COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

29 MARCH 2021

It's my party and I'll wait until I want to..

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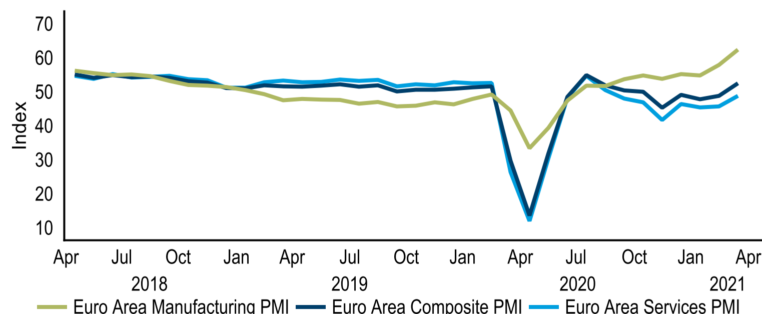
Markets at a glance

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	1.65%	-7 bps	-0.8%	-4.2%
German Bund 10 year	-0.34%	-5 bps	0.3%	-2.0%
UK Gilt 10 year	0.75%	-8 bps	1.2%	-6.3%
Japan 10 year	0.08%	-4 bps	0.9%	-0.3%
Global Investment Grade	100 bps	1 bps	-0.7%	-3.2%
Euro Investment Grade	91 bps	0 bps	0.3%	-0.6%
US Investment Grade	101 bps	1 bps	-1.3%	-4.4%
UK Investment Grade	95 bps	-1 bps	0.4%	-3.5%
Asia Investment Grade	203 bps	-1 bps	-0.2%	-0.7%
Euro High Yield	329 bps	0 bps	0.4%	1.4%
US High Yield	348 bps	-19 bps	-0.1%	0.6%
Asia High Yield	563 bps	19 bps	-0.4%	0.1%
EM Sovereign	326 bps	10 bps	-0.7%	-4.4%
EM Local	5.0%	7 bps	-3.1%	-6.7%
EM Corporate	301 bps	5 bps	-0.6%	-0.7%
Bloomberg Barclays US Munis	1.2%	-8 bps	0.6%	-0.4%
Taxable Munis	2.5%	-7 bps	-1.5%	-4.1%
Bloomberg Barclays US MBS	17 bps	2 bps	-0.5%	-1.1%
Bloomberg Commodity Index	179.53	-0.5%	-1.3%	7.8%
EUR	1.1767	-0.9%	-2.3%	-3.5%
JPY	109.60	-0.7%	-2.8%	-5.8%
GBP	1.3827	-0.6%	-1.0%	0.9%

Source: Bloomberg, Merrill Lynch, as at 26 March 2021.

Chart of the week: Euro Area PMIs



Source: HIS Markit, Macrobond, Columbia Threadneedle Investments as at 29 March 2021.

Macro / government bonds

Core government bond yields were lower and curves were flatter after a volatile week which, at one point, saw US and Europe diverge with US treasuries bear steepening while European government bonds experienced a bull flattening on Wednesday. Markets were caught between inflation concerns given the recent $1.9 trillion American Rescue Plan and talk of a further new $3 trillion infrastructure, childcare and healthcare package. Offsetting this was the continued "Policy unchanged" message from central banks as US Federal Reserve speakers, especially Chairman Powell, emphasized that rates and QE would not change until the economy had fully recovered. The European Central Bank reiterated the same story that accommodative monetary policy would be maintained as PEPP purchases were accelerated. In both cases, the central banks remain unconcerned over inflation and consider any risk transitory at best.

Some positive news from Europe's private sector as both manufacturing and service PMIs **(see chart of the week)** came in much stronger than expected (manufacturing: 62.4 vs expected 57.6; services: 48.8 vs 46.0) powered by a sharp rise in factory output. This comes even as a rise in Covid-19 numbers is forcing renewal and/or stricter lockdowns and restrictions across the continent.

The China vs North America story continues, this time with sanctions over the forced labour Uyghur story. US, Canada and Europe slapped sanctions on Chinese officials at the beginning of the week with China retaliating with sanctions, by the end of the week, against US and Canada officials and a Canadian parliamentary committee.

Investment grade credit

Credit spreads closed the week more or less flat across the board after a busy week of new issuance. We saw resilience in the sterling markets due to the strong vaccine programme and subsiding worries around Brexit.

London Stock Exchange Group Plc came to the US investment grade market last week for $4.5 billion to help fund the recent acquisition of financial tech company Refinitiv Holdings Ltd. The debt will refinance the $27 billion purchase from earlier this year.

Computer software company Oracle issued the second largest issue this year at $15 billion. According to a filing the six-part sale will go towards various refinancing, stock repurchases, dividends and future acquisitions as well as other general corporate purposes. This did trigger both Fitch and Moody's to downgrade the company as it strays from expectations to reduce debt upon maturity. Fitch now rates Oracle as BBB+ (down one notch) with Moody's at Baa2 (down two notches).

US structured credit

The US Agency MBS market posted a positive return of 16bps as the market broadly side-stepped the rate move on the week. Primary mortgage rates are now up 50bps from the lows in December. As a result, the US Federal Reserve has eliminated the 1.5%s from its purchase programme, which resulted in some modest widening on that coupon as 2s and 2.5s have dominated the schedule. The expectation is that 3%s will slowly making their way onto the balance sheet as production increases. CRT spreads were unchanged on the week; however, new issue supply weighed on senior spreads. Non-QM spreads have also widened marginally since the end of February on higher supply and potentially higher rates/slower speeds. Delinquencies are still lower than their pandemic peaks but the improvement in DQs has tapered. Recent stimulus checks and vaccine driven re-openings should be catalysts for improvement.

High yield credit

US high yield bond prices increased over the week alongside an oscillating equity market and US treasury yields off their 14-month highs. The ICE BofA US HY CP Constrained Index returned 0.67%, spreads were 19bps tighter and the yield-to-worst declined 0.27% to 4.24% over the week. Primary market activity remained active with another $10 billion of new issuance over the week, bringing the month-to-date total to $56.8 billion, which is the second most active month on record. According to Lipper, the asset class reported a $1.4 billion outflow, leaving year-to-date net flows at -$10.3 billion.

European high yield finished the week with spreads unchanged at 329bps. Stabilisation was the theme last week as even the nervousness in the longer maturities abated as they found better support compared to the previous weeks. There were net inflows into the asset class even as ETFs continued to experience a sell off. European high yield had €330 million added, via managed funds, into the asset class last week.

It was a heavy primary week with €4.7 billion in corporate bonds that included a special focus on ESG-linked bonds. Novelis (aluminium sheet manufacturer) came with a green bond; Hapag-Lloyd (the German shipping firm) offered €300 million with coupons linked to environmental targets; other issuers were Renault, Saipem, Advanz Pharma and Douglas. Given the general oversubscription, companies continue to be able to get financing without much issue as demand for yield remains quite strong.

Rating actions continue to be on the positive side with another upgrade as Wagamama was moved from B2 to B1 given the recent equity raise earlier in the month.

Leveraged loans

Unlike bonds, leveraged loan prices decreased modestly over the past week and are now $0.35 below the year-to-date high reached on 24 February. The average price of the J.P. Morgan Leveraged Loan index declined $0.04 to $98.11 over the week. Lower quality issues continued to outperform with split-B/CCC-rated loans increasing $0.11. The asset class reported its 11th consecutive inflow with a $784 million contribution over the week.

Asian fixed income

There were several positive ratings actions for Asia corporates last week. S&P raised the credit ratings of Powerlong from B to B+ with a stable outlook because the company's financial profile is expected to improve over the next 12 months from solid sales execution, stable income from investment properties and better profitability compared with its peers. S&P also upgraded JD.com by one notch to BBB+ with a positive outlook due to the improvement in JD.com's business position in China's ecommerce sector. Furthermore, Moody's upgraded Sunny Optical from Baa2 to Baa1 to reflect the improvement in its geographical diversification in production. The company invested in production facilities in India and Vietnam since 2019. Given that Sunny Optical's customers are building up their production facilities outside of China, the geographical diversification helps Sunny Optical to improve its operating scale and asset base.

The Chinese government reportedly proposed a joint venture with the large domestic technology companies to oversee the data that these companies collect from their customers (Bloomberg). The PBOC is supposedly leading this initiative, which is one of the options that the Chinese government is considering to gain more control over the data collected on online platforms run by Alibaba Group, Tencent Holdings, Meituan and other e-commerce and social media companies. Tencent does not view that the tighter regulations will be detrimental for the industry. Tencent

highlighted that it has been compliant with various key regulations and also pointed out its emphasis on risk management and its cooperation with financial institutions instead of seeking to disrupt the system.

Emerging markets

In Argentina, IMF negotiations continue. On Wednesday, Vice President Fernandez announced the country will be unable to repay the $45 billion owed, under current negotiating conditions. However, on Thursday, Economy Minister Guzman said important steps have been taken towards a deal. Argentina restructured $65 billion of debt with private creditors last year.
Chile was downgraded by S&P to A with a stable outlook. This follows Fitch's downgrade to A- last year. Chile has experienced rising social pressures which many believe will lead to higher fiscal deficits going forward. Chile's debt to GDP stood at around 33% at the end of 2020 and remains South America's highest-rated sovereign.
In Colombia the central bank held rates at 1.75% and rejected calls for further stimulus. Additionally, the bank lifted its 2021 GDP forecast to 5.2% from 4.5%. In Mexico the central bank kept rates on hold at 4%. The Philippines also held rates at 2% despite inflation surging to 4.7% in February. Finally, in Thailand the bank held rates at 0.5% as GDP forecasts were revised down on the back of lower expected tourism this summer.

Commodities

Commodities saw a modest decline (-0.5%) as the market grappled with issues of nautical nature. The Suez Canal blockage resulted in a choppy week for energy markets. As of Monday morning there were at least 35 crude oil tankers and 24 product and chemical tankers awaiting passage. The biggest impact was in natural gas (+2.0%) as 8% of global LNG supply passes through the canal. Brent was flat (0.1%) despite a volatile week, with markets balancing the supply blockage vs the demand shock of lockdowns across Europe. In 2019, the canal transported 5 million b/d of crude and crude products.
In base metals, Aluminium rallied by 1.4%, reaching its highest level since 2018. The move has been driven by China's push to reduce carbon emissions resulting in production cuts. China produces over half of the world's aluminium.

Responsible investments

In a bid to eliminate transport pollution by 2050, the UK is considering including the shipping industry in its new carbon market. In other pollution-eliminating news, EDF plans to close its last coal plant in Britain by September 2022.
The world's first conservation bond will be sold this year by the World Bank, as it issues a bond designed to raise funds to help grow the population of endangered black rhinoceros in South Africa. Returns to investors will be determined by the rate of growth of the populations of the animals in two South African reserves. If successful, we could see other conservation bonds for other wildlife species.
The European Union issued a two-part social bond last week amounting to €13 billion. This pushed total issuance in the European bond market to 17% ahead of this time last year. The two bonds, maturing in 5 and 25 years, took orders of 41 and 40 billion euros respectively. Investor demand for the EU's SURE bond programme is clear as day (Support to Mitigate Unemployment Risks in an Emergency).

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

29th March 2021

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	■ 2021 data is shaping up to be noisy once again, but in a much different way than 2020. This time, growth is going to be robust, especially in the US. In addition, issuers on the whole are coming into this environment better than they went into the pandemic. ■ Valuations in most areas of credit provide much less cushion for volatility. But compared to similar spread levels in the decelerating global economy pre-COVID, we still prefer to carry more credit risk in today's accelerating economy. ■ Question marks on the sustainability of super easy financial conditions, inflation, & the labour market widen the range of outcomes for spreads in one year's time.	■ Rapidly rising Treasury yields tighten financial conditions or make all in yields of credit less attractive. ■ A recovering economy propels spreads to all-time tights, especially if vaccinations accelerate quickly ■ Geopolitical tensions rise above a simmer, particularly in the US China relationship, which has not meaningfully improved with a new US Administration.
Duration (10-year) ('P' = Periphery)	P ¥ $ Short -2 -1 0 +1 +2 Long £ €	■ Valuations suggest lower yields likely ■ 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	■ 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$ $	■ US growth outperformance on back of fiscal stimulus boosts USD ■ ECB increasingly sensitive to Euro appreciation	■ Vaccine rollout in Europe improves and narrows growth gap ■ US fiscal push fades
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	■ Favourable advanced economy policy settings support EM assets in near term ■ EM real interest rates relatively attractive, curves steep	■ Sharp escalation in global risk aversion, leading to higher EM inflation via fx ■ EM funding crises drive curves higher and steeper
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	■ The long leash markets gave EMs in 2020 is not extending into 2021. Questions about fiscal stability are rising again (see Brazil). ■ Index composition changes over the last 5 years have added a lot of duration to the sector, leaving it vulnerable. ■ US growth outperformance is starting to cause weakness in EMFX, and financial conditions for EMs is tightening.	■ 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. ■ Governments show little willingness to address deficits post-COVID.
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	■ Index spreads are back to pre-COVID levels, but the duration of US indices have also lengthened by ~10%. ■ Issuer balance sheets still look remarkably strong, and cash reserves remain very high. Our base case is that a fair amount of deleveraging can occur with this cash, but as the economic recovery accelerates and COVID moves to the rear-view mirror, the spectre of M&A and shareholder return still looms. ■ IG has been historically resilient in the face of inflation, even if other sectors may benefit more from it.	■ 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 inside LT averages, even adjusting for the better quality of today's index. But spreads are still wider than pre-COVID. ■ Access to capital remains easy even through more volatile markets of late, and a return to normalcy disproportionately benefits low-quality credits. ■ The positive effects of easy financial conditions hit HY later than higher quality sectors, and tighter conditions will hit HY first.	■ Upside risks include:intensified reach for yield keeps drawing new investors, 2020's downgrade cycle turns quickly into an upgrade cycle. ■ Downside risks include:travel & leisure habits slowly revert to pre-COVID, commodity sell-offs, or financial conditions suddenly tightening.
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	■ Fed buying has overwhelmed highly negative fundamentals, as seen by the near-zero spreads in bonds the Fed buys and poor performance elsewhere. ■ Fed buying cannot be expected to increase in 2021, exposing negative fundamentals and valuations ■ Duration in the sector is now rising quickly as mortgage rates move higher.	■ 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.
Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	■ 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 pockets of value still exist. ■ CMBS: a return to normalcy won't look 'normal' for sectors like office space or convention hotels, but pockets of value still exist in these and other areas (but there are simply fewer opportunities than 6 months ago) ■ Our preference remains for non-agency RMBS in this area.	■ Changes in consumer behavior 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, butseems unlikely to derail it.
Commodities	Under-weight -2 -1 0 +1 +2 Over-weight	■ o/w Copper vs Aluminium ■ o/w Lead vs Zinc ■ o/w Soybeans ■ u/w Livestock	■ US China trade war

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