COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

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"Turning to the tasks of our time"

Joe Biden, 46th President of the United States

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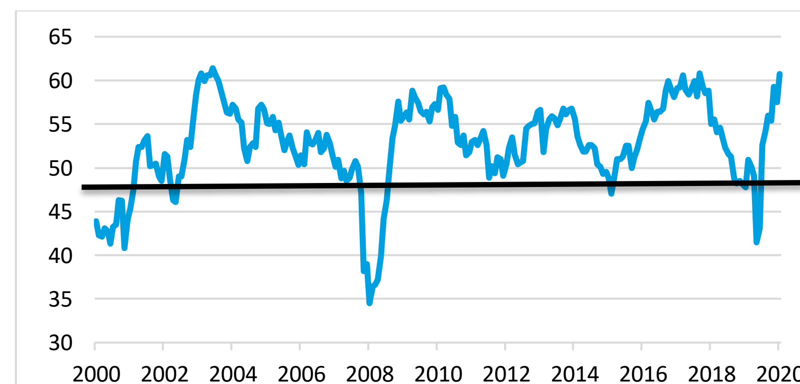
Markets at a glance

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	1.06%	-2 bps	-1.1%	-1.1%
German Bund 10 year	-0.54%	0 bps	-0.4%	-0.4%
UK Gilt 10 year	0.28%	-1 bps	-1.8%	-1.8%
Japan 10 year	0.05%	1 bps	-0.2%	-0.2%
Global Investment Grade	100 bps	0 bps	-0.7%	-0.7%
Euro Investment Grade	90 bps	-1 bps	0.0%	0.0%
US Investment Grade	101 bps	1 bps	-1.1%	-1.1%
UK Investment Grade	97 bps	-1 bps	-0.7%	-0.7%
Asia Investment Grade	233 bps	-2 bps	-0.2%	-0.2%
Euro High Yield	344 bps	-12 bps	0.7%	0.7%
US High Yield	375 bps	1 bps	0.4%	0.4%
Asia High Yield	583 bps	-3 bps	0.0%	0.0%
EM Sovereign	327 bps	-2 bps	-1.3%	-1.3%
EM Local	4.3%	2 bps	-1.2%	-1.2%
EM Corporate	325 bps	0 bps	-0.2%	-0.2%
Bloomberg Barclays US Munis	1.0%	-4 bps	0.2%	0.2%
Taxable Munis	2.1%	-4 bps	-0.2%	-0.2%
Bloomberg Barclays US MBS	21 bps	2 bps	0.0%	0.0%
Bloomberg Commodity Index	169.41	-1.7%	1.4%	1.4%
EUR	1.2151	0.7%	-0.4%	-0.4%
JPY	103.74	0.1%	-0.4%	-0.4%
GBP	1.3684	0.7%	0.1%	0.1%

Source: Bloomberg, Merrill Lynch, as at 22 January 2021.

Chart of the week: US Manufacturing PMI



Source: Bloomberg, Columbia Threadneedle Investments, as at 25 January 2021.

Macro / government bonds

President Biden kicked off his new term with a flurry of executive orders and directives (30) in his first three days of office. These were largely focused on undoing directives of former President Trump, as well as focusing on the pandemic issue. The backroom negotiation on his $1.9 trillion Covid-19 relief plan has begun, with hopes of bi-partisan support as well as a speedy passing of the bill. However, as Trump's impeachment trial is also supposed to start soon, there is already talk of some 'horse-trading' by both parties, linking the two events.

The shortened week saw core markets trading in a relatively tight range with the US 10-year yield finishing the week unchanged although the US yield curve did steepen about 3-4bps. This suggests that the inflation trade is not totally dead. US data was better than expected last week with figures showing a pick-up in manufacturing (**see chart of the week**), services, housing as well as more easing on the jobless claims front. A good start for the new 46th President of the US.

The latest statement from the European Central Bank on Covid-19 did not include any major policy changes except to make more explicit that there is flexibility in the use of the Pandemic Emergency Purchase Programme. As the economy recovers the ECB will try to manage financial conditions to avoid automatic tightening. This could result in rising yields, widening spreads, or a steepening curve. In the UK, January Services PMI came in much lower than expected at 38.8 (forecasted 45). December's UK retail sales were also worse than expected.

In Covid-19 news, there was talk of delays in shipping vaccinations to Europe and delivery of the second vaccination. The US hit the 25 million mark for Covid cases while Hong Kong reinstituted a partial lockdown.

Investment grade credit

Core market spreads were relatively flat on the week with some tightening seen in Asian, UK and euro areas. The global investment grade credit spread did tighten below 100bps throughout the week to 99bps, a double-digit figure last seen in January of last year.

We continue to see low issuance levels across investment grade as expected.

High yield credit

US high yield bond prices were largely unchanged over the week as investors began to assess Q4 earnings and absorbed another active week for capital markets as issuers take advantage of historically low yields. The ICE BofA US HY CP Constrained Index returned 0.06% and spreads were unchanged over the week. Energy and lower-rated issuers continued their notable outperformance. The index has returned 0.41% thus far year-to-date while Energy and CCC-rated issuers have returned 1.9% and 2.0% respectively. The asset class experienced its fifth outflow over the last six weeks with a $905 million withdrawal over the week.

In European High Yield (EHY), Beta compression continued. There were strong bounces in single names (excluding Netflix), as well as distressed retailers, such as German retailer Douglas, (on rumours of realisation of better than expected results). High beta single names continue to outperform as investors look for yield. Even as spreads tightened in 12bps, EHY flows were almost flat last week with an outflow of only €3 million. Another heavy primary market week with €5.3 billion priced over seven issuers. Where the previous week had focused on BB issuers, this week

saw some lower rated single B's via issuers including INEOS Quattro (10x oversubscribed), Rekeep, Pinewood and Webuild, taking year-to-date total corporate EHY issuance to €11.4 billion (twice 2020's level for the same period).

Leveraged loans

Leveraged loan prices rose for 13th consecutive session to begin the year as asset class inflows continued. The average price on the J.P. Morgan Leveraged Loan index has risen to $98.28, up +$0.16 during the week and up +$1.18 year-to-date. Meanwhile, loan yields and spreads (3-year) decreased 6bps and 4bps during the week to 4.71% and 444bps, respectively, and are down 39bps and 41bps in January. This is the lowest yield for the index since inception, while spreads of 444bps compare to as low as 441bps on January 21, 2020. The Loan index is providing a +1.41% gain in 2021 with Split B/CCC loans (+3.67%) outperforming B loans (+1.27%) and BB loans (+1.07%). The asset class saw its largest weekly inflow in four years with a $1.4 billion inflow for the week. The was also the sixth inflow over the last seven weeks following two years of nearly constant outflows.

Structured credit

Higher rates have been supportive of RMBS given an expected slowing of refis; however, prepayments continue at a historic pace. On recent bear steepening, 15-year RMBS has outperformed 30-year and higher coupons beat lower coupons on higher projected mortgage rates going forward. That said, mortgage rates have been very sticky and are still hovering near the lows. Fundamentals are improving with 5.5% of mortgage borrowers past due on payments vs 7/4% in August. The housing market remains a tailwind for non-agency RMBS given low supply, strong demand and historically low rates. While there has been considerable spread tightening, the sector still offers decent yield for the risk. In CMBS, industrial and multi-family properties are performing best while business-centric hospitality and lower quality retail continue to lag given extended covid-related WFH and travel restrictions. The CMBS sector has experienced the most bifurcated price recovery within the structured credit universe. In ABS, consumer borrower performance is starting to mean revert from exceptionally strong levels.

Emerging markets

EM Sovereign and corporate spreads experienced further tightening of 1bps and 6bps respectively. EM local rallied with 40bps return, largely on US dollar weakness. The year's heavy inflows continued, with a multi-period high of $4.5 billion of which $2.8 billion went into local currency EM and overall, largely into managed funds ($3.7 billion). This bring year-to-date inflows for EM bonds to $9.5 billion.

In central bank news, policy decisions kept rates unchanged (Indonesia at 3.75%, Malaysia at 1.75%, South Africa at 3.5%, Ukraine at 6.0%, and Brazil at 2.0%.) This is a clear sign that the market has reached the end of the rate cutting cycle. In the primary market, there was continued strong issuance on both the sovereign and corporate front with names like Bahrain, Chile, Turkey as well as a green bond by Hong Kong. On the quasi sovereign and corporate front, Gazprom as well as several Asian names came to the market. Very little concession is being offered relative to the existing curve with most issuers coming with long-dated bonds or tapping existing long-dated bonds. This has been a trend since last year, resulting in the market's duration, based on JPM EMBIG index, rising by more than 0.5 years. It is likely to continue.

Asian fixed income

Early last week, the Trump Administration revoked the export licenses that allow US companies such as Intel to supply components and services to Huawei. This is one of the last measures taken by the Trump Administration against China ahead of the transition to the Biden administration.

In Indonesia, Pan Brothers has reached a standstill agreement for its $138.5 million revolving credit facility which comes due on 27 January. Pan Brothers plans to seek shareholder approval during its shareholder meeting on 26 January to raise $350 million through bonds.

Adani Group (promoter group) will sell a 20% stake in Adani Green to Total SA for around $2.5 billion. Total will also obtain a 50% in a stake in a JV that holds the operating solar assets of Adani Green. Fitch downgraded Delhi International Airport from BB+ to BB with a negative outlook to reflect the significant drop in DIAL's volume and a slow recovery in traffic volumes.

Commodities

The energy index declined 2.5% with natural gas as the biggest detractor, falling by 8.9%. Henry Hub average prices sit at their lowest in decades on the back of milder weather in the US. In crude oil, Iraq pledged to taper output in January and February after breaching its OPEC+ quota in 2020.

Base metals rallied by 0.6% with tin and nickel supporting the rally. Tin surged by 4.4% to reach its highest level since 2014. LME stockpiles of the metal fell close to the lowest levels since 1989. Nickel rallied by 1.4%, which has been supported by growing demand for EV batteries in China.

In Agriculture, the sub-index declined by 6.3%. The biggest drivers were soybeans (-7.4%) and wheat (-6.1%). This was driven by rains benefiting Brazilian growing regions. South American weather is expected to be more crop friendly going forward.

In precious, gold rallied by 1.4% with silver surging by 2.8% as the market awaits the US Federal Reserve's first meeting of 2021.

Responsible investments

Biden kept true to his promise of re-joining the Paris Agreement as part of his first signing of executive orders. Along with imposing a moratorium on oil & gas and leasing permits, a review of the domestic environmental regulation and considering the social cost of carbon, this is just the start of many pledges Biden made during his campaign that focused on his care for climate change. Soon we should hear his announcement on an emissions target for 2030 for the US, as well as what he plans to do to achieve it.

Tesco issued a €750 million sustainability-linked bond last week that ended up having €5.75 billion in orders. If the company fails to meet its emission targets the coupon will step up 25bps per year come July 2027. Sustainability-linked bonds total issuance year-to-date is already over 35% of last year's total issuance.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

25th January 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 has started with continued positive credit performance – and not for nothing: fundamentals in 2021 should continue to improve as economic activity normalizes amid more widespread vaccination. ▪ Despite this outlook, valuations matter. Most spread sectors are well inside long-term averages. ▪ We have likely already seen peak liquidity in financial markets. We do not expect material tightening in financial conditions next year, but spreads at these levels no longer offer cushion for unforeseen hiccups. ▪ We have a modestly positive outlook but realistic returns are lower than in 2020.	▪ 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 back to normality in the services sector
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 EM HY credits. ▪ Low yields, lots of liquidity, and global recovery still could provide tailwinds for EM in 2021.	▪ 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	▪ IG companies continue to adapt well to the economic environment, given that they are the best-in-class operators in their industries. ▪ Valuations are the biggest drawback: with spreads this tight, widening could very quickly more than offset carry. ▪ Technicals remain strong, especially as global investors survey the universe of high-quality assets and see extremely low government bond yields.	▪ IG bonds further cement their place in global investors' portfolios as safe assets, replacing government bonds. ▪ Management teams eschew M&A and shareholder return in order to continue to pay down debt during the recovery.
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 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, M&A lifts HY companies into larger IG conglomerates. ▪ 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 ▪ Prepays remain and will remain high, with >70% of mortgages having incentive to refinance.	▪ 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 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

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