since mid-March, declining $0.50. Loan inflows continued with a

$558m contribution, albeit the lightest weekly inflow since mid-March as well. YTD loan retail fund inflows total $25bn.

It was a challenging week for European High Yield (EHY) with performance down 1.8% accompanied by significant spread widening. EHY yields, based on the market index, rose to 5.9%, an increase of almost 1% in the last two weeks. Outflows from EHY continued (-€84k), again led by ETF sales, with YTD at -€5.9bn. The primary market saw only one deal last week with Biofarma issuing a floating rate note. There is a sense that besides market volatility issues, corporates are still coming to terms with the higher yields as well as higher premiums required by the market, especially given the rising interest rate environment.

In rating news downgrades dominated, for once. Boparan saw Moody's cut its rating to Caa1 from B3 due to the increased challenges to improving its credit metrics given the difficult environment with high inflation, cost increases and squeezed consumer. Standard Profil saw S&P downgrade them to CCC+ stating that slow global auto recovery and sustained RM inflation are expected to continue to pressure on the firm's credit metrics. Adler Group, continued to be in the headlines with S&P downgrading the issuer to 'CCC' on increasing debt refinancing concerns.

In issuer specific news, the Adler Group story continues. The corporate presented findings of the KPMG report, stating that there was not any fraud present but there was evidence of significant corporate governance failings. It was also noted that KMPG may not provide an unqualified audit opinion to the FY accounts. Later the same day, KPMG issued its report, which painted a much more negative view of the company. Crucially, it said that Adler had not provided KPMG with a substantial amount of requested documents so the auditors could neither confirm nor refute many of the allegations posed by Viceroy. The next day, Saturday, 30 April, the last available day before breaching its reporting covenants, Adler published its FY21 accounts, which included the statement by KPMG that they could not provide an opinion, as already described. The auditors further stated that, "the possible effects on the consolidated financial statements could be both material and pervasive." The board of directors (excluding the chairman), including the two co-CEOs, tendered their resignations in response.

Structured credit

It was another tough week for the Agency MBS sector with a total return of -91bps. The abrupt rise in yields in reaction to Chair Powell's press conference comments challenged duration-sensitive asset classes and the mortgage market was not immune. Higher interest rates have lifted the average 30-year fixed-rate home loan above 5% for the first time since 2018. The impact has been multi-fold with affordability declining significantly, prepayments slowing as the incentive to refinance waned and mortgage indices extending.

The Fed's announced plan to allow its existing balance sheet of bonds to slowly roll-off beginning 1 June was already priced into wider spreads across the sector. As the Fed steps back in the Agency RMBS market, the sector loses a significant investor and will need to look towards private investors such as banks, insurance companies and money managers to pick up the slack. These buyers have tended to be underweight agency risk at tight spreads which should shift as relative value improves. Reduced supply as mortgage rates move higher should also lend support to the sector as well as a potential risk-off bid if there is a tip towards recession.

Investors should expect more headlines related to increasing foreclosures and worsening delinquencies. Payment holidays are coming to an end as covid-related fiscal and monetary support programmes conclude. Cash balances are being drawn down and credit card lines are extending. These trends will reflect a return to normal as we come off all-time low and unsustainable level of delinquencies, defaults and foreclosures.

Asian credit

ICTSI Q1,21 results were solid with revenue and EBITDA growth of 21% y/y and 27.5% y/y respectively, helped by tariff adjustments in some terminals, new contracts with shipping lines and contributions from new terminals (Manila, Nigeria, Brazil). The company saw some disruption from the Shanghai lockdown towards the end of Q1, but management expects this to have only delayed volume and that there will be a strong recovery on the back of pent-up demand once China is able to control the pandemic outbreak.

The US SEC has added more than 80 US-listed Chinese firms on to the list of companies that could be delisted if they do not meet the SEC audit requirement for three consecutive years. Altogether, there are now 128 Chinese firms on the SEC list. The prominent US bond issuers include JD.com, Baidu, Tencent Music, Chalco, Sinopec Corp, Weibo, Melco and Studio City. The Sri Lanka Finance Minister Sabry said that the country is in talks for a $3bn-5bn bridge financing with the potential appointment of debt and legal advisors. The Finance Minister also stated that the IMF programme will take as long as six months to start.

Most of the Macau gaming companies have announced their Q1 results with Sands China, MGM China and SJM Holdings reporting negative Q1 EBITDA. By contrast, Melco Resorts posted positive Q1 EBITDA, largely helped by the positive performance in its City of Dreams Macau and City of Dreams Manila. However, Melco's Q1 EBITDA was 49% lower q/q because of heightened border restriction, especially in Feb-March 2022 after the Chinese New Year period. Macau GGR fell more than 50% y/y in Feb-March 2022. As previously communicated, the company will complete the Studio City Phase 2 construction by the deadline set in the land concession of 27 Dec 2022. Wynn Macau announced that it has amended the $1.5bn facility agreement (matures in Sep 2025) with Bank of China Ltd with waivers for its quarterly ratio tests till 31 March 2023.

Emerging markets

Chinese premier Li Keqiang has raised the concern of the "grave and complex" employment situation, following strict covid lockdowns in Beijing and Shanghai. At least 27 Chinese cities are now under full or partial lockdown. He emphasised the need for measures to maintain job stability including helping small businesses, supporting the internet economy, and incentivising business start-ups.

Sri Lankan president Rajapaksa has declared a state of emergency for the second time in five weeks as a result of nationwide protests. Shops and public transport were closed on Friday by unions who blame the president for the current economic crisis.

EM central banks delivered an assortment of hikes with Brazil (+1%), Poland (+0.75%), The Czech Republic (+0.75%) and Chile (+1.25%) all raising rates. The Brazilian central bank has now hiked rates 10% since May 2021.

Commodities

The commodity index appreciated modestly last week as the rally in energy markets was offset by the heavy decline in industrial metals alongside a more modest aggregate decline in agricultural markets.

Brent rallied 4.9% last week, finishing at $112.The rise was driven by the news of the EU-27 block looking to ban imports of Russian crude and refined fuels; however, this plan has been met with opposition from Hungary (dependent on Russian energy), which has stalled these talks. Brent has eased this morning following the EU block dropping a proposed ban on its vessels transporting Russian oil to third countries.

There's currently no direct ban on Russian LNG; however, top buyers Japan and South Korea have halted purchases. Indian companies are buying Russian LNG at discounted prices as sweltering heat and ongoing blackouts have forced the nation to sure up supplies with additional shipments. India is also looking to re-open more than 100 coal mines previously seen as financially unviable.
Base metals were the worst performer down 5.7% on aggregative with Zinc and Nickel falling 8.2% and 5.4% respectively. Prices are being dragged down by reduced industrial activity in China because of covid lockdowns alongside a stronger US dollar following a more aggressive US Federal Reserve hiking path.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

9th May 2022

COLUMBIA THREADNEEDLE INVESTMENTS

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	■ Credit spreads have tightened from recent volatility- driven widening, technicals are neutral to worsening and fundamentals remain stable in most sectors. This, along with potential rates-driven credit vulnerability keep the group neutral to credit risk. ■ We are past the peak of economic growth, with first hike announced at the March FOMC meeting and expectations for many more. Pullback in forecasted 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: more spillover from Russian invasion, sanctions difficult to remove post-conflict. Lockdowns from Covid variants. Supply chain disruptions and inflation persist to H2 2022. Simultaneous low unemployment, hiking and slowing growth could cause a recession. Persisting commodity shocks
Duration (10-year) ('P' = Periphery)	P ¥ $ Short -2 -1 0 +1 +2 Long £ €	■ Carry offered by front end yields now attractive ■ Longer yields continue to be capped by long-run structural downtrends in real yields ■ Inflation likely to normalize over medium term ■ Hiking cycles to be shortened by easing inflation and moderating demand	■ 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 $ E £	■ The invasion of Ukraine will hit global growth, hinder risk markets and lend a bid to the Dollar ■ The associated impact of higher inflation on central banks is uncertain, but is more likely to see a dovish repricing of the ECB than the Fed, we turn neutral on the Euro	■ The ECB becomes concerned around potential second round effects and presses on with policy normalisation
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight 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)	Under-weight -2 -1 0 +1 +2 Over-weight	■ Spreads have tightened since invasion blow-out and many of the main stories are playing out (defaults, invasion impacts, commodity price moves, new covid shutdowns) ■ Fundamental consequences of invasion are unevenly distributed via trade links and commodity exposure. Commodity prices provided nice tailwind, however continued higher prices will hurt large resource importers. ■ Fundamental headwinds: elevated fiscal deficits, significant inflation, Chinese growth, idiosyncratic political risks ■ Flows recently turned positive however risk aversion keeps primary issuance slow; focus on select relval opportunities	■ Continued spillover from Russian invasion: local inflation (esp. food & commodity), slowing growth ■ A replay of 2013 occurs with a taper tantrum or swift appreciation of the USD ■ Persisting COVID growth scars hurt economies & fiscal deficits ■ Weakening technicals with large fund outflows and slower supply
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	■ US and EMEA spreads have tightened since last month with an improved carry profile. Fundamental view remains strong, however inflation, monetary tightening and technicals remain headwinds. ■ 2021 saw better-than-forecasted revenue growth in nearly every industry. Focus during Q1 earnings: margins, customer retention with price increases, status of supply chains and labor availability. ■ Good fundamentals with strong balance sheet management and deleveraging from capital management & free cash flow growth.	■ Supply dynamics remain a headwind ■ Investors return to government bonds from IG as their risk/return preference for safe assets is changing in new environment ■ Russian Invasion worsens operating environment globally ■ M&A and shareholder enhancing activities pick up, but most are leverage neutral.
High Yield Bonds and Bank Loans	Under-weight -2 -1 0 +1 +2 Over-weight	■ Spreads no longer at attractive levels. Rising star opportunities remain attractive; however, risk management is increasing along with volatility. ■ Risks for EMEA HY are heightened because of proximity to and economic impact of Russian invasion ■ Bank loans have bounced back from Ukraine-driven lows, and we expect tailwinds will continue retail fund flows, strong issue calendar, CLO demand. ■ Bonds & loan defaults set to remain near historic lows	■ Default concerns are focused on demand destruction, margin pressure and macro risks ■ 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	Under-weight -2 -1 0 +1 +2 Over-weight	■ 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. ■ Specified Pools have repriced- prefer lower coupons. In CMOs, preference is shifting to IIO over IO	■ 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	Under-weight -2 -1 0 +1 +2 Over-weight	■ Our preference remains for Non-Agency RMBS ■ RMBS: Housing continues to perform well but expect normalization coming from heavy supply and extension concerns. Selectively adding to positions at wider spreads. ■ CMBS: Most segments maintain strong fundamentals but widening has shifted relval preferences to other sectors ■ CLOs: Spreads hold in well vs other sectors with strong flows and liquidity. Secondary spreads recovered to fair value vs new issue as the new issue supply is lower ■ ABS: US consumer looks well positioned, watching performance given inflation & rates. Select opportunities in de-levered structures in consumer loans or subprime auto	■ Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening ■ Changes in consumer behavior in travel and retail fail to return. ■ Work From Home continues full steam-ahead post-pandemic (positive for RMBS, negative for CMBS). ■ SOFR deals slows CLO new issue ■ Rising interest rates may dent housing market strength but seems unlikely to derail it
Commodities	Under-weight -2 -1 0 +1 +2 Over-weight	■ o/w Copper & Lead vs Zinc ■ u/w Livestock ■ u/w Gold ■ o/w Oil	■ Global Recession