INFORMATION FOR INVESTMENT PROFESSIONALS

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In Credit

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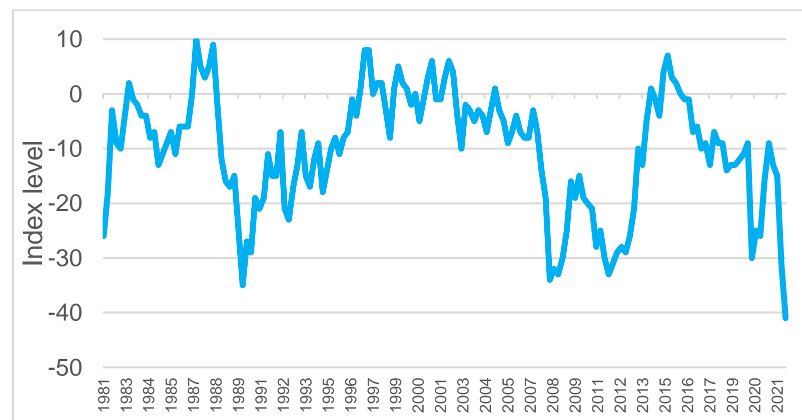
The good news is the bad news.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	3.15%	-7 bps	-4.8%	-10.1%
German Bund 10 year	1.50%	-16 bps	-7.1%	-11.8%
UK Gilt 10 year	2.36%	-14 bps	-7.6%	-14.6%
Japan 10 year	0.25%	2 bps	-1.4%	-2.9%
Global Investment Grade	165 bps	5 bps	-6.8%	-13.2%
Euro Investment Grade	196 bps	5 bps	-7.1%	-12.0%
US Investment Grade	155 bps	5 bps	-7.2%	-14.3%
UK Investment Grade	156 bps	3 bps	-6.3%	-12.1%
Asia Investment Grade	230 bps	10 bps	-3.1%	-8.3%
Euro High Yield	597 bps	41 bps	-9.0%	-13.2%
US High Yield	518 bps	3 bps	-8.2%	-12.4%
Asia High Yield	896 bps	85 bps	-8.8%	-18.6%
EM Sovereign	430 bps	4 bps	-9.5%	-17.9%
EM Local	7.0%	-15 bps	-8.0%	-13.9%
EM Corporate	385 bps	23 bps	-5.3%	-13.6%
Bloomberg Barclays US Munis	3.3%	-13 bps	-3.3%	-9.3%
Taxable Munis	4.4%	-8 bps	-8.3%	-17.1%
Bloomberg Barclays US MBS	49 bps	-4 bps	-4.9%	-9.6%
Bloomberg Commodity Index	259.27	-4.3%	-2.3%	22.7%
EUR	1.0579	0.5%	-4.6%	-7.2%
JPY	135.11	-0.2%	-10.0%	-14.9%
GBP	1.2291	0.2%	-6.6%	-9.3%

Source: Bloomberg, Merrill Lynch, as at 27 June 2022.

Chart of the week: UK – GFK consumer sentiment, 1980-2022



Source: Bloomberg, Columbia Threadneedle Investments, as at 26 June 2022.

Macro / government bonds

Enough was enough. After a meltdown in bond prices, recession fears bringing a reduction in interest rate expectations finally prompted a rally in core bond prices.

Three reasons prompted this improvement in prices. Firstly, in testimony to the US government, US Federal Reserve Chair Powell noted the possibility of recession but an unconditional commitment to reduce inflation. Meanwhile, economic data pointed to growth slowing globally. The Flash PMI data in the eurozone and in the US undershot expectations and dropped toward the 50 mark (the pivot point between expansion and contraction). In the US, jobless claims rose to the highest since February of this year. The UK was hardest hit; retail sales contracted by 0.5% in May and is now contracting at 4.7% y/y. Lastly, the GFK measure of UK consumer sentiment fell to its lowest level since data began **(see chart of the week)**. This reflects the effects of surging food and fuel prices on the beleaguered consumer. The country faced a shutdown in public transport while British Airways seems to be facing a walkout of staff, reflecting labour discontent in the face of a sharply rising cost of living. Lastly, euro gas prices rose again threatening German industrial output.

So, all this bad news meant that fears of interest rate rises moderated while inflation expectations reduced. This in turn helped government bonds to rally in what have been very volatile markets.

Investment grade credit

As core government bond yields fell, credit markets responded by tightening at the end of last week after reaching the widest point of the year thus far in spread terms.

Euro credit markets have underperformed this year with spreads close to double the level seen at the end of last year. This has been led by a widening in swap spreads in the euro market. The reasons for this move are not totally clear though a shortage of German government bonds, rising systemic risk, a shortage of US dollars and mortgage fixing are cited as reasons.

The new issue market has picked up in the last week or so with issuers coming with attractive new issue premia (estimated at around 10-15bps) and being well received. This might be interpreted as a sign of a more positive market background.

After the recent sell-off and widening in spreads valuations have improved. Euro spreads are now around one standard deviation cheap to the long-term average (20 years), while US dollar credit is close to its long-term average.

High yield credit & leveraged loans

US high yield bond prices were modestly higher and spreads largely unchanged over the week amid lower commodity prices and global bond yields as investors scaled back the cumulative amount of rate hikes by 50bps over the past week amid weaker data and recession fears. The ICE BofA US HY CP Constrained Index returned 0.64% and spreads were 3bps wider. According to Lipper, the asset class saw a $2.6bn outflow from retail funds, pushing the YTD total outflow beyond $40bn. Meanwhile, the average price of the J.P. Morgan Leveraged Loan Index continued to move lower, down $0.37 over the week to $93.48. Loan retail funds also saw continued outflows with a $1.2bn withdrawal over the period, leaving YTD inflows at $17bn.

It was another week of negative performance for European high yield, resulting in what is looking to be the worst performing month since March 2020. Spreads widened, almost reaching 600bps at one point, while yields were only marginally higher over the week given the rally in underlying government bond yields. Market dispersion remained elusive with CCCs still outperforming. There was one new issue this week due to a private equity buyout deal: Manuchar (chemicals), which is helping to finance Lone Star's acquisition of the portion of the chemical distribution business to emerging markets. It came about 200bps wide to the initial price talk a few weeks ago, at a yield of 11% (coupon of 7.25% + (OID) original issue discount of 86). Fund outflows continued to climb, amounting this week to -€471m, largely out of managed accounts as ETF outflows were marginal. Liquidity continues to be very poor with price bids, at times, completely absent.

Some news of capital raising with Faurecia announcing that it has raised €0.75m from a rights issue to help delever the business. This comes on the heels of news that Ocado raised £55m, placing 2.3 million shares at £7.95 (at a 10% discount to the previous day's close).

In scandal news: Rexel bonds were down this week on reports that the company may have been involved in price fixing and tax evasion. This is while Paprec, the recycling and waste management company's rating was reaffirmed by S&P despite the investigation into the founder/CEO for alleged anti-competitive practices. The week finished with another Viceroy Research real estate target (the previous one was the Adler Group); this time it was SBB, a Swedish real estate company. In Viceroy's report, allegations were made regarding governance, party transactions and over valuations, similar to those made against the Adler Group.

Structured credit

The US Agency MBS market staged a strong rally last week posting a total return of 91bps and beating the broad US investment grade market by nearly 30bps. There was similar performance across both 30-year and 15-year agency MBS as the curve bull flattened. In his semi-annual testimony, Fed Chairman Powell acknowledged the potential for MBS sales down the line, which didn't appear to deter investors. Mortgage rate increase have taken refis to multi-decade lows, essentially zero, and cash-out refis are even starting to slow now as well as rates move into the 6% range. In non-agency RMBS, spreads were flat to wider week-over-week, with CRT seeing the majority of widening down the stack.

Asian credit

In Indonesia, PM Jokowi passed a law that regulates the omnibus law legislation, allowing for the implementation of October 20's job creation law. Philippine policy makers raised the base rate by 25bps to 2.5% to combat inflation, in line with forecasts. Indonesia remains on hold. Malaysia's May consumer prices rose 2.8% y/y. In China, Guangdong province raised its flood warning to the highest level, which may threaten further supply chain disruptions on top of the covid-related lockdowns. Macau shut most venues including bars, cinemas, gyms and banned dining-in services at restaurants to contain the latest covid outbreak starting from Thursday. The city has already shut schools and public venues and is conducting a mass testing. Casinos are not affected by the restrictions for now.

Macau gaming operators (Melco, SJM, MGM China, Wynn Macau, Sands China, Galaxy) formally stated in HKEX filings that their concessions are extended by six months to 31 December 2022. This is not a surprise because back in March 2022, the Macau government already announced its intention to extend the concessions (expiring on 26 June 2022) by six months to 31 December

2022. This will give more time for the government to complete the revision to the Gaming Law and subsequently launch the public bidding process for the concessions. Based on the final amendments to the Gaming Law, the concessions will have a 10-year duration with a potential extension of three years. In the interim, the concessions for the six operators are extended for six months to 31 December 2022. For Melco, the company will pay the Macau government MOP47m (equivalent to c.$5.8m) for the 6-month extension. Within three months of signing the Extension Agreement, Melco Resorts will submit a bank guarantee of not less than MOP820m (c.$101.4m) to the Macau government.

Contemporary Amperex Technology, the largest maker of batteries for electric cars, launched a CNY45bn share placement in Shenzhen, with the issue of 110 million shares, at CNY410, compared with the floor price of CNY339.67. The stock exchange filing shows that there are 42 bidders, of which 22 obtained the final allocation. Proceeds will be used to fund capacity expansion and R&D related to five projects.

Bharti Airtel, an Indian telecommunication company, is offering to redeem up to $300m of its 2024 Notes. This is the second time this year that Bharti has done an early redemption. In March, it redeemed $505m 2023 Notes.

In Chinese property, there are several negative rating actions on distressed developers, including Greenland, Country Garden, Jingrui and Guangzhou R&F. One to note is Greenland, the investors passed a 1-year extension on the '22s and S&P downgraded its rating to selective default. This is the first developer with SOE background entering the distressed club. Country Garden, the largest property developers in China in terms of contracted sales, has been downgraded to Ba1 from Baa3 by Moody's, with a negative outlook. After the downgrade, Country Garden would have two out of three credit ratings as high yield, becoming a fallen angel. That said, the rating downgrade should have been well anticipated, and the forced selling post the downgrade should be limited.

Emerging markets

Mexico (+75bps), Philippines (+25bps) and the Czech Republic (125bps) all delivered rate hikes. Turkey, Egypt, and Indonesia held rates at 14%, 11.25% and 3.5% respectively.

While many EM central banks have been hiking aggressively to quell surging inflation and maintain an interest rate buffer against the US, the Philippines has been a notable exception. Its base rate stands at 2.5%, with inflation at 5.4%; additionally, the Philippine Peso has sold off in excess of 7% YTD. The rationale: the central bank governor believes inflation is largely cost push and therefore doesn't warrant excessive hiking.

Elsewhere, Oman announced a tender offer to buyback $1.75bn of debt as part of its "proactive debt strategy." The move comes as Oman's state budget revenue swelled 27% y/y, driven by a 52% increase in oil revenues in 2021.

Quasi-sovereign Pakistan failed to complete a July LNG (liquefied natural gas) tender for the third time this month in the face of elevated pricing. The government is attempting to conserve energy by cutting hours for public servants and ordering shopping malls and factories to shut early. Rising prices are also hitting the consumer as the government have been forced to scrap fuel subsidies as a contingency of the ongoing IMF programme.

Commodities

The commodity index sold off 4.3% last week driven by a decline in agriculture and industrial metals. WTI sold off 1.3% as US President Biden is looking for a temporary suspension on federal tax on gasoline. The measure could save US consumers up to 18.4 cents a gallon but would require congressional approval; the measure has faced opposition, including from senior democrats.

Corn and soybeans declined by 7.5% and 7.4% respectively following a bumper corn crop from Brazil, where corn is being stacked up outside silos at the fastest rate in years. Prices have also been suppressed by reports of favourable weather conditions in US growing regions. Corn prices (measured by the BCOM sub-index) have now given back most of the gains following the invasion of Ukraine.

In industrial metals, despite 90% of China’s smelters currently undergoing maintenance, tin prices have slumped 21% on the week, the highest weekly loss recorded. Prices have come under pressure due to weak demand for electronic goods in China alongside broad-based concerns of declining industrial activity.

Responsible Investments

Goldman Sachs Group is currently under investigation by the US SEC as to whether certain ESG metrics assigned to funds from its asset management arm have misled investors, otherwise known as ‘greenwashing’. Not so long ago, concerns were raised around Deutsche Bank and its asset management arm DWS misrepresenting how ESG was integrated in its annual report.

The world’s largest oil producer, Saudi Aramco, has said it doesn’t plan to cut carbon emissions for another 13 years. Its pledge is to become net zero by 2060 (a decade beyond the goal for many other nations and companies), but in the meantime intends to use carbon capture and storage methods to work towards being carbon neutral. Aramco’s oil production will increase by one million barrels a day by 2027, according to its recent sustainability report publication, partly as a result of the recent surge in energy prices. This in turn will produce the same level of absolute emissions in 2035 as those recorded in 2021.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

27th 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

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