COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

25 OCTOBER 2021

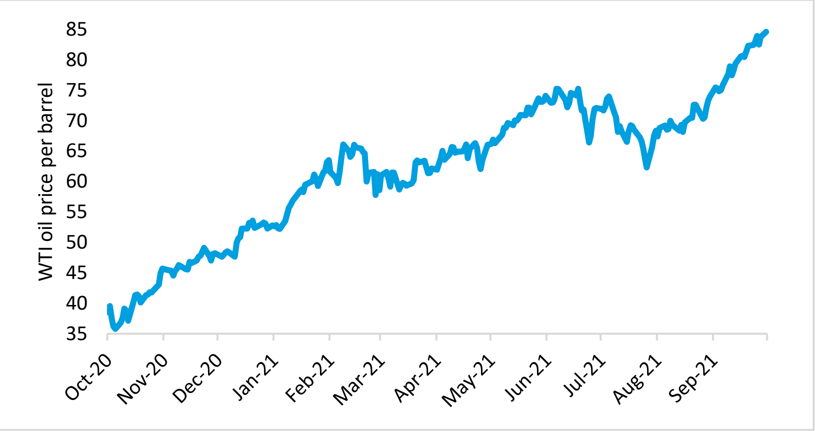
No time to tighten.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	1.61%	15 bps	-0.4%	-3.1%
German Bund 10 year	-0.13%	9 bps	-0.3%	-3.2%
UK Gilt 10 year	1.21%	21 bps	-1.5%	-9.0%
Japan 10 year	0.09%	3 bps	-0.1%	-0.2%
Global Investment Grade	92 bps	1 bps	-0.5%	-1.5%
Euro Investment Grade	86 bps	1 bps	-0.2%	-0.6%
US Investment Grade	90 bps	1 bps	-0.6%	-1.7%
UK Investment Grade	89 bps	1 bps	-1.1%	-4.4%
Asia Investment Grade	201 bps	3 bps	-0.4%	-0.4%
Euro High Yield	331 bps	11 bps	-0.5%	3.2%
US High Yield	320 bps	0 bps	-0.3%	4.3%
Asia High Yield	827 bps	123 bps	-5.3%	-11.3%
EM Sovereign	326 bps	-3 bps	-0.6%	-2.1%
EM Local	5.4%	12 bps	-0.5%	-6.8%
EM Corporate	304 bps	-1 bps	-0.5%	1.1%
Bloomberg Barclays US Munis	1.2%	3 bps	-0.2%	0.6%
Taxable Munis	2.3%	11 bps	-0.8%	0.0%
Bloomberg Barclays US MBS	25 bps	-1 bps	-0.3%	-0.9%
Bloomberg Commodity Index	221.82	1.7%	1.8%	31.5%
EUR	1.1575	-0.2%	-0.1%	-5.3%
JPY	112.79	-1.0%	-0.9%	-7.9%
GBP	1.3648	0.5%	1.0%	-0.4%

Source: Bloomberg, Merrill Lynch, as at 25 October 2021.

Chart of the week: Oil prices continue to rise – LTM



Source: Bloomberg, Columbia Threadneedle Investments, as at 25 October 2021.

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Macro / government bonds

Core government bond prices remain under pressure amid a further increase in inflation expectations around the globe.

In the US, for example, 10-year expectations have exceeded the heightened levels of May and are now the highest since 2005 at around 2.6%. A similar pattern is in evidence in both Europe and the UK where expectations are the highest since 2011 and 1996 respectively.

Against this backdrop, the European Central Bank meets this week with markets looking for any signs of tightening in policy; an outcome that we feel is very unlikely. We also get the flash CPI data for the Europe this week.

In the UK, Chancellor Rishi Sunak presents his budget and has already indicated higher taxation of corporate and personal taxes to try and contain the budget deficit. He has been somewhat aided by expectations that growth will be higher in 2021 and 2022 by government forecasters. The UK faces the possibility that this tighter fiscal policy will be accompanied by rising interest rates, with a rate hike now priced into markets before year end.

Investment grade credit

Investment grade spreads have been unmoved by all the volatility in core government markets, with spreads for the global index remaining around 91bps. These spreads have been in very tight range since mid-April. As we have mentioned before valuations look full at best.

In specific news last week, global bellwether HSBC delivered strong results with large writebacks, steady margins and high levels of capital (likely to be returned to shareholders). In less good news. it appears talks between UniCredit and the Italian government have collapsed over troubled lender Monte Dei Paschi. Bonds were weaker on the news.

We are in the middle of corporate results season, which means that new issuance is seasonally light.

High yield credit

US high yield bond prices dipped initially but ultimately recovered over the week amid positive earnings and ongoing volatility in stocks, rates and commodities. The ICE BofA US HY CP Constrained Index returned 0.18% and spreads were 9bps tighter. Primary issuance slowed to $5.8bn this week with the US holiday on Monday, as well as the recent price volatility. According to Lipper, the asset class experienced its largest retail outflow since June with $1.8bn of withdrawals over the week.

European High Yield (EHY) had a negative week as spreads widened and lower-rated credit underperformed. This came in a week of heavy issuance (€4.5bn over 10 offerings, mostly new money and focused on lower-rated credits) where some new issues underperformed after exiting the gate. It was also another week where EHY underperformed US high yield. On the flows front, the numbers were still negative (-€115m), though only due to managed accounts as ETFs experienced a small inflow. Market liquidity was noticeably poor last week, except for new issues.

In M&A news, ASDA and EG Group announced they have terminated the planned sale of Asda's Forecourt business. This came due to changes in the financial evaluation, post the lifting of a "hold separate order." Given the cancellation, Moody's cut Asda's rating to Ba3 (from Ba2).

In IPO news, HT Volvo announced it will issue an IPO. It is said this could be the largest European IPO in 2021 given the price target, and this could trigger a rating upgrade. In the gaming sector, Scientific Games announced it is looking to IPO its Australian lottery business. In other rating news, S&P Raises TUI AG Rtg To B- From CCC+ with outlook stable.

Finally, the Adler Group (German real estate) story had some positive news. The Bundestag has reviewed the complaints booked to them by MPs. Bafin (German Federal Financial Supervisory Authority)'s investigation has not found any fault but at the same time said it couldn't comment on any of the allegations.

Leveraged loans

Leveraged loan prices were modestly lower over the week. The average price of the J.P. Morgan Leveraged Loan index declined $0.01 off the year-to-date high as the asset class continues to decouple from macro driven moves. To wit, loans had significantly outperformed fixed income alternatives over the preceding three weeks' stretch of rising rates. Meanwhile, the retail loan fund base posted its 39th inflow in 40 weeks ($560m) with year-to-date inflows totalling $37bn.

Asian credit

Evergrande Group has staved off an imminent default by paying the overdue coupon payment of $83.5m on the EVERRE 8.25% '22s before the 30-day grace period ended on 23 October 2021. Over the coming weeks, Evergrande needs to pay around $193.3m of overdue coupon payments on four offshore bonds, before the respective 30-day grace periods run out. The holders of the JUMENT 8.5% (private placement bonds, $260m) have also reportedly agreed to extend the payment schedule to avoid triggering cross-default. Evergrande Group did not pay the bondholders when the JUMENT bond matured on 3 October 2021. On a related note, Evergrande's proposed deal to sell a 50.1% stake in Evergrande Property Services for more than HKD40bn (c. $5.1bn) to Hooplife, a subsidiary of Hopson Development Holdings, has been terminated. According to Evergrande, the purchaser has not met the pre-requisite to make a general offer.

S&P has upgraded several Tata Group entities to reflect the reassessment of the influence and potential for extraordinary financial support from the parent Tata Sons, which S&P regards as having investment grade credit quality. The entities include Tata Steel, Tata Motors Ltd and Jaguar Land Rover Automotive PLC. Tata Steel and its 100%-owned subsidiary ABJA Investment Co was upgraded from BB to BBB- with a stable outlook.

Emerging markets

Russia's central bank hiked 75bps to 7.5% as yearly inflation hit 7.4%. The country's inflationary pressures are driven by food prices, which have a 40% weighting in Russia's CPI basket. Globally food prices are at their highest in six years and Russia specifically has suffered from adverse weather conditions during it's growing and harvest season. On the covid front, President Putin has ordered a nationwide week off due to rising deaths.

In Turkey the central bank cut rates by 200bps, exceeding market expectations of 100bps. The Turkish lira dropped to an all-time low against the US dollar as a result. Despite surging inflation Erdogan argues high interest rates cause inflation. Opposition leaders are now calling for central bank independence.

Turkey was also placed on the "grey list" by FATF due to insufficient anti-money laundering / anti-terrorist financing controls. On Monday, Erdogan threatened to expel ambassadors of 10 countries, including the US and Germany.

Commodities

WTI rallied 2% on the week **(see chart of the week)** continuing its foray north of $80 a barrel. The rally was supported by words of caution from OPEC+ regarding production hikes. Surging gas prices have supported the oil price with Goldman Sachs saying switching from gas to oil could add up to 1 million barrels per day in demand.

On the natural gas front, US company Venture Global LNG has agreed to supply up to 5 million tonnes of LNG to China. The agreement is set to span over 20 years; total US LNG exports to China last year stood at 4 million tonnes.

Industrial metals declined 6.7% following the previous week's rally (+10.3%). The drop was driven by China's push to drive up coal output, via waiving production quotas, to support electricity starved metal smelters. Aluminium, the most energy intensive metal to produce, fell by 9.5%.

Responsible investments

The UK government issued its second tranche of Green Gilts last week. The 2053 bond is the longest sovereign green bond issued to date and was just over 12 times oversubscribed. The £6bn issue takes the total in green gilts to £16bn, £1bn over the original planed issuance for this year. This came as the UK government also released detailed plans on becoming net-zero by 2050. The plans have had mixed reviews with some environmental groups stating the strategy is "riddled with holes and omissions".

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

25th October 2021

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	▪ The worsening Delta variant is threatening global reopening/growth stories as case counts rise and restrictions return. In areas with high vaccination rates, low mortality rates may deter policy moves. ▪ Although credit spreads have widened slightly, they are still near all time tights and leave little room for the growth story to get derailed. Pockets of opportunity with deleveraging & upgrade activity exist. ▪ We are past the peak of central bank accommodation. The pullback in liquidity won't be aggressive, but it leaves opportunity for market volatility. ▪ Uncertainty is rising as Delta threatens the recovery, monetary & direct fiscal support wane, and unemployment benefits expire.	▪ Upside risks: the unique COVID recovery in fundamentals allow spreads to rocket past all-time tights. Spreads have spent extended periods near tights in other periods as well. ▪ Downside risks Delta variant cases worsen and restrictions return, threatening returns to schools, offices and travel Once spreads hit these extreme levels, future returns are rarely good Both fiscal and monetary stimulus are removed just as growth decelerates could cause a sell off
Duration (10-year) ('P' = Periphery)	P ¥ $ Short -2 -1 0 +1 +2 Long £ €	▪ Yields have broken out of their earlier tight ranges but likely to remain capped by structural downtrend in real yields and growth ▪ Pandemic scarring keeps reflation credibility low ▪ Fed QE and high personal savings underpin demand for treasuries ▪ ECB likely to lean against rising financing rates ▪ Duration remains best hedge for further risk asset correction	▪ Inflation becomes more persistently entrenched, warranting much higher rate structure ▪ Permanent fiscal policy shift rebuilds reflationary credibility and raises r* ▪ Fiscal largesse steepens curves on issuance expectations ▪ Consumption rebound stimulates long-term inflation expectations ▪ Risk hedge properties deteriorate
Currency ('E' = European Economic Area)	¥ £ EM Short -2 -1 0 +1 +2 Long E A$ $	▪ The US leads the way on the economic recovery from the pandemic, which drives a monetary wedge between the Federal Reserve and ECB ▪ Window for dollar underperformance has narrowed as central banks globally turn more hawkish on inflation expectations at the expense of growth	▪ Re-acceleration of global growth forecasts led by reversal of China credit contraction ▪ US fiscal push fades
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	▪ Selective opportunities ▪ Still-favourable global liquidity conditions ▪ Dollar resilience may crimp scope for EMFX performance ▪ EM real interest rates relatively attractive, curves steep in places	▪ Central banks tighten aggressively to counter fx weakness ▪ EM inflation resurgence ▪ EM funding crises drive curves higher and steeper
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Dispersion in outlooks across EM is rising as the recovery begins at different paces. Countries with commodity exposure and better fiscal adaptability rise to the top. ▪ Index composition changes over the last 5 years have added a lot of duration to the sector, leaving especially IG EM vulnerable. We prefer HY EM (selectively). ▪ US growth outperformance is starting to cause weakness in EMFX, with the exception of countries aggressively hiking rates (like Russia and Brazil).	▪ A replay of 2013 occurs with a taper tantrum or swift appreciation of the USD ▪ Growth scars from COVID persist and hurt commodity prices & ability to grow out of deficits. ▪ There are even further delays in mass vaccination outside of developed markets.
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ US spreads are the tightest since 2005, when average credit quality was higher and duration was 50% lower. ▪ IG has been historically resilient in the face of inflation, even if other sectors may benefit more from it. ▪ Good fundamentals after most recent earnings, with strong balance sheet management and deleveraging from capital management & sales growth	▪ IG bonds further cement their place in global investors' portfolios as safe assets, replacing government bonds. ▪ M&A and shareholder returns remain in the backseat of management's priorities for an extended period of time.
High Yield Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads are nearly to all-time tights, although credit quality has improved through defaults and ample liquidity ▪ The best performing parts of these sectors have been the most volatile and lowest quality. ▪ Defaults are set to drop dramatically in 2021 in part due to the rapid recovery, but also due to an ability to remove near-term maturities by companies across the credit spectrum.	▪ The reach for yield continues to suppress spreads. ▪ Waves of ratings upgrade begin to occur this year. ▪ There are few exogenous shocks that shake the tight spread environment.
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ The Fed has been the 1000lb gorilla in this market since COVID hit, and it is progressively getting closer to tapering. The Fed will taper MBS alongside USTs, but tapering will still be a headwind to the market. Banks, the other major buyers, have slowed their purchases as well. ▪ With interest rates falling again, fundamentals worsen as prepayment speed will remain elevated. Changes to FHFA housing policies could also be marginally negative for fundamentals over time.	▪ Housing activity slows considerably and prepays move back down to normal levels, without denting households' ability to service mortgages. The Fed maintains or increases MBS purchases next year. ▪ The Fed maintains or increases MBS purchases next year.
Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Our preference remains for non-agency RMBS in this area. ▪ RMBS: Housing continues to outperform in the recovery as HH balance sheets are strong, demographics are positive, and supply is constrained. Valuations are less compelling, but can provide stable carry in de risking portfolios. ▪ CMBS: favored bonds are still 'story' bonds. A return to normal won't look 'normal' for sectors like office space or convention hotels and recently has lagged. ▪ Spread tightening looks somewhat excessive along the margins of credit quality.	▪ Changes in consumer behaviour in travel and retail last post pandemic ▪ Work From Home continues full steam ahead post pandemic (positive for RMBS, negative for CMBS). ▪ 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 Soybeans ▪ o/w Oil	▪ US China trade war ▪ Renewed Covid lockdowns ▪ Global Recession

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