COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

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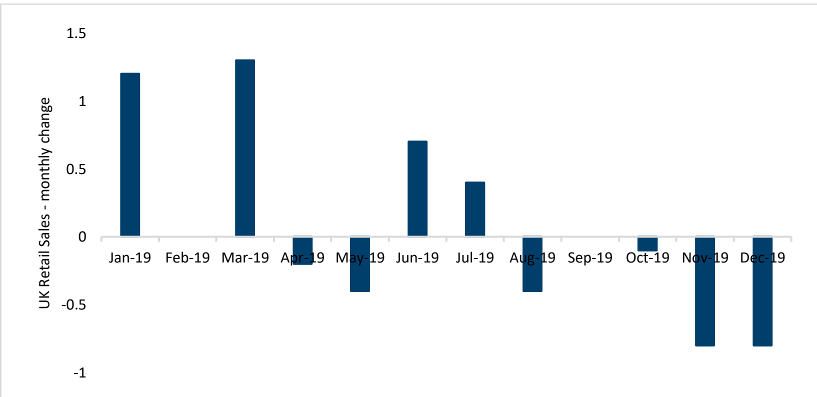
All quiet on the UK high street.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	1.82%	0 bps	0.5%	0.5%
German Bund 10 year	-0.21%	-1 bps	0.3%	0.3%
UK Gilt 10 year	0.63%	-14 bps	2.1%	2.1%
Japan 10 year	0.01%	1 bps	-0.3%	-0.3%
Global Investment Grade	100 bps	-2 bps	0.7%	0.7%
Euro Investment Grade	93 bps	-2 bps	0.3%	0.3%
US Investment Grade	99 bps	-2 bps	0.7%	0.7%
UK Investment Grade	108 bps	-2 bps	1.9%	1.9%
Asia Investment Grade	191 bps	-3 bps	0.7%	0.7%
Euro High Yield	320 bps	-9 bps	0.6%	0.6%
US High Yield	339 bps	-9 bps	0.8%	0.8%
Asia High Yield	529 bps	-7 bps	1.5%	1.5%
EM Sovereign	278 bps	-6 bps	0.9%	0.9%
EM Local	5.2%	0 bps	-0.2%	-0.2%
EM Corporate	303 bps	-6 bps	1.2%	1.2%
Bloomberg Barclays US Munis	1.6%	-6 bps	1.0%	1.0%
Taxable Munis	2.9%	0 bps	1.5%	1.5%
Bloomberg Barclays US MBS	38 bps	0 bps	0.3%	0.3%
Bloomberg Commodity Index	169.85	-1.1%	-1.3%	-1.3%
EUR	1.1087	-0.3%	-1.1%	-1.1%
JPY	110.15	-0.6%	-1.4%	-1.4%
GBP	1.2968	-0.4%	-1.8%	-1.8%

Source: Bloomberg, Merrill Lynch, as at 20 January 2020.

Chart of the week: UK Retail Sales – Monthly change LTM



Source: Bloomberg, Columbia Threadneedle Investments, as at 20 January 2020.

Macro / government bonds

Aside from the UK, government bond yields were little changed last week. In the UK, sterling was weaker and gilt yields were lower last week with dovish rhetoric from the Bank of England supported by a weak GDP report and dismal retail sales data.

The November reading for UK GDP recorded -0.3%, taking the annual rate of expansion to 0.6% - the worst since 2012. Core (CPI) inflation fell to 1.4% y/y, which was lower than expected while house prices rose 0.3% m/m to 2.2% y/y. The December retail sales data showed a 0.6% m/m decline - taking the annual rate to only 0.8% and showing no growth in the last five months. The chances of a rate cut in the UK are rising. In other news the German economy expanded by 0.6% y/y in 2019 (1.5% 2018). The country recorded a budget surplus of 1.5% of GDP in the same period.

The US and China have made peace and signed phase one of a trade deal. The key Consumer Prices Inflation data revealed a 0.2% rise in the last month of the year (core +0.1%). That takes the annual rate of increase for both to 2.3%. US Retail sales were also reasonably robust with an (ex-autos) 0.7% m/m increase.

Investment grade credit

Corporate bond spreads were a couple of basis points tighter last week with the US index breaching the 100bps spread level.

The last couple of months rise in government bond yields has not meant that corporate bond markets offer much more attractive yields. The global corporate bond index which offered a yield of around 2.1% in August of last year (the lowest in 20 years) is fairly unchanged at around 2.2% today. Spread tightening has compensated for the rise in government bond yields.

In specific news, the pace of new issuance calmed from the frenzied conditions of last week. US bank results came and went without much excitement. They showed reasonable loan growth, challenged margins but a decent performance from investment banking - especially related to fixed income. The US bank index trades with a spread of 77bps, the tightest since January 2018.

High yield credit

US high yield bond prices continued to climb over the past week alongside additional gains for equities as a strong start to the 4Q earnings season; modestly improving global economic data; and a formally signed Phase One trade agreement are boosting risk appetite.

According to Lipper, the asset class reported a $1.7 billion inflow for the week, making it two consecutive $1 billion weekly inflows to start the year. New issuance totalled an 8-week high $12.1 billion over the past week to bring month-to-date issuance to $20.4 billion.

European high yield performed well last week led by strong performance by CCC rated issues. Issuance was lighter from the previous week with only one new issue, Salini, an Italian construction company. In issuer specific news, S&P downgraded Autostrade per L'Italia from BBB- to BB- and its holding company, Atlantia, to BB- (from BB+) last week, putting both on negative watch. This comes after the broad changes made in Italy to the toll road regulatory framework, making it easier for contracts to be cancelled or terminated.

Asian fixed income

Asian credit has posted a total return of 0.9% year-to-date, helped by spread tightening and lower US treasury yields.

In 2019, numerous Chinese high yield corporates have successfully undertaken the 'bond exchange and tender offer' route to refinance their short-term debt maturities. These companies included China Grand Auto, CAR Inc, Zhongrong International, Hilong Holdings and Fosun.

In India, the Supreme Court dismissed the October 2019 petition from Bharti Airtel and Vodafone Idea to review the ruling on the AGR dues. This implies that both Bharti and Vodafone Idea are liable to pay the AGR dues by 23 January 2020. This development is also negative for Bharti Infratel (tower business) due to the pressure on tenancy. The two companies are considering to file a curative petition or may also request for an extension to the payment timeline.

As of 17 January, Asia has seen $30.6 billion of new supply year-to-date (prior year period: $14.7 billion), with Chinese high yield property accounting for more than one-third of the primary issuance.

Emerging markets

Emerging market hard currency spreads were 6bps tighter last week as the asset class continued to perform strongly. Inflows were up again at $2.5 billion last week (compared to the previous week of $1.7 billion).

On the rating cutting front, it was South Africa (-25bps to 6.25%) and Turkey (-75bps to 11.25%) while Egypt kept rates unchanged (resulting in a rally in the Egyptian pound). The South African government did not give the ZAR 2 billion that it had promised South African Airlines (which has already received ZAR 57 billion in bailouts, since 1994). As Utility Eskom is in the same position as South African Airlines, there is a concern that the government could be becoming stricter about supporting these entities.

Commodities

Commodity prices were down last week, with the index falling 1.1% - largely led by energy.

Natural gas led the fall in energy as prices deteriorated by over 10% as the market became concerned about above average inventories and further supply coming to the market during a period of warmer than average weather so far this year. This is happening at a time where shale production of natural gas is booming.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

20th January 2020

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	■ Global economic data continues to register at low or contractionary levels across many sectors and regions. There are modest signs of stabilization, however spread levels appear to reflect this already. Trade headlines continue to fly back & forth, but we see risks that are more fundamental than these.	■ Fast and fierce fiscal stimulus, especially in Europe or China. ■ Reacceleration of growth trends
Duration (10-year) ('P' = Periphery)	¥ $ Short -2 -1 0 +1 +2 Long € P £	■ Global manufacturing remains in stagnation ■ US trade policy undermines business investment at home and abroad ■ US and global monetary policy continues to respond to softening macro backdrop	■ Global trade détente stimulates improvement in risk sentiment ■ US economy stages consumption-driven cyclical upswing
Currency ('E' = European Economic Area)	EM $ A$ E Short -2 -1 0 +1 +2 Long ¥ £	■ The Dollar is richly valued on the basis of growth outperformance and high carry. With the US economy catching down and the Fed cutting rates, the twin pillars of support should give way to the structural drag of the twin deficits ■ An improvement in global risk sentiment due to progress on Phase 1 trade deal may undermine some of the dollar's 'safe haven' demand.	■ Further leg lower in global growth driven by increasing trade frictions.
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	■ EM real interest rates still relatively attractive ■ EM growth likely to outperform DM, while inflation benign ■ Fiscal and external fundamentals still largely sound	■ Sharp escalation in global risk aversion ■ Broad dollar strength
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	■ Fundamentals have been not deteriorated as much as would have been expected given a strong USD and catering global trade ■ While spreads have tightened much like other asset classes, pockets of valuations gaps have open-ended up ■ The number of idiosyncratic blow-ups is increasing: first Argentina, now Ecuador and Lebanon are precipitously deteriorating	■ Oil & commodity rally will boost sentiment and current account balances. ■ A rapidly weakening USD will ease financial conditions ■ Reversal of recent electoral trend towards market-friendly candidates.
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	■ Broad valuations have become unattractive on an absolute basis, even before considering higher debt levels and decelerating growth ■ Fundamentals don't show signs of imminent crisis, but several of the tailwinds are fading. Valuations look even more offside when considering this	■ A re-acceleration of growth especially in the more downtrodden European and Asian economies ■ Beneficial technicals from low and negative yields globally continue to funnel cash to the market.
High Yield Credit	Under-weight -2 -1 0 +1 +2 Over-weight	■ Valuations are unattractive relative to other asset classes. ■ Forecasted default rates have started rising faster than expected earlier this year. ■ Technicals remain positive as net supply remains very negative through rising stars & called bonds.	■ Oil quickly rebounds, likely from supply side shocks. ■ US fiscal stimulus or unexpectedly large sentiment boost from trade war resolution boosts valuations.
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	■ Prepayments have increased as a result of lower rates, however they have lagged expectations given the fall in Treasury yields. ■ Spreads have widened to near post-GFC wides despite relatively muted prepayment activity.	■ Interest rates continue falling aggressively as they did through the summer ■ Rate volatility increases.
Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	■ Fundamentals remain relatively strong as the Household balance sheet is strong and house price appreciation is still positive. ■ Leverage trends within these sectors have continued to be contained, especially compared to rising asset valuations. ■ Valuations in CMBS are notably less attractive than non-agency MBS.	■ Tightening in credit conditions for US consumer. ■ Housing activity begins to contract. ■ Stress in traditional mall-based retail becomes more entrenched across the board.
Commodities	Under-weight -2 -1 0 +1 +2 Over-weight	■ o/w Cu vs Zinc ■ o/w Soybeans, Corn vs u/w Wheat ■ o/w Sugar ■ o/w Brent vs WTI ■ o/w Platinum vs Aluminium ■ o/w Gasoline vs Distillates	■ Material China slowdown, weighing on economic growth, metals & petrol