COLUMBIA THREADNEEDLE INVESTMENTS

Your success. Our priority.

In Credit

30 MAY 2022

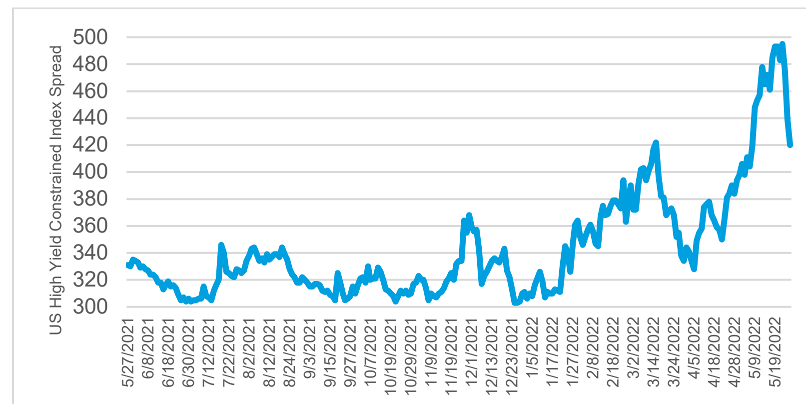
Sunlight after the storm

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	2.74%	-4 bps	-2.6%	-8.1%
German Bund 10 year	1.05%	11 bps	-3.6%	-8.5%
UK Gilt 10 year	1.99%	9 bps	-4.0%	-11.2%
Japan 10 year	0.24%	-1 bps	-0.3%	-1.8%
Global Investment Grade	148 bps	-9 bps	-3.7%	-10.4%
Euro Investment Grade	164 bps	-1 bps	-3.5%	-8.6%
US Investment Grade	141 bps	-14 bps	-4.1%	-11.6%
UK Investment Grade	140 bps	-4 bps	-3.1%	-9.1%
Asia Investment Grade	231 bps	2 bps	-1.6%	-6.8%
Euro High Yield	506 bps	-7 bps	-4.3%	-8.8%
US High Yield	419 bps	-72 bps	-3.4%	-7.7%
Asia High Yield	841 bps	5 bps	-3.6%	-14.0%
EM Sovereign	390 bps	-30 bps	-5.0%	-13.8%
EM Local	6.7%	-12 bps	-4.2%	-10.4%
EM Corporate	364 bps	-11 bps	-2.7%	-11.2%
Bloomberg Barclays US Munis	2.9%	-48 bps	-1.5%	-7.6%
Taxable Munis	4.1%	-6 bps	-6.2%	-15.2%
Bloomberg Barclays US MBS	34 bps	-7 bps	-2.0%	-6.8%
Bloomberg Commodity Index	286.53	2.6%	7.8%	35.3%
EUR	1.0742	1.6%	-3.0%	-5.6%
JPY	127.34	0.6%	-4.2%	-9.4%
GBP	1.2624	1.2%	-3.9%	-6.7%

Source: Bloomberg, Merrill Lynch, as at 30 May 2022.

Chart of the week: US High Yield Spreads - LTM



Source: ICE Indices, Bloomberg and Columbia Threadneedle Investments, as at 27 May 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 truly terrible first four months of 2022, core government bond yields have stabilised and even rallied in May. The benchmark 10-year US Treasury note has a yield of around 2.75% which has come down from 3.15% in the first week of this month.
Meanwhile, fears on inflation have given way to concerns about growth and even the risk of recession. This has seen risk markets perform poorly with both equity indices and corporate bond excess returns deeply in negative territory for the year. Evidence of slowing economies can be seen in the US housing market where higher mortgage rates (tied to long bond yields) have dented appetite, and in the revision lower to Q122 US GDP to -1.5% q/q. All of this has helped sooth expectations of interest rate rises and while we expect to see another couple of 50bps increases, the market expects rates to end the year around 2.55%, down from 2.75% a couple of weeks ago.

The UK consumer is also going through a tough time. Rates have gone up four times and are expected (by the market) to rise further to more than 2% by year-end. All the while, increases in food prices and surges in fuel and energy bills are eating into disposable income. The UK government responded last week by offering a lifeline to the more needy. In a £15 billion package Chancellor Rishi Sunak sought to offset, at least in part, the £24 billion energy bill rise. Payments will be made to lower income households, the elderly and those with disabilities. This is certainly a porisitve for an economy that is expected to slow – but less welcome news for oil and gas companies who will be required to foot part of the bill.

Investment Grade credit

The better performance for government bonds has proved somewhat infectious. Credit markets also enjoyed some stability and spreads tightened as we approach month end.

The outlook for investment grade credit is mixed. Tightening policy conditions provide a headwind – albeit one that is well understood and discounted. The slowing economy warrants attention, but a “not too fast-not too slow” outlook is not a bad backdrop for investment as it reins in corporate excess while not risking a rise in financial stress or default. Corporates are also heading into this uncertain time after a solid earnings season and with lower leverage and higher margins than has been the case for several years.
Valuations, too, are clearly more attractive. We started the year with corporate spreads well through long-run averages, but after the widening seen this year spreads are well above five-year and slightly better than 20-year averages.
From a technical perspective we feel a lot of the new issuance for the year has been front run into the first few months of the year as companies seek to pre-empt the rise in interest rates expected in the US and elsewhere. This means the second half of the year should be a period where primary market issuance is less likely to cause market indigestion.

High Yield credit & Leveraged Loans

US high yield bond spreads tightened dramatically over the second half of the week as buyers waded in following seven consecutive weeks of equity losses and spread widening. The ICE BofA US HY CP Constrained Index returned 3.4% and spreads were 72bps tighter, ending the week at +423bps (**see Chart of the week**). According to Lipper, the asset class reported a modest $236 million outflow and YTD outflows total $37 billion.

Meanwhile, the average price of the JP Morgan Leveraged Loan Index dipped and tentatively recovered $0.31 by week’s end as dip buyers also waded in following a more than $3 decline in prices during May. The index remains on track for its worst monthly total return since March 2020,

however, with a -2.74% return thus far. Retail fund outflows continued for loans as well with $1.4 billion withdrawn from the asset class over the week. YTD flows total $22 billion.

European High Yield saw some recovery, but only after an initial weak start, as spreads tightened in 7bps on the week and EHY yields fell 9bps to 5.81% (but only after touching 6% mid-week). This came on the back of the strong rally in US High Yield. The market had an overall better tone even as trading volumes remain down, while still biased to BBs – confirmation of market decompression continuing – and shorter dated maturities. ETFs actually returned to premium territory after pricing at a discount for some time. However, fund outflows continued with another -€548 million, evenly divided between ETFs and managed accounts. Primary markets remained subdued with only a €500 million Volvo Car six-year green note which was well oversubscribed, coming in tighter than initial price talk.

Results season continues for EHY. More companies are starting to lower or remove their full year earnings' guidance due to increased uncertainty given supply chain shortages, shipping disruptions, difficulty in passing through increased costs, as well as inflation concerns. As an example, UK groceries are showing that they are experiencing challenges as they report lower sales and downsize full year expectations.

In credit rating news, Elior was cut to B+ by S&P, following Moody's cut of a month or two ago. Elevated leverage was cited. In M&A news, Europcar's acquisition by Green Mobility (VW & Co) is confirmed to be going through. Closing day is now set for 10 June.

Finally, some company specific stories: more bad news for the Adler Group as it was reported that Frankfurt's public prosecutor's office has started criminal investigation on the company. For Altice, the UK government is probing Drahi's stake in BT over "National security fears." This comes more than six months after Altice's purchase of BT shares.

Asian Credit

Alibaba's 4Q results (quarter ended March 2022) came ahead of consensus amid a tough operating environment. The 4Q revenue was CNY204 billion (-15.9% q/q, +8.9% y/y) and adjusted EBITDA was CNY23.4 billion (-54.5% q/q, -21.8% y/y). The weakness in EBITDA was driven by high investments in China commerce (specifically through Taobao deals and Taocaicai), the ongoing impact of Covid and asset impairment in Sun Art etc. Positively, its financial profile remained strong with net cash positions of CNY305 billion (~$47 billion) at March 2022. FCF was lower but respectable at $15.6 billion (-43% y/y) due to higher capex and lower operating cash flow generation. Management stated that over the past two weeks express deliveries have resumed, and merchants are preparing for the mid-year shopping festival (6/18 shopping season).

Lenovo reported a sequential decline in 4Q revenue (quarter ended 31 March 2022), impacted by q/q weakness in its Intelligent Devices Group (PC, table, smartphones), it cloud and enterprises businesses as well as its Solutions and Services Group (SSG). That said, SSG is Lenovo's fast-growing segment with solutions such as data centre hardware provided through pay-as-you-go model.

As part of India's fiscal measures to address inflationary pressure, the government announced the reduction of import duty on coal (from 2.5% to 0%), increase of export duty on iron ore (from 30% to 50%) and export duty on most steel exports (hot roll, cold roll, rods and bars). With the fuel taxes largely lowered to pre-Covid levels, this provides some room to the oil marketing companies (OMC) to manage their own pricing of petrol and diesel, ie the prices charged to dealers. The Cabinet Committee on Economic Affairs (CCEA) has also approved the Indian government's plan to sell its 29.5% in Hindustan Zinc (HZL), which could generate proceeds of around INR380 billion (~ $4.9

billion). Vedanta Ltd which owns around 64.9% in HZL, has previously expressed its interest in acquiring the stake held by the Indian government.

Emerging Markets

Emerging market spreads have also contracted this past week – following the better trend seen in most “risk markets”.
Former guerrilla Gustav Petro has secured 40% of the vote in Colombia’s presidential runoff. Petro is seen as the market unfriendly candidate (very left wing) and is aiming to tax wealthy landowners, halt new oil projects and redistribute pension funds. Petro’s rival, populist businessman, Hernandez received 24% of the vote, Hernandez is running on an anti-corruption campaign.
In Ukraine, negotiations are ongoing with Russia to allow the flow of grain from Ukrainian ports, over 20 million tonnes are stuck in Silos. Shipping lanes are currently mined and blockaded by the Russian navy; Putin has indicated he’s willing to allow passage of around 300 ships from the port of Odessa, but only if sanctions are lifted.
In central bank news, South Korea (+0.25%), Israel (+0.4%), Nigeria (+1.5%) and Ghana (+2.0%) all delivered rate hikes. Russia delivered a 3% base rate cut, further unwinding the 10.5% hike following the invasion of Ukraine. Turkey kept rates on hold at 14%, the Lira is currently down 20% YTD and inflation is running at 70%.
In ratings news, Egypt’s outlook was downgraded to negative by Moody’s because of the narrowing foreign exchange buffer. Egypt has been struggling with food price inflation (specifically wheat) and has recently secured an additional $3 billion (now $6 billion total) in funding from the International Islamic Trade Finance Corporation to support imports of oil and wheat.

Commodities

The commodity index rallied 2.6% on the week lead by a strong rally in energy markets.
Brent rallied 5%, supported by the news of restrictions being lifted in Beijing and Shanghai. Shanghai will lift measures imposed on businesses from Wednesday. The city also released a 50-point plan aimed at revitalising the economy.
US natural gas rallied 6.7% on the week and is now trading at the highest level since 2008, over double the price at the start of the year. US storage is below normal for this time of year coupled with an expectation of higher gas power plant generation needs to fuel air conditioning units this summer. US futures are still trading at around a third of European prices.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views
30th May 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 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)	$ 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	▪ 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 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	Under-weight -2 -1 0 +1 +2 Over-weight	▪ 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	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. 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	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.	▪ 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, 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	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

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 23.05.2022, 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