INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

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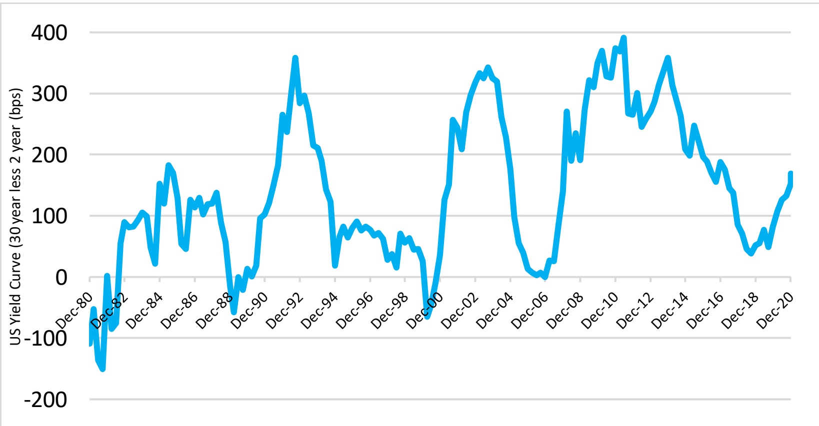
US bond yields buoyed by the 'Blue Wave'

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	1.10%	19 bps	-1.2%	-1.2%
German Bund 10 year	-0.53%	4 bps	-0.2%	-0.2%
UK Gilt 10 year	0.28%	8 bps	-1.6%	-1.6%
Japan 10 year	0.04%	1 bps	-0.1%	-0.1%
Global Investment Grade	101 bps	-2 bps	-0.9%	-0.9%
Euro Investment Grade	88 bps	-5 bps	0.2%	0.2%
US Investment Grade	102 bps	-1 bps	-1.4%	-1.4%
UK Investment Grade	97 bps	-2 bps	-0.6%	-0.6%
Asia Investment Grade	237 bps	2 bps	-0.6%	-0.6%
Euro High Yield	351 bps	-18 bps	0.6%	0.6%
US High Yield	376 bps	-10 bps	0.2%	0.2%
Asia High Yield	587 bps	8 bps	-0.5%	-0.5%
EM Sovereign	317 bps	-6 bps	-0.9%	-0.9%
EM Local	4.3%	6 bps	-0.7%	-0.7%
EM Corporate	320 bps	-8 bps	-0.3%	-0.3%
Bloomberg Barclays US Munis	1.1%	2 bps	-0.1%	-0.1%
Taxable Munis	2.2%	11 bps	-1.4%	-1.4%
Bloomberg Barclays US MBS	22 bps	-17 bps	-0.1%	-0.1%
Bloomberg Commodity Index	169.36	2.1%	2.1%	2.1%
EUR	1.2164	0.0%	0.0%	0.0%
JPY	104.20	-0.6%	-0.6%	-0.6%
GBP	1.3475	-0.7%	-0.7%	-0.7%

Source: Bloomberg, Merrill Lynch, as at 8 January 2021.

Chart of the week: Steeper US yield curve (1980-2021)



Source: Bloomberg, Columbia Threadneedle Investments, as at 7 January 2021.

Macro / government bonds

As the US Political landscape evolves (after Democratic Party victories in Georgia) and the risk of increased (bond-financed) government spending grows, US bond yields have also risen materially. This is driven by supply fears but also rising inflation concerns. Evidence of the latter can be seen in a steeper yield curve and in rising 'breakeven' yields as well as the highest bond yields in many months. A rise in the oil price added to the theme.

Specifically, the difference between long-dated (30-year) US government bonds and their shorter dated (2-year) cousins has widened from around 50bps in February of last year to over 160bps at the time of writing **(see chart of the week)**. Meanwhile long-term inflation expectations, as measured by the yield gap between conventional and inflation-protected government bond yields, have risen to over 2% (from around 0.5% in Spring of 2020). This is now a more 'normal' level and more a reflection of the panicky and illiquid market conditions that prevailed in March 2020.

This phenomenon has been US centric, however, and the same conditions and outcomes have been far less visible in Europe or the United Kingdom. Indeed, yields in both areas have barely moved in the last few weeks. To underline this, inflation in Germany came in at a miserable -0.3% y/y last week. We stick to the view that longer-term inflation is likely to remain pretty subdued; the secular forces of technology use (including WFH), deunionisation and its effect on collective bargaining, ageing populations with a lower propensity to spend, as well as globalisation, are likely to constrain price rises in the coming years. This comes at a time of sub-standard economic growth and higher unemployment.

In other news, the battle between rising Covid-19 infections (new and old variant) and the rollout of vaccines continues with the UK seemingly having a sharp rise in new variant cases but a sizeable programme of immunisations.

Lastly in a data heavy week, German retail sales and employment were stronger than expected, while eurozone money supply growth headed into double digit percentage growth. Car sales for 2020 showed a 15% decline in the US. Non-farm payrolls showed a disappointing 140k loss in jobs, which was focused on the service sector and in areas such as restaurants and bars. Meanwhile, the US unemployment rate came in at 6.7%. In Europe there was better employment news with a decline in the unemployment rate to 8.3%.

Investment grade credit

Credit markets enjoyed a better week than their government cousins with spreads tightening. All investment grade markets were tighter, but euro-denominated credit has outperformed this year thus far. It was a busy week for new issuance after the year end lull, while we expect this year to be relatively light for primary market activity after the deluge of funding last year.

In specific news in the Telecom sector, we are coming to the end of the US C-band spectrum auction that started on 8 December. The market is now expecting these auctions to raise around $90 billion, up from previous expectations of $35 billion. For key players such as Verizon and AT&T the cost of these auctions delays their planned deleveraging. UK Utility Centrica sold it US business with use of proceeds directed to support its balance sheet and pension scheme. Meanwhile, food retailers appear to have had a good Christmas period with lockdowns supporting sales.

High yield credit

US high yield bond prices were roughly unchanged over the week despite a rise in 10-year US treasury yields to a 10-month high as the Democratic sweep of the two Georgia Senate run-off elections is likely to materially alter the near-term outlook for fiscal policy. The ICE BofA US HY CP Constrained index returned 0.21% and spreads were 10bps tighter over the week. The asset class experienced a modest $196 million outflow over the week and saw the new issue calendar re-open with $7.4 billion of issuance.

A quiet start to the new year for European high yield as the world returned from the break. With more lockdowns and pressure on health systems across Europe, it's hard to see the subdued mood lifting in the immediate future. The primary market opened up slowly with one issue by Adler, the German real estate group, but in good size as the initial €1 billion talk for the 2-tranche deal was upsized to €1.5 billion with final price coming in tighter by 50bps from initial price talk. A return to inflows with €170 million into the asset class, both via ETFs and managed accounts. The market was firm as spreads tightened in 18bps from the start of the year.

A slew of M&A news started the year as Groupe Ecor (ECOREG) confirmed they were in exclusive talks with Derichebourg for the sale of the company. Entain (GVC/ Ladbrokes) announced that it is buying Sweden's Enlabs (online gaming) for £250 million. At the same time, Entain has received a takeover offer from MGM resorts. Finally, the Fiat (Ba1 dev/ BB+ W pos and BBB- Sta) – Peugeot (Baa3/ BBB-/ BBB) merger to create Stellantis was signed off by shareholders this week. S&P rewarded the news, upgrading Fiat Chrysler back to investment grade with a rating of BBB-.

Leveraged loans

Leveraged loans prices were very firm in the first week of 2021 as a combination of a bid for risk assets and refocus on rate risk increased the attractiveness of the asset class. The loan index returned +0.66% with Split B/CCC loans (+1.36%) outperforming B loans (+0.59%) and BB loans (+0.63%). Referencing the J.P. Morgan Leveraged Loan index, yields and spreads (3-year) decreased 18bps and 21bps over the past week to 4.92% and 465bps, respectively. As with high yield bonds, absolute yields are the lowest yield for the index since inception, although spreads of 471bps compare to as low as 441bps on 21 January 2020. The asset class reported a small $10 million outflow following four consecutive weekly inflows. However, inflows were strong over the second half of the week following the 'Blue Wave' outcome in the Georgia Senate elections.

Structured credit

The Agency MBS market posted a negative 11bps return last week, besting their more duration sensitive high-quality peers in both investment grade corporates and treasuries. The sector overall benefits from a significantly shorter duration of roughly 3.3 years as rates back-up. The housing market remains robust with limited supply and strong affordability. Speeds are still fast despite higher rates, which in theory should slow refis. Interest-only investments are performing well, as expected in this bear steepening environment. In ABS, spreads continue to compress on continued demand and light supply. New issuance volumes finished 2020 down 20% vs. 2019. Delinquencies climbed across a number of products going into year-end, however, the outcome of the Georgia Senate run-off elections and the Democratic victories in both Senate races should result in more substantial fiscal expansion and benefit the sector.

Emerging markets

Emerging markets started the year with a firm footing as hard currency and corporate spreads both contracted 6bps. Local EM returned -0.7% largely due to EM FX losses. The asset class saw a substantial inflow of $2 billion, of which two thirds was for hard currency and the rest into local currency funds.

The primary market opened with 'a bang' with a record issuance of $24.5 billion in government and corporates. Mexico kicked off 2021 with a 50-year US dollar bond, issue size $3 billion and largely oversubscribed. The bond was largely targeted to Taiwanese life insurance companies, which means it will likely be quite illiquid, as a 'buy and hold bond'. India and Indonesia quickly followed with issue sizes of $1 billion and $3 billion and were similarly more than 3x oversubscribed. Corporates, like Sinopec who issued a 3-tranche bond, were active this week as firms scrambled to issue opportunistically to redeem high-coupon existing bonds or to raise new money to booster liquidity. Notably, Chinese non-SOEs were seen looking to print new bonds given they are less vulnerable to sanction noise from the US.

In regional news, the rift between Saudi Arabia and Qatar eased as Saudi announced a re-opening of its borders with Qatar. Major issues remain, however, as key differences have yet to be resolved (eg, Qatar's foreign relations with Iran and Turkey; closing of Al Jazeera news network). Still, this is a step in the right direction.

Asian fixed income

On 5 January 2021, the Trump administration issued an Executive Order to prohibit transactions on eight Chinese apps. The Executive Order, which will take effect in 45 days, affects Alipay, WeChat Pay, Tencent QQ, QQ Wallet, Camscanner, Vmate, ShareIT and WPS Office. With regards to Alipay, as of end September 2020, there were 731 million MAU (monthly active users) with 80+ million monthly active merchants. The bulk of payment volume is in Mainland China. Total Payment Volume (TPV) on Alipay in Mainland China was CNY118 trillion for the June 2020 LTM period. The amount of international TPV transaction was CNY622 billion (less than 1% of the domestic TPV).

The Trump administration is also reportedly considering a potential investment ban on Alibaba and Tencent Holdings. The investment prohibition currently applies to 35 Chinese companies on the Military List and this takes effects on 11 January 2021. Among others, the affected Chinese companies comprise China National Offshore Oil Corp, SMIC, Huawei, ChemChina and China General Nuclear Corp. Moody's downgraded Saka Energi and placed the ratings on review for further downgrade. Saka Energi has made a partial repayment of a shareholder loan to its parent company, Perusahaan Gas Negara (PGN). Moody's highlights its expectation of a lower likelihood of financial support from PGN to Saka Energi.

Commodities

The commodity index rallied 2.1% last week. WTI climbed by more than 7%, to exceed the $50 a barrel threshold for the first time since February 2019. This was on the back of the Saudi Arabia production cut announced for February and March as well due to the enhanced demand from Asia. The US rig count rose to 360 but is still significantly below the 781 count for this time last year. Agricultural commodities rallied by 1.9%. Weather concerns persist for South America and China continues its strong demand for grains. In base metals, nickel rallied by 4.5% spurred by favourable forecasts for electric vehicle sales, particularly in China as well as supply issues in Indonesia

In precious, gold and silver prices declined by 2.4% and 4.7% respectively as treasury yields rose above 1% making non-interest-bearing assets less attractive.

Responsible investments

The Prince of Wales is to introduce an Earth Charter at the One Planet Summit this week, to give guidance to businesses and corporate leaders to plan for a more sustainable future by 2030. This charter is part of the 10-point Sustainable Markets Initiative first launched by the Prince last year at the World Economic Forum.

Orders for new ships haves declined owing to the coronavirus pandemic, global trade disputes as well as firms working on their emissions targets and looking for alternative-fuel technologies. In efforts to avoid the downfall Odfjell SE, a Nordic shipping company, is planning to issue a sustainability-linked bond that will fund its ‘fleet transition plan’. It hopes to half the carbon intensity of its fleet by 2030 from the level in 2008.

Green, social and sustainable bond issuance this year so far as reached $5.8 billion (according to Bloomberg), which is an 89% increase on this time last year.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

11th January 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	▪ Recent performance is entirely justifiable based on better fundamentals & balance sheets, and the arrival of a vaccine. ▪ Despite this outlook, valuations matter. After a monster month of returns, most spreads are well within long-run average. ▪ We have likely already seen peak liquidity in financial markets. We do not expect material tightening in financial conditions next year, but it is certainly a risk worth watching.	▪ Moving to neutral, risks are two-sided. ▪ A recovering economy propels spreads to all-time tights. ▪ The recovery gets bungled by vaccine delays, geopolitical interruptions, or a limping
Duration (10-year) ('P' = Periphery)	P ¥ $ Short -2 -1 0 +1 +2 Long £ €	▪ Renewed virus concerns and economic disruption to keep nominal growth subdued ▪ Reflation credibility still low, although risks from fiscal policy ▪ Fed QE and high personal savings underpin demand for treasuries ▪ ECB bond buying scheme supports Eurozone market ▪ Duration remains best hedge for further risk asset correction	▪ Vaccine development pace exceeds expectations, permitting rapid normalisation ▪ Permanent fiscal policy shift rebuilds reflationary credibility ▪ Fiscal largesse steepens curves on issuance expectations ▪ Risk hedge properties deteriorate
Currency ('E' = European Economic Area)	¥ £ EM Short -2 -1 0 +1 +2 Long A$ $E	▪ A Biden presidency should see a weaker dollar through the reduction of trade war risk premium. ▪ Longer term, expensive valuations and twin deficits presage a weaker Dollar	▪ Fiscal gridlock continues in the US, which undermines growth and risk sentiment ▪ Extension of Covid restrictions in Europe and accommodative ECB policy
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	▪ Favourable advanced economy setting support EM assets near term ▪ EM real interest rates relatively attractive, curves steep	▪ Sharp escalation in global risk aversion ▪ EM funding crises drive curves higher and steeper
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ EM economies have been given very long leashes to respond to COVID: deficits and debt have skyrocketed with no plans for reigning them in. Any slowdown will likely exacerbate these 'back burner' issues. ▪ Valuations are still a slight benefit to EM, particularly HY credits. ▪ Low yields, lots of liquidity, and global recovery still could provide tailwinds for EM in 2021.	▪ The USD strengthens. ▪ Growth scars from COVID persist and hurt commodity prices & ability to grow out of deficits. ▪ Governments show little willingness to address deficits post-COVID.
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ IG companies continue to adapt well to the economic environment, given that they are the best-in-class operators in their industries. ▪ Outside of the sectors most affected by COVID, IG spreads are close to all-time tights, and the duration of the asset class has increased 1 full year YTD. Long-end bonds may have more room to flatten, but there is little juice left in lower duration bonds. ▪ The end of the Fed credit facilities has had little impact on the market.	▪ Foreign buyers slow for geopolitical or regulatory reasons. ▪ The cash stockpiles taken out at the depths of the crisis are deployed on large-scale M&A instead of deleveraging. ▪ Yields remain low and TINA (There Is No Alternative) pushes buyers to IG instead of Treasuries.
High Yield Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads are inside LT averages, even adjusting for the better quality of today's index. But higher yields give more cushion than slightly higher quality bonds. ▪ The ability to access financing has dramatically improved the prospects for many companies, especially for COVID-affected industries. ▪ The effects of easy financial conditions hit HY later than higher quality sectors, and tighter conditions will hit HY first.	▪ Prolonged COVID-19 related slump in activity would hurt these companies most. ▪ The sector most sensitive to changing financial conditions. ▪ The combination of policy support, vaccine, positive technical, and economic recovery takes spreads well-inside averages
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Fed buying has overwhelmed highly negative fundamentals for most of 2020, but on-the-run spreads have reached 0. ▪ Fed buying cannot be expected to increase in 2021, exposing negative fundamentals and valuations ▪ Prepays remain and will remain high, with >80% of mortgages having incentive to refinance.	▪ Housing activity slows considerably and prepays move back down to normal levels. ▪ The Fed maintains or increases MBS purchases next year.
Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ RMBS: Housing has been a major outperformer in this recovery, as demand rises and inventory remains low. Strong household balance sheets amongst homeowners has kept fundamentals strong as well. However, many of these bonds are now call-constrained. ▪ CMBS: vaccine news reminded investors that a post-COVID world will exist, and CMBS short covering has been fast & furious.	▪ Changes in consumer behaviour in travel and retail last post-pandemic. ▪ Work From Home continues full-steam-ahead post-pandemic. ▪ Built-up savings from fiscal stimulus/enhanced unemployment benefits are drawn down and mortgage forbearance increases.
Commodities	Under-weight -2 -1 0 +1 +2 Over-weight	▪ o/w Copper vs Aluminium ▪ o/w Lead vs Zinc ▪ o/w Soybeans vs Corn and Wheat ▪ o/w refining margins (o/w products, u/w Brent) ▪ u/w Sugar ▪ u/w WTI	▪ Oil production disruption