

Expecting an uneven recovery for investment-grade bonds

Companies will not benefit equally from a recovery, making credit selection essential in picking the winners

By Ryan Staszewski,
Senior Portfolio Manager

When financial markets woke up to the coronavirus pandemic's likely level of contagion in early 2020, there was a disorderly flight to safety. Fortunately, though, the huge international policy response that followed restored confidence and markets rebounded.

From peak to trough the FTSE Global Equity Index Series was down more than 20% early in 2020.¹ Bond markets were hit, too, as high yield and investment-grade bonds were initially sold off. Indeed, the months of March and April 2020 were noted for their massive redemptions of both high yield (HY) and investment-grade (IG) mutual funds.

But just as the sell-off was both rapid and deep, so too the policy response was unprecedented. Globally, central banks pumped around US\$6 trillion into the economy via quantitative easing in 2020.² Some central banks, such as the US Federal Reserve, also expanded their toolkit, purchasing corporate bonds for the first time.³ Meanwhile the fiscal response worldwide has been historic in proportions, with governments in many cases

furloughing salaries of employees, as well as providing tax breaks and state guarantees of lending.

With 2021 well underway, bond markets are now past the distress stage and, with stimulus ongoing, are well on the road to recovery. The huge stimulus ensured that almost all fixed income asset classes recorded respectable returns in 2020: many bond yields hit all-time lows while the amount of negative-yielding bonds hit all-time highs. IG bonds also did well: global returns for 2020 as a whole were 7.7%.⁴

Credit selection will be key

But what about 2021? It is clear that an aggressive roll out of vaccines is required before the global economy can return to an environment resembling "normal". In the meantime, economies will remain reliant on stimulus measures to get the recovery up to speed.

In the short to medium term, at least, there are few signs that central banks are easing off the gas. Indeed, we expect them to continue injecting substantial liquidity throughout 2021.



Major central banks such as the European Central Bank and the US Federal Reserve have also called for more fiscal measures to aid economic recovery. In the US, we think there is a strong likelihood of additional large-scale fiscal stimulus under President Joe Biden.

Clearly, bond markets are recovering. But that recovery will be unequal, and some sectors and companies will fare better than others. In such challenging markets, credit selection will be key. This plays into our strengths at Columbia Threadneedle Investments, given our 150-strong global fixed income team⁵ covering research, portfolio management and trading. We are bottom-up investors, calling upon fundamental research from a global team of in-house credit analysts.

As we enter 2021, we expect most IG bonds to weather the storm of Covid-19, despite record levels of corporate debt. Following significant debt issuance in primary markets in 2020, most IG companies have ample liquidity should unexpected

pandemic-related downside risks materialise, which impede the expected global recovery.

In addition, management teams at many companies are now looking to deleverage their balance sheets by paying down debt. On our forward-looking models we see leverage coming down in 2021 and, over the course of the year, corporate leverage broadly returning to levels last seen at the end of 2019 – a major achievement given the damage inflicted to global economies by the Covid-19 pandemic.

Nevertheless, we are keeping a close lookout for warning signs – such as share buybacks, M&A or dividend increases – that management teams are being distracted from such debt reduction plans.

Stimulus is here to stay

What other potential headwinds are there? Perhaps the biggest risk to bond markets is inflation. We have seen slight upticks in prices but, so far, nothing to give us major concern.

Longer term, we are comforted by the fact that global economies face powerful structural downward pressure on prices, given deflationary phenomena such as technological advances and ageing demographics.

The withdrawal of stimulus is another worry for fixed income investors, given the huge support global policy responses have bestowed on bond – and equity – markets. A fast and effective programme of global vaccine roll-outs could set the stage for a strong economic rebound, reducing the need for policy support.

But even in such a rosy scenario, we believe stimulus measures are here to stay, at least for the short to medium term. That means they are likely to provide support for global bond markets into 2021 and beyond.

Sources:

- 1 Bloomberg, January 2021.
- 2 FitchRatings, Global QE Asset Purchases to Reach USD6 Trillion in 2020, 24 April 2020.
- 3 Bloomberg, Fed Will Begin Buying Broad Portfolio of Corporate Bonds, 15 June 2020.
- 4 ICE BofA Global Corporate Index, January 2021.
- 5 As at March 2021.

To find out more visit
COLUMBIATHREADNEEDLE.COM



Important Information: For use by Professional and/or Qualified Investors only (not to be used with or passed on to retail clients). This document is intended for informational purposes only and should not be considered representative of any particular investment. This should not be considered an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services. **Investing involves risk including the risk of loss of principal. Your capital is at risk.** Market risk may affect a single issuer, sector of the economy, industry or the market as a whole. The value of investments is not guaranteed, and therefore an investor may not get back the amount invested. **International investing** involves certain risks and volatility due to potential political, economic or currency fluctuations and different financial and accounting standards. **The securities included herein are for illustrative purposes only, subject to change and should not be construed as a recommendation to buy or sell. Securities discussed may or may not prove profitable.** The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Threadneedle Investments (Columbia Threadneedle) associates or affiliates. Actual investments or investment decisions made by Columbia Threadneedle and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be suitable for all investors. **Past performance does not guarantee future results, and no forecast should be considered a guarantee either.** Information and opinions provided by third parties have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. This document and its contents have not been reviewed by any regulatory authority.

In Australia: 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.

In Singapore: Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, 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.

In Hong Kong: 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 the Companies Ordinance (Chapter 622), No. 1173058.

In EEA: Threadneedle Management Luxembourg S.A. Registered with the Registre de Commerce et des Societes (Luxembourg), Registered No. B 110242 44, rue de la Vallée, L-2661 Luxembourg, Grand Duchy of Luxembourg.

In UK: Issued by Threadneedle Asset Management Limited. 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 Switzerland: Issued by Threadneedle Portfolio Services AG, Registered address: Claridenstrasse 41, 8002 Zurich, Switzerland.

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 Market 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 Issued 05.21 | Valid to 12.21 | J31497 | APAC_EMEA 3560122