COLUMBIA THREADNEEDLE INVESTMENTS

Your success. Our priority.

In Credit

6 DECEMBER 2021

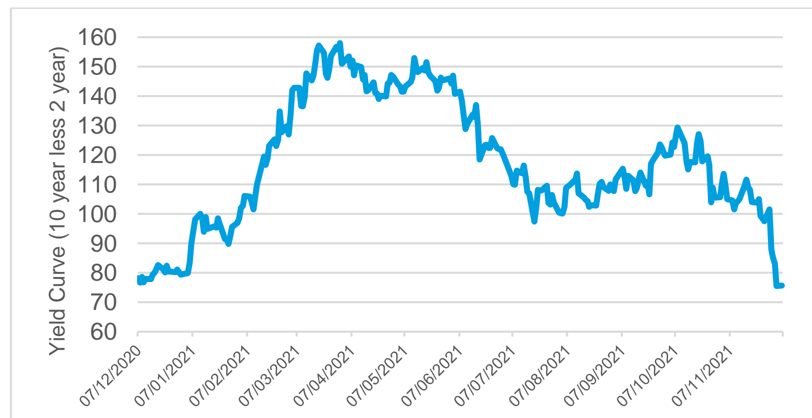
Yields lower, curves flatter & stronger dollar.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	1.38%	-9 bps	0.5%	-1.3%
German Bund 10 year	-0.38%	-5 bps	0.2%	-0.8%
UK Gilt 10 year	0.76%	-6 bps	0.3%	-2.3%
Japan 10 year	0.05%	-3 bps	0.0%	0.1%
Global Investment Grade	105 bps	0 bps	0.5%	-0.3%
Euro Investment Grade	104 bps	-7 bps	0.4%	-0.5%
US Investment Grade	103 bps	2 bps	0.6%	-0.2%
UK Investment Grade	99 bps	0 bps	0.3%	-1.6%
Asia Investment Grade	194 bps	1 bps	-0.2%	-0.1%
Euro High Yield	369 bps	-4 bps	0.4%	2.9%
US High Yield	356 bps	-6 bps	0.5%	3.9%
Asia High Yield	872 bps	38 bps	-1.0%	-13.4%
EM Sovereign	349 bps	-5 bps	1.0%	-1.9%
EM Local	5.7%	-9 bps	0.1%	-10.0%
EM Corporate	327 bps	9 bps	0.2%	0.7%
Bloomberg Barclays US Munis	1.1%	-3 bps	0.1%	1.4%
Taxable Munis	2.2%	-6 bps	0.8%	3.6%
Bloomberg Barclays US MBS	38 bps	5 bps	0.0%	-1.0%
Bloomberg Commodity Index	203.65	-4.3%	0.0%	22.8%
EUR	1.1288	0.0%	-0.2%	-7.4%
JPY	113.19	0.5%	0.3%	-8.4%
GBP	1.3257	-0.8%	-0.5%	-3.2%

Source: Bloomberg, Merrill Lynch, as at 6 December 2021.

Chart of the week: US yield curve (10-year less 2-year)



Source: Bloomberg, Columbia Threadneedle Investments, as at 6 December 2021.

David Oliphant
Executive Director,
Fixed Income

Contributors

David Oliphant
Macro / Government bonds,
Investment Grade Credit

Angelina Chueh
Euro High Yield Credit

Chris Jorel
US High Yield Credit,
US Leveraged Loans

Katherine Nuss
US Investment Grade Credit

Kris Moreton
Structured Credit

Justin Ong
Asian Fixed Income

Doug Rangel
Municipals

Charlotte Edwards
Responsible Investments

Jake Lunness
Commodities
Emerging Markets

3945553 Issued December 2021 | Valid to end February 2022

Macro / government bonds

Core government bond yields were lower and yield curves flatter last week (**see chart of the week).** More hawkish rhetoric from the recently reappointed Chair of the US Federal Reserve has upset the short end of markets, forcing yields higher. The spread of very contagious new variant of Covid threatens economic activity and helped push longer-dated bond yields lower. Longer bonds were also helped by a weaker jobs report in the US at the end of the week. This data showed that 'only' 210k jobs were created last month, rather lower than an expectation of around 600k.The unemployment rate did decline though to 4.2% from 4.6% in the prior period.

The Fed (Powell) has suggested that inflation is rather stickier than had been expected and employment conditions remain healthy, which makes the provision of ongoing asset purchases inappropriate/unnecessary. By contrast, the mantra from the European Central Bank has been rather more measured/dovish. This has meant that the US dollar has continued to strengthen.

Meanwhile, rating agency Fitch upgraded its rating of Italy to BBB at the end of the week.

This week brings US Consumer Price Inflation and European Q3 GDP final data

Investment grade credit

Credit spreads were wider again last week. Having tightened to 88bps at the end of September they ended Friday at 105bps. As was mentioned last week, euro-denominated debt has underperformed in this period of weakness although rebounded last week. This reflects German government bonds becoming more expensive to swaps as a result, it appears, of central bank buying. This has meant that all things equal, credit markets have cheapened relative to their government cousins.

Given the weakness in markets, primary market activity has been more muted, which provides a more positive technical background (especially in euros and sterling). Inflation cost pressures were noted by FMCGs (eg, Heineken and Proctor & Gamble), with an expectation that these will be passed through to consumers.

High yield credit & leveraged loans

US high yield bond prices tentatively recovered this week amidst volatility in equities, commodities and rates as investors attempt to digest the risks from Omicron following the largest setback for the asset class over the last year. The market also dealt with a hawkish shift by Fed Chair Powell and an unexpected OPEC+ decision. The ICE BofA US HY CP Constrained Index returned 0.68% and spreads were 7bps tighter. According to Lipper, the asset class reported s $2.6bn outflow, the largest outflow since March. The asset class enters December having posted two consecutive monthly losses with CCC-rated bonds underperforming in three of the last five months. Leveraged loan prices declined initially but recovered by the end of the week amid the broader market volatility, as well as only the second retail outflows in 46 weeks of $495m.

After the sell-offs seen in the previous weeks, European high yield bounced back with a week of tightening spreads and a positive return for the asset class as CCCs strongly outperforming BBs and Bs. Outflows turned negative with almost €600m exiting, the largest since February, via both ETFs and managed accounts. The primary market was quiet with only one issue and that was a €445m floating rating paper offered by the Italian paper packaging company, Rimini.

Several potential deals are being pulled/postponed, given market volatility, with offerings now more looking to be in Q1, 2022. The market remains resilient but also volatile.

In credit rating news: Boparan, the UK chicken supplier, had its outlook moved to negative by S&P, from stable. This rating outlook change mirrors Fitch's action. S&P said it expects H1, 2022 will be weak but also said it believes that increased prices, if put through, should improve the overall picture in H2,2022.

In stock specific news, Adler, the German real estate group, recently under market scrutiny, had a volatile week as its earnings call, with good figures, was not well received as a Q&A was not offered. In a follow up call, Q&A was offered, but only for written submissions. There was no new news but still something positive could be taken away given an earlier announced sale of assets by Adler to LEG. The good news was that sales would include one of the more controversial assets which was being sold, at a 10% premium to book value.

Structured credit

The US Agency MBS market posted an 8bps total return last week as the rally in interest rates and resulting curve flattening offset an expected faster taper and increased impact of Omicron. The market is locked and loaded for next week's Fed meeting and at this point it will be a surprise if the Fed does not accelerate the taper given recent employment and inflation data. The FHFA announced new lending limits for confirming loans, boosting the level nearly $100k to $647,200 effective January 1, 2022. In CMBS, spreads widened on the Omicron variant as well as further expected tightening by the Fed. AAA bonds are at April levels now, around +70bps, while BBB conduit bonds are trading in the high +200bps range. In Single Asset Single Borrower, volumes have been modest given seasonal liquidity challenges and demand for higher premiums against macro volatility.

Asian credit

The investigation of cross-border gambling syndicate led to the arrest of Alvin Chau who heads Suncity Group, the leading casino junket operator in Macau. The potential for a broader crackdown on junket VIP is negative but the overall impact could be limited over time because the gaming companies have been working to increase the contribution from their mass market/slot machines and non-gaming segments. On average between 2016 and 2020, the VIP segment as a percentage of market GGR is around 43%. However, the VIP contribution has been trending lower for the six concessionaries in Macao, from around 48% in 2016 to 38% in 2019 and then 34% in 2020.

Evergrande Group has received a demand to perform its offshore debt obligations under a guarantee in the amount of $260m. The company stated its plans to engage with offshore creditors to formulate a viable restructuring plan.

Emerging markets

The Turkish lira continued its losses against the US dollar following the resignation of finance minister Elvan, who was in favour of restrictive policy. The news comes as Turkish president Erdogan doubled down on his low interest rate policy in a 2-hour televised interview. The lira has now lost 45% of its value against the dollar this year.

At the Russian Ukrainian boarder tensions continue to rise as US intelligence revealed a Russian plan to invade Ukraine in early 2022. The US and European allies are weighing up sanctions in response. Ukrainian government bonds and state-owned oil and gas company Naftogaz weakened on the news.

In China, distressed property developer Kaisa group failed to reach a bondholder agreement to extend the maturity of $400m of bonds by 18 months. In more positive news China cut its reserve ratio requirement by 50bps, which according to the PBOC will release 1.2 trillion yuan of long-term liquidity to the banking sector.

In Mexico Victoria Rodriguez was approved by the senate as the country's first female central bank governor.

Commodities

In crude brent fell by 2.4% as OPEC+ surprised markets by deciding to continue to raise production despite concerns surrounding the omicron variant. Saudi Arabia also raised crude prices for both Asian and US buyers.

The biggest mover on the week was once again natural gas, with a 24.6% decline. The drop was driven by milder winter weather on the US east coast and rising supply from the Marcellus shale region, alleviating supply concerns.

Responsible investments

An automotive focus this week as Tesla is soon to open its German production operations that could see around 30,000 vehicles roll off the production line by June 2022. Original plans to open in the summer were delayed due to local environmental clearance, with the company rumoured to be getting approval in the coming days.

Other advances last week in the electric car space come from Nissan, which plans to invest $17.6bn (2 trillion yen) over the next few years to electrify its product range. The company has announced it will launch 23 new models by 2030, including 15 new electric models.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

6th December 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	▪ 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 ▪ Tactically reduced EURUSD short given the uncertainty around Omicron and potential impact on Fed tightening cycle.	▪ Re-acceleration of global growth forecasts led by reversal of China credit contraction ▪ US fiscal push fades ▪ Omicron variant requires reimposition of health measures and knocks Fed off course, to the benefit of low yielding majors versus the Dollar.
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	▪ Selective opportunities ▪ 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 ▪ Tightening global financing conditions
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 Oil	▪ US China trade war ▪ Renewed Covid lockdowns ▪ Global Recession

Important information: For use by Professional and/or Qualified Investors only (not to be used with or passed on to retail clients). Source for all data and information is Bloomberg as at 06.12.2021, unless otherwise stated.

This material in this publication is for information only and does not constitute an offer or solicitation of an order to buy or sell any securities or other financial instruments to anyone in any jurisdiction in which such offer is not authorised, or to provide investment advice or services. Offerings may be made only on the basis of the information disclosed in the relevant offering documents and the terms and conditions under the relevant application forms. Investment involves risk. You are advised to exercise caution in relation to this material. Please refer to the relevant offering documents for details and the risk factors. Past performance is not a guide to future performance. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. The research and analysis included in this publication have been produced by Columbia Threadneedle Investments for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice and should not be seen as investment advice. Information obtained from external sources is believed to be reliable but its accuracy or completeness cannot be guaranteed. The mention of any specific shares or bonds should not be taken as a recommendation to deal. This document includes forward looking statements, including projections of future economic and financial conditions. None of Columbia Threadneedle Investments, its directors, officers or employees make any representation, warranty, guarantee, or other assurance that any of these forward looking statements will prove to be accurate. This document may not be reproduced in any form or passed on to any third party in whole or in parts without the express written permission of Columbia Threadneedle Investments. This document is not investment, legal, tax, or accounting advice. Investors should consult with their own professional advisors for advice on any investment, legal, tax, or accounting issues relating an investment with Columbia Threadneedle Investments. This document and its contents have not been reviewed by any regulatory authority.

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. Issue by Threadneedle Investments Singapore (Pte.) Limited, 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. 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 Companies Ordinance (Chapter 622), No. 1173058. Issued by Threadneedle Asset Management Limited (TAML). 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 Japan: Issued by Columbia Threadneedle Investments Japan Co., Ltd. Financial Instruments Business Operator, The Director-General of Kanto Local Finance Bureau (FIBO) No.3281, and a member of Japan Investment Advisers Association. 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 Marketing 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