INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

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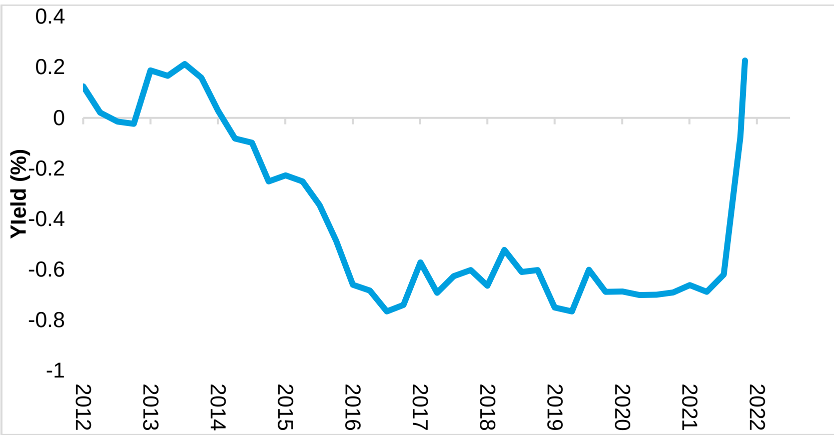
Bad year for bonds.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	2.83%	-2 bps	-3.3%	-8.7%
German Bund 10 year	0.90%	6 bps	-3.1%	-8.1%
UK Gilt 10 year	1.92%	3 bps	-3.1%	-10.3%
Japan 10 year	0.25%	0 bps	-0.6%	-2.2%
Global Investment Grade	135 bps	6 bps	-3.8%	-10.4%
Euro Investment Grade	136 bps	4 bps	-2.3%	-7.5%
US Investment Grade	133 bps	6 bps	-4.7%	-12.1%
UK Investment Grade	126 bps	5 bps	-2.5%	-8.5%
Asia Investment Grade	204 bps	-2 bps	-2.0%	-7.2%
Euro High Yield	418 bps	-9 bps	-1.4%	-6.0%
US High Yield	365 bps	1 bps	-2.8%	-7.2%
Asia High Yield	766 bps	20 bps	-1.0%	-11.7%
EM Sovereign	363 bps	14 bps	-4.4%	-13.2%
EM Local	6.7%	14 bps	-4.0%	-10.2%
EM Corporate	322 bps	5 bps	-1.6%	-10.3%
Bloomberg Barclays US Munis	3.1%	18 bps	-2.5%	-8.6%
Taxable Munis	4.1%	11 bps	-5.9%	-14.9%
Bloomberg Barclays US MBS	48 bps	11 bps	-3.9%	-8.7%
Bloomberg Commodity Index	270.53	-6.3%	1.7%	27.7%
EUR	1.0728	-0.5%	-3.1%	-5.7%
JPY	128.19	-0.9%	-5.1%	-10.2%
GBP	1.2718	-2.3%	-3.1%	-6.0%

Source: Bloomberg, Merrill Lynch, as at 25 April 2022.

Chart of the week: German 2-year yield, 2012-22



Source: Bloomberg, Columbia Threadneedle Investments, as at 25 April 2022.

Macro / government bonds

2022 is turning out to be a truly awful year for bond returns (**see markets at a glance**). Total returns in many areas of the fixed income market are worse than in any year since most bond indices were created. For government bonds, the fall in prices has taken longer-duration indices such as UK gilts into double-digit negative territory.

The pace of the sell-off also seems to have gained speed with government bond yields the highest for a number of years and led upwards by a combination or increased inflation expectations and real yields. Markets are being buffeted by the effects of increasingly hawkish rhetoric from central bankers in the US and elsewhere, multi-year high levels of inflation and the uncertainty arising from conflict in the Ukraine and Covid- related lockdowns in China.

If there is some good news it would be the return of more attractive yields to markets. Indeed, while 10-year US government bonds are over 1.3% higher than at the end of 2021, so investment grade, high yield and of course emerging market debt markets are offering a far more palatable income opportunity than was the case only a few months ago. Perhaps most pronounced in that regard has been euro-denominated debt. We had grown accustomed to the absurdity of negative yields over the last few years, but now even short-term German government bonds offer a small positive yield: the first time this has been the case since 2014 (**see chart of the week**).

Last week, the sobering reality of the effect of the Ukraine conflict on economic performance was brought into sharp relief. The IMF reduced its expectations for global growth in 2022 from a 4.4% annual growth rate forecast in January of this year to 3.6%. The organisation also reduced its expectation for the next year to the same 3.6%, which is again lower than the 3.8% expected only a few months ago. The IMF cited that war and rising food and energy prices as brakes on economic acceleration.

Investment grade credit

The expected slowing of the global economy (described earlier) and present heightened inflation rates amount to a form of economic stagflation and have not been well received in ‘risk markets’ such as investment grade credit this year. The market has had to deal with the rising government bond yields outlined earlier but also for the year as a whole wider spreads, so excess returns are negative relative to government bonds in 2022.

After a brief, but meaningful, tightening in credit spreads from mid-March to early April the widening spread trend has re-exerted itself and spreads are now around 10bps wider for the global IG index in the last couple of weeks. For context and at present levels, spreads are now very close to the long-term average at present. So, the valuation argument for the market is better than at the start of the year but only neutral from a longer-term perspective. For a sectoral perspective, utilities are outperforming with banks lagging – mostly driven by the burden of heavy issuance.

We are in the thick of earnings season which has gone quite well thus far. Corporate results from the likes of Danone and Nestle were strong. Bank earnings were also encouraging from our perspective. Margins are starting to expand and loan books are growing in most areas. On credit, cost of risk is just returning to normalised levels after several quarters of writebacks. Capital markets revenues held up reasonably well relative to Q1,21. Capital levels fell on the quarter, partly driven by regulation and partly due to increased market and counterparty risk.

High yield credit & leveraged loans

US high yield bond yields rose, and spreads tightened as hawkish Fed and ECB speak recalibrated policy expectations further and fueled a 30bps weekly rise in 2-year US treasury yields. The ICE BofA US HY CP Constrained Index returned -0.89% and spreads were 3bps tighter. According to Lipper, the asset class reported an $886m outflow following a $4bn outflow the prior week. YTD outflows now total approximately $32bn. Meanwhile, leveraged loan prices declined slightly over the week (-$0.04). The asset class continues to attract retail fund inflows with another $826m subscription over the period. YTD inflows now total $23bn.

European high yield (EHY) continues to experience losses, but due more to underlying rising government yields with spread widening being responsible to a much lesser extent. While spreads widened the week before Easter, they narrowed last week. EHY yields are now back at 5% levels (based on market index), a good 200bps higher than yields at the end of 2021. The asset class reverted to outflows during the last couple of weeks after starting the month with a small net inflow, with the weekly size increasing over the last couple of weeks, largely due to ETF sales. ETFs continue to price at a discount, the longest running case of discount pricing since March 2020. The primary market remained shut over the Easter weeks with talk that new deals are not likely to appear until May, at best. Market liquidity remains poor while trading is balanced but more in the shorter end of the yield curve. Trading in higher beta stock as well as longer maturities continues to be challenging with rallies being seen as a selling opportunity. It was noted that the asset class is at risk of having seven negative returning months out of the last eight months. The closest to anything like this string of continued losses was in 2008.

Despite the trading environment, we continue to see improving credit stories. Europcar was upgraded from CCC+ to B- on improving performance. LKG saw their rating upgrade BY S&P to BBB- from BB+. Now only S&P still has the issuer as a HY at Ba2. Loxam was upgraded by S&P to BB- from B+. Paprec, the recycling company, was upgraded by Moody's to B1 from B2.

In recent financial reporting, a number of companies are showing strong sales with solid margins indicating good pricing power as they are able to pass on price increases. Sales are higher too, returning to or close to 2019 levels (ex. PureGym issued results they were back at 100% of 2019 levels in terms of subscribers).

In the continuing Telecom Italia saga, there was disquieting news that the corporate is looking to the Italy's trade insurer for a guarantee on a new credit line to the tune of €3bn. This comes after Telecom Italia reported a new record loss (€8bn) and is an effort to boost its balance sheet.

Asian credit

Fitch has withdrawn the ratings of several property developers including Ronshine, Logan Group, Shimao Group and Sunac China given that these companies have stopped participating in the ratings process. Longfor Group has received the approval for an IPO in Hong Kong for its property management subsidiary that could raise around $1bn. Times China has demonstrated its adequate liquidity position by repaying $200m 5.3% bond due on 20 April 2022 and it announced the remittance of funds for the repayment of the 5.75% bonds due on 26 April 2022. The company has also paid a CNY467m ABS tranche. On another hand, Sunac has missed the payment of coupons on several US dollar bonds, which are currently subject to 30-day grace periods for payment before an event of default occurs.

Emerging markets

Rising covid cases in Beijing are causing concern about a city-wide Shanghai-style lockdown. Shanghai's lockdown has been ongoing for almost a month, with measures taking a draconian shift as metal barriers are being deployed, preventing residents from leaving apartment blocks. Residents in Shanghai are unable to get access to reliable food and healthcare. With a population of 3.5m, Beijing's Chaoyang district has already had 14 communities “sealed off” and has designated 14 “controlled areas”. Rising cases combined with China's continued zero covid policy brings into question the government's 5.5% 2022 growth target, both the 1- and 5-year prime loan rates were held last week despite expected easing.

Sri Lanka met with IMF last week and is seeking up to $4bn to help ease shortages of critical supplies, with the IMF saying rapid aid depends on debt restructuring. Protests are ongoing with the aim of removing the current president. According to Sergii Marchenko, finance minister of Ukraine, there's no need for a debt haircut as the country has no problem servicing its bonds. However, the minister did express the need for a financing bridge for the next few months and has stressed the need for a concessional grant following the World Bank and IMF's spring meeting to assist with re-building the country post-war.

Commodities

The commodity index sold off last week, driven by a broad decline in energy markets. The continued lockdown of Shanghai alongside the partial lockdown of Beijing drove oil down 4.2%; brent is currently trading below $100. US Natural gas sold off 10%, declining from its recent peak on 18 April. The price decline follows the recent rally after US president Biden agreed to supply 50bcm a year of LNG to the EU, offsetting a portion of the 155bcm of gas imported from Russia.
Indonesia has banned palm oil exports to ensure the availability of food products within the country following record-high food inflation. Indonesia is the world's largest palm oil producer, a widely used product in food and cosmetic products. Retailers in the UK recently made headlines for switching from sunflower oil to palm oil following surging sunflower oil prices. Soybean oil, the second most used vegetable oil, rose 4.7% last week.

Responsible investments

Hydropower from Canada may soon provide energy to New York City after regulators approved a $4.5bn transmission line project. This could be a huge step in achieving the state’s goal of removing carbon from its power supply by 2040. An hours-worth of a methane leak from a Texan natural gas pipeline caused as much pollution as the annual emissions from 16,000 US cars. An eastern province in South Africa suffered the worst floods in six decades last week, that has caused hundreds of casualties and damaged roads, ports, railway lines and much more. It’s been calculated that the country will need around $120m in disaster relief funding as the country announced a national state of disaster.

The largest US public pension fund, the California Public Employees’ Retirement System, is calling a shareholder proposal to vote Warren Buffet out of his Chairman seat at Berkshire Hathaway and replace him with an independent. The pension fund has around $2.3bn Berkshire shares and thinks the governance structure is weakened with Buffet sat in both the CEO and Chairman role. Warren Buffett, 91, has made it clear there are no plans to step down soon but has planned for his son, Howard Buffett, to serve as non-executive chairman and have Greg Abel as CEO when the times does come (Abel has been deputy CEO for some time).

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views
25th April 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