INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

Your success. Our priority.

In Credit

20 JUNE 2022

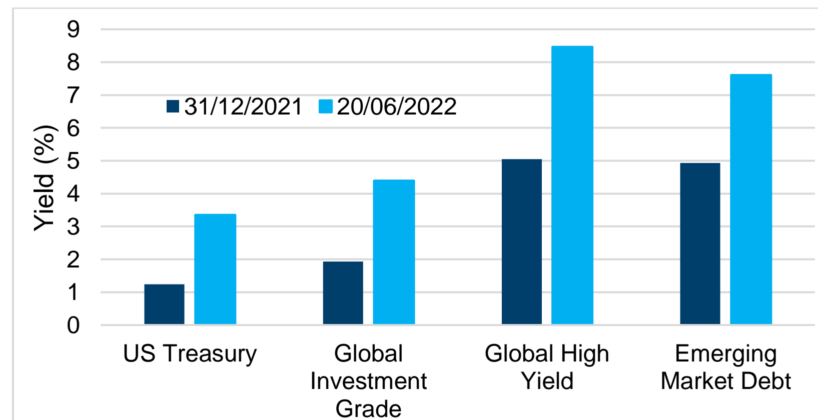
Breaking badly – yielding so much more.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	3.23%	7 bps	-5.4%	-10.7%
German Bund 10 year	1.62%	10 bps	-8.6%	-13.2%
UK Gilt 10 year	2.49%	4 bps	-9.2%	-16.0%
Japan 10 year	0.24%	-1 bps	-1.4%	-2.9%
Global Investment Grade	160 bps	12 bps	-7.4%	-13.8%
Euro Investment Grade	191 bps	25 bps	-8.2%	-13.0%
US Investment Grade	150 bps	9 bps	-7.6%	-14.7%
UK Investment Grade	153 bps	11 bps	-7.3%	-13.0%
Asia Investment Grade	220 bps	4 bps	-3.3%	-8.4%
Euro High Yield	556 bps	66 bps	-8.4%	-12.8%
US High Yield	515 bps	64 bps	-8.8%	-12.9%
Asia High Yield	810 bps	48 bps	-6.0%	-16.2%
EM Sovereign	426 bps	26 bps	-9.8%	-18.2%
EM Local	7.1%	20 bps	-8.6%	-14.5%
EM Corporate	362 bps	26 bps	-4.8%	-13.2%
Bloomberg Barclays US Munis	3.4%	37 bps	-4.1%	-10.1%
Taxable Munis	4.5%	10 bps	-8.8%	-17.5%
Bloomberg Barclays US MBS	53 bps	13 bps	-5.7%	-10.4%
Bloomberg Commodity Index	271.54	-6.4%	2.1%	28.2%
EUR	1.0515	-0.2%	-5.1%	-7.7%
JPY	134.65	-0.4%	-9.8%	-14.7%
GBP	1.2235	-0.6%	-6.8%	-9.5%

Source: Bloomberg, Merrill Lynch, as at 20 June 2022.

Chart of the week: Increase in yield this year – major markets



Source: Bloomberg, Columbia Threadneedle Investments, as at 20 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

Another five days, another rout in financial markets. Short of an investment in a few choice commodities, this year has been a bit of a reckoning and a time of significant wealth destruction. Amid such turmoil one would typically look to risk-free US treasuries to offset the implosion in equities and credit markets; this has not been the case. This year has been about a normalisation of real yields and discount rates and that affects all assets and, of course, government debt.

Last week, central banks delivered a verdict of 'guilty of too much inflation' and sentenced economies to higher interest rates, and markets to sharp declines. The US Federal Reserve was the first to act, taking rates higher for a third time and by 75bps. The Bank of England came next with its fifth quarter point move, then the Swiss central bank ushered in a new era of tightening with a first rate rise in 15 years. There is more to come. Markets are priced for US rates to reach around 3.5% by the end of this year and to peak around 4% in 2023. So, financial conditions are certainly tightening as US 30-year mortgage rates reached the highest rate since late 2008 at 5.875%, according to lender Freddie Mac.

On the other side of the Atlantic, and in the face of ballooning peripheral European government spreads, the European Central Bank panicked and held an emergency meeting seeking to assure investors it hadn't abandoned these fragile markets. It has seemed to work – at least for now.

But what of the good news hidden in all this muddle? For income-seeking investors yields in all asset classes warrant a relook. As the **chart of the week** illustrates, high yield is once again high and yielding while other areas of the market offer a similarly more interesting income proposition.

Inflation is also likely to fall in coming quarters. Aside from the obvious base effects, numerous secular forces, which ushered in the era of disinflation are largely intact (aside perhaps globalisation), while central banks have an arsenal full of ammunition to blast their foes, just as Mr Volker did all those years ago. Let's hope it's the former not the latter outcome from a market perspective.

Investment grade credit

As mentioned, credit markets took a bit of a hit last week. Indeed, spreads hit a new wide print for the year. The global index ended the week with a spread of 160bps. This is the widest valuation since mid-2020 and now some 60% higher than where we started the year. Within the widening this masks a significant geographic dispersion. Euro credit is 95% wider while the bigger US dollar market is around 53% higher than at the end of last year.

Amid the turmoil there was a decline in liquidity and lack of new issuance that normally accompanies this type of market condition.

Touching on higher yields, however, the global index now offers a yield of just below 4.5%. Unlike the spread comparison this is much more eye-popping. You must go back to 2009 (just after the GFC) to be offered such a high yield. This reflects, of course, the additional effect of rising government bond yields, which have not been a feature until relatively recently.

High yield credit & leveraged loans

US high yield bond valuations widened dramatically over the week as stickier inflation and a more front-loaded response from the US Fed shifted the focus to downside growth risks. The ICE BofA US HY CP Constrained Index returned -2.94% and spreads were 63bps wider. The asset class also experienced its third largest weekly outflow on record with $5.7bn withdrawn over the period. This was the largest weekly outflow for US high yield bonds since early 2018. Meanwhile, the average price of the J.P. Morgan Leveraged Loan Index declined $1.46 over the week to $93.84, outperforming bonds but not immune to the risk-off tone. Retail loan funds also saw large outflows with $2bn withdrawn over the week; the largest outflow from loan funds since March 2020.

European High Yield experienced its worst performing week so far this year, with a return of -3%. It was a very messy week with lots of volatility as spreads widened (+66bps) and yields rose (+0.85% to 7.11%) with the former being responsible for three-quarters of the increase in EHY yields. Single Bs were, marginally, worse than the other high yield rating buckets but all were within a stone's throw of the -3% return. There does not appear to be much distinction between sectors or credit rating buckets in this sell off. Individual names saw their bond prices drop between 2 to 7 points. The primary market remained firmly shut. Commentary from the banks suggests that other than regular refinancing activity (which is low due to the high amount of issuance in 2021), September may be the earliest for new issuance. Fund flows were €400m out, evenly split between ETFs and managed accounts. ETFs continue to price at a discount. Funds were seen to be selling their better-quality names to cover liquidity needs. Market liquidity remains very poor with longer maturities continuing to being the hardest to trade. There is talk that one must go back to 1982 to see similar market moves. With yields now at around +300bps above their 10-year average and spreads around +330bps above the average for the same period, there were some small signs of selective buying.

On the rating front, positive news from Coty, a US beauty products firm, as it was upgraded to BB-, from B+ by S&P. This follows the upgrade last month by Moody's to Ba3 from B1. S&P cited better than anticipated de-leveraging and an expectation that special dividends from the Wella business will be used to pay down debt. This contrasts with Revlon, another US beauty product business, who filed bankruptcy last week, going into default.

Asian credit

In Macau gaming, the Macau government published the final draft of the revised gaming law on 14 June, following the publication of the initial draft five months ago on 14 January. Barring any major last-minute push-back by members of the legislative assembly standing committee, the final draft may be voted on and signed into law by the legislative assembly sometime in the week of 20 June. Once the gaming law has been approved, the licence re-tendering process will kick off. The positives are: [1] lower risk for satellite casinos, as the requirement for satellite casinos to operate within the same premises as the concessionaires has been removed; and [2] 10-year maximum licenses with potential extension of three years. The negatives are: [1] Minimum capital requirement – net asset value at the concessionaire entity to be increased from MOP200m to at least MOP5bn ($600m) and this must be maintained throughout the concession period. This is negative but manageable; operators such as Sands China will need to inject more capital to its concessionaire Venetian Macau; and [2] Minimum annual GGR requirement, which will be adjusted to the current economic conditions. In addition, the small change in tax rate of 40% from 39% of GGR and local ownership raised to 15% from 10% are neutral.

In China, May credit growth rose to 10.5% y/y from 10.2% in April, mainly driven by an improvement in new loans and an increase in government bond issuance. At the same time, the contraction in off-balance sheet lending eased compared with a year earlier. Meanwhile, the total spending on land purchases fell 65% y/y to CNY 468bn in the first five months of 2022, with 60% of China's top 100 developers failing to buy a single piece of land during the period.

Country Garden announced that it will offer to purchase the outstanding $683m COGARD 4.75% 22s at par using internal funds, ahead of its maturity in July 2022. The development is positive as it is in line with the management's comments during an investor call held earlier this month and will boost the investors' confidence in the company.

In the non-property space, during the "618" shopping season; ie, the mid-year shopping season started by JD.com in 2022, JD.com reported over CNY 379.3bn ($56.5bn) of transaction volume, up 10.3% y/y. Unsurprisingly, the growth lagged the prior-year growth of 27.7% y/y, given the Covid impact.

Last week, Moody's placed Fosun's Ba3 ratings on review for downgrade on tight liquidity and large onshore and offshore debt maturities in the next 6-12 months. Fosun is now offering to purchase two offshore notes due October and August 2023 after a record week of decline for its bonds.

Emerging markets

Emerging market hard currency sovereigns posted a negative return over the week with spreads 26bps wider. Negative sentiment continues as a result of hawkishness from developed market central banks, uncertainty over the activity rebound in China, and lower commodities prices. High yield / investment grade spreads are decompressing and are now at wides close to those seen at the start of the pandemic. High yield underperformance is being predominantly driven by a sell-off in African bonds where oil exporters are being negatively impacted by the recent lower price. EM debt is now approaching extremely attractive long-term valuation levels in terms of yield, and at 7.6% (JP Morgan EMBI Global) with an average credit rating of BBB-, the asset class appears to offer an interesting income proposition.

In Colombia, leftist candidate Gustavo Petro defeated market-favoured candidate Rodolfo Hernandez in the final round of the presidential elections. Petro's key stances include taxing big landowners, curtailing oil new exploration licenses and renewing ties with socialist Venezuela. Oil and coal currently account for half of Colombia's exports and are therefore crucial to the economy. Petro aims to phase out these industries in favour of a tourism / knowledge-based economy. However, despite the win, Petro lacks a majority in congress so it remains to be seen which of his radical proposals he will be able to implement. Investors will now closely watch whom he appoints as Finance Minister.

In central bank news, Brazil raised the Selic rate by 50bps to 13.25%, the highest level since early 2017. The policy committee also raised its 2023 inflation forecast from 3.4% to 4% (May CPI is 11.7%). On the fiscal front incumbent president Jair Bolsonaro has implemented a series of tax breaks including lower import tariffs and industrial taxes. More recently congress approved a bill aiming to lower some state VAT tax and reduce federal taxes on fuel until the end of the year.

Commodities

The commodity index sold off sharply last week led by a decline in energy and industrial metal markets.

On the energy front, the sector was dragged down by a sharp sell-off (-22.4%) in US natural gas with most of the price action happening last Tuesday. The decline was driven by the previously mentioned damage and outages to the Freeport LNG terminal, with a full restart of the facility not expected to the end of the year. Given the high share of LNG exports coming from the terminal, export disruption has resulted in a demand shock for US natural gas and subsequently higher US natural gas supply.

In crude, brent sold off 5.6% worth most of the selloff occurring on Friday as the market weighed up the impact of rising interest rates on the global growth outlook. In Europe, Russian officials have shut down a terminal that handles two-thirds of Kazakhstan's oil exports, citing unexploded WW2 bombs, the shutdown follows the Kazakh president not recognising the Russian breakaway regions of Donetsk and Luhansk.

Industrial metals sold off 6.1% on aggregate with aluminium (-6.9%) and copper (-6.5%) leading the decline. In a similar vein to crude the metals market weakened as traders digested rate hikes from Switzerland, US and UK and the increasingly concern of recession.

Responsible investments

A record amount of solar energy was generated last week in Germany, as a heat wave made its way across Europe. Other countries on the continent also generated a high level of solar power, as the sun beat down and gave us the first taste of summer. As we endured the sweltering 30C+ heat, those of us lucky enough to turn on an air conditioning unit meant the surge did little for electricity demands and had no bearing on the high energy prices.

In the UK, the Department for Transport has immediately brought a stop to the Plug-in grant being offered to motorists purchasing an electric vehicle under £32k. The original lump sum amount back in 2011, when the scheme started, was £2,500 and was reduced to £1,500 last December. The department has said funding would instead be refocused towards building more public electric charging ports as well as providing a grant when purchasing an electric van, motorcycle or taxi. Many motoring groups and societies have hit back saying the timing is bad and is "sending the wrong message to motorists and to an industry that remains committed to government's net zero ambition".

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views
20th June 2022

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 widened from March volatility- driven tightening, as we are seeing a market-wide softening in technicals fundamentals. This, along with rates-driven credit vulnerability, **has kept the group negative on credit risk** ▪ We are past the peak of economic growth, with the first hike 75bps done and expectations for more 50/75bp 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)	¥ 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 $ E £	▪ 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)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads more attractive, new optimism for struggling fundamentals motivated upgrade despite weak technicals. ▪ 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 ▪ 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 ▪ Weaking technical with large fund outflows and slower supply
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ US & 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 erratic, 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ 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 and reflect default outlook. Elevated risks for EMEA HY because of proximity to Russian invasion. ▪ Primary market slow and weak liquidity in secondary ▪ Bank loan market drifted lower with more volatility; sentiment weakening over slowing economy and higher interest cost, still see primary market support ▪ Bonds & loan defaults set to remain near historic lows	▪ Default concerns are focused on demand destruction, margin pressure and macro risks ▪ Loan technicals and flows weaken ▪ 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	▪ Mortgages recently outperformed as volatility dropped. ▪ Higher Coupon securities are the most attractive, as lower coupons appear vulnerable due to tight valuations, poor carry and upcoming Fed sales and less money manager sponsorship. ▪ A preferred place to add positions in TBA, pools and IIO	▪ 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: Fundamental performance remains strong but expect normalization coming from heavy supply, extension concerns, and general risk off. Like higher quality collateral ▪ CMBS: Fundamentals remain mostly solid but weakening. Widening has shifted relval preference to other sectors. ▪ CLOs: Spreads have been widening in sympathy with structured product credit; secondary bonds difficult to source as sellers became buyers. ▪ 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ o/w Copper & Lead vs Zinc ▪ ow Livestock ▪ o/w Softs ▪ o/w Grains ▪ 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 20.06.2022, 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