INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

20 JULY 2020

David Oliphant
Executive Director,
Fixed Income

'In Credit' contributors

David Oliphant
Macro / Government bonds,
Investment Grade credit

Angelina Chueh
Euro High Yield credit,
Emerging Markets,
Commodities

Chris Jorel
US High Yield credit

Katherine Nuss
US Investment Grade credit

Kris Moreton
Leveraged Loans
Structured Credit

Justin Ong
Asian Fixed Income

Doug Rangel
Municipals

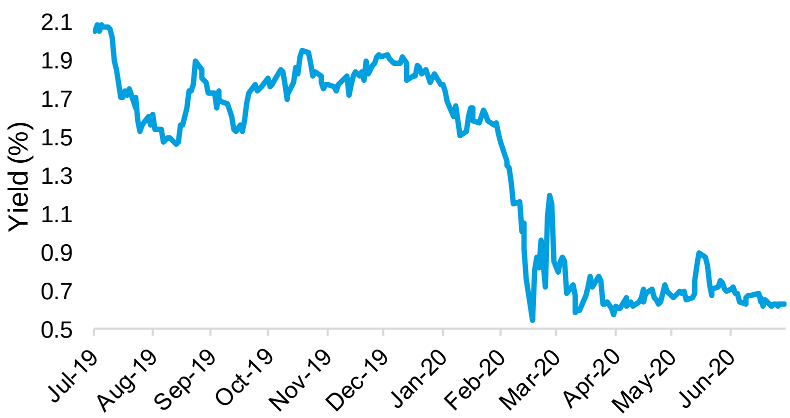
Nothing to see here.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	0.62%	-3 bps	0.4%	9.5%
German Bund 10 year	-0.44%	3 bps	-0.1%	2.1%
UK Gilt 10 year	0.16%	1 bps	-0.4%	9.1%
Japan 10 year	0.03%	0 bps	0.2%	-0.8%
Global Investment Grade	146 bps	-6 bps	1.4%	4.6%
Euro Investment Grade	134 bps	-8 bps	0.7%	-0.5%
US Investment Grade	146 bps	-6 bps	1.8%	6.8%
UK Investment Grade	138 bps	-3 bps	0.7%	4.1%
Asia Investment Grade	269 bps	0 bps	0.6%	3.8%
Euro High Yield	525 bps	-16 bps	1.1%	-4.0%
US High Yield	574 bps	-40 bps	2.3%	-2.6%
Asia High Yield	710 bps	0 bps	0.8%	0.5%
EM Sovereign	419 bps	-7 bps	1.7%	-0.2%
EM Local	4.5%	0 bps	1.2%	-5.8%
EM Corporate	429 bps	-1 bps	1.0%	0.8%
Bloomberg Barclays US Munis	1.3%	-8 bps	0.9%	3.0%
Taxable Munis	2.3%	-3 bps	1.4%	9.9%
Bloomberg Barclays US MBS	67 bps	4 bps	0.1%	3.6%
Bloomberg Commodity Index	141.50	-0.2%	2.3%	-17.5%
EUR	1.1451	1.1%	1.7%	1.9%
JPY	107.25	-0.1%	0.8%	1.5%
GBP	1.2592	-0.4%	1.3%	-5.2%

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

Chart of the week: 10-year US Treasury Note Yield – LTM



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

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Macro / government bonds

Core government bond markets seemed trapped in a tight range in what appears to be a summer lull – **see chart of the week**.

There was little economic data to disturb the calm. We await the result of an ongoing EU Council Meeting wherein the 'frugal four' (Austria, Netherlands, Sweden and Denmark) would like to see a greater weighting to loans versus grants in the package.

This week offers a similar lack of market moving information though it will be interesting to see whether the ongoing rise in Covid-19 cases has a negative effect on business and consumer sentiment in the US.

Investment grade credit

Credit markets are also somewhat becalmed. That said spreads continue to grind tighter aided by inflows into the market.

US bank results presented a positive picture for those with capital markets businesses. A deluge of news issuance has been good news for investment banking. This week will bring a fresh set of corporate quarterly results for the market to digest.

High yield credit

US high yield bond prices increased for a second consecutive week as new issue activity tapers, earnings season kicks off and investors weigh up the forward-looking assumption around a vaccine and treatment versus the economic fallout from the recent rise in new Covid-19 cases in certain parts of the country. The ICE BofA US HY CP Constrained index returned 1.17% over the week and spreads were 40bps tighter. According to Lipper, the asset class reported a second consecutive weekly inflow of $834 million, albeit more modest versus the $2.8 billion per week average over the last 16 weeks. The net inflow since the week ending 3/25 stands at a considerable $51.6 billion.

European high yield had another strong week as spreads tightened in another 16bps. However, flows into the asset class were light with only €25 million of inflows. This was mainly due to outflows in ETFs as inflows into managed accounts still amounted to €125 million. It was another busy primary week with new issuance from Carnival, the cruise line firm, Game Net, the Italian gaming company, Tennet, a Dutch utility and AMS, an Austrian technology group.

Big news in the auto sector as the Peugeot-Fiat mega merger was announced with a new name: Stellantis. Completion is expected early in 2021. The news came the same week as European auto sales figures indicating the challenges for car firms in recovering from the sharp fall in sales. Sales across Europe were -24% in June, down but still an improvement to May and April figures (-78%, and -57%, respectively). This brings the Q2, 2020 figures to -22.3% and the H1,2020 figure to -38.1%.

A recent report from Deutsche Bank showed that around 10% of issuers are now in receipt of state support.

Leveraged loans

Leveraged loan prices increased $0.47 to $92.31 over the past week, with the average price for BB loans increasing $0.30 to $96.01, Single B loans increasing $0.39 to $94.21, and Split B/CCC rising $0.20 to $75.86. Meanwhile, loan yields and spreads (3-year) decreased 16bps and 17bps over the past week to 6.77% and 653bps, which compare to as low as 6.62% and 634bps in early June. The leveraged loan market has now recouped 671bps or 77% of the 873bps of spread widening between 2/21 and 3/23 (452bps/1325bps). The Leveraged Loan index is providing a +1.08% gain in July, with BBs (+1.08%) outperforming B (+1.17%) and Split B/CCC loans (+0.62%). The asset class reported outflows totalling -$303 million for the week, which is comparable to the prior week's -$207 million withdrawal. The loan asset class has now only reported five inflows across the last 86 weeks.

Structured credit

Agency mortgages underperformed duration-US treasuries last week after generating -0.3% in total and -0.6% in excess returns. Secondary volumes picked up in credit sectors, driving spreads 3-5bps tighter. The market saw $10 billion in new issuance over the last five days, and strong demand saw many deals 10x oversubscribed. Black Knight reported that total loans in forbearance fell for a third consecutive week and the average 30-year mortgage rate dropped to a new low of 2.98%.

Emerging markets

Emerging markets continued to rally as EM hard currency and corporate spreads tightened with hard currency outperforming local EM bonds. Strong performance came largely from higher beta names though not all names rallied due to idiosyncratic reasons. In local EM debt, yields were basically unchanged. Flows into the asset class continued with a third straight week of inflows, this time amounting to $1.7 billion.

There was positive news for the market as Ecuador is getting additional support from China, with lower debt payments on Chinese loans for 2020 and 2021. Ukraine was a standout as Kyrylo Shevchenko, the CEO of Ukrgazbank, was named the new central bank governor was announced to replace Governor Smoliy who resigned the previous week. This should safeguard the IMF $5 billion aid package.

In rate news, Bank Indonesia (BI) lowered rates by 25bps to 4.0%. The BI governor also indicated that even though recovery is expected to take longer than originally thought, the bar for further rate cuts is likely to be higher, going forward.

There was more global QE news with Israel being the latest country to announce a bond purchase programme.

Asian fixed income

The Semiconductor Manufacturing International Corp (SMIC) has completed an IPO on the Sci-Tech Innovation Board of the Shanghai Stock Exchange which raised $6.5 billion of proceeds. The IPO, together with the $2.25 billion of cash injection from the National IC Fund, positions SMIC well to fund its investment plans. For 2020, SMIC has increased its capex budget from $3.2 billion to $4.3 billion, with the incremental capex largely for the equipment and facility in the Shanghai fabrication plant and to replace mature technology production lines. The 2020 capex target is materially larger than the $1.8 billion spent in 2019.

During its AGM, Reliance Industry announced the binding agreement with Google in which the latter will invest INR337.37bn ($4.5 billion) for a 7.73% in Jio (Reliance's mobile telecom business). Jio and Google will also jointly develop entry level, affordable smartphone to accelerate the path to India's digitization. The proposal deal to sell a 20% stake in core oil segment (refining and petrochemical; i.e. excluding upstream exploration and production) to Saudi Aramco for $15 billion has been delayed due to the volatility in the energy market and the pandemic.

In Indonesia, Modern land Realty which missed the principal payment of its IDR150mn ($10.4 million) bonds, has announced that 90% of bondholders have agreed to restructure the bonds. Modern land will extend the principal payment by one year to July 2021 and lower the bond coupon to 10% (previous: 12.5%). The collateral was increased to 200% of the principal value, with the collateral in the form of land at several project sites.

Commodities

The asset class was marginally down for the week as energy was down, metals were a little weaker and agriculture was mixed.

Crude oil was basically unchanged, still holding above $40/barrel. An OPEC meeting announcement by the Saudis confirmed that the production cut agreement will likely stay in place until April 2022 even as OPEC tapered cuts by lifting production 2 million barrels/day. This comes on the expectation that the countries lagging on cuts implementation (ex. Angola, Nigeria) will still adhere to the agreed cuts and make up for their earlier lack of adherence.) However, crude oil demand at 8.3 million barrels/day still remains much lower relative to historical levels of 10.0 million barrels/day. With the entry of China as an oil exporter. The country is starting to unload some of the oil reserves that they have been stockpiling.

In metal news, gold rose marginally, closing the week at $1810/oz while Copper continued to rise, albeit marginally this week, on the news of the potential strike at Chilean copper mines. Aluminium led the weakness in base metals as global demand for the metal has fallen 5%. Normally demand for aluminium grows at a rate of 5% to 7%.

In agriculture news, big purchases by China were reported in corn, soybeans, smaller grains, and meats. This is in spite of the US-China rhetoric

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

20th July 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	▪ Valuations remain attractive at these wide levels, however the rally since March has taken moderated the opportunity. Worsening fundamentals argue for fair value being wider than before. ▪ Central bank support remains a key technical for now, one that will be become more relevant if there are relapses (of market volatility and/or COVID 19 infections). ▪ Fundamentals remain challenging for large swaths of issuers, despite some signs that they may be better than recent expectations. Sorting out issuers with the combination of fragile balance sheets and lasting industry headwinds is key.	▪ Major economies cannot' flatten the curve' of COVID-19 and 'recession' becomes 'depression'.' ▪ Reopening begets a widespread reclosing. ▪ Central banks pull back support too early and positive technicals vanish.
Duration (10-year) ('P' = Periphery)	P ¥ $ Short -2 -1 0 +1 +2 Long € £	▪ Disinflationary global recession now a base case ▪ Consumption to flatten out after initial sequential recovery surge ▪ Monetary policy will seek lower, flatter curves and more than offset increased issuance ▪ Duration remains best hedge for further risk asset correction	▪ Unexpected medical advance allowing full, rapid economic re-opening ▪ Extraordinary fiscal/monetary accommodation inspires consumption-driven cyclical upswing and higher inflation ▪ Fiscal largesse steepens curves on issuance expectations
Currency ('E' = European Economic Area)	EM E Short -2 -1 0 +1 +2 Long $ A$ ¥ £	▪ The Dollar is richly valued on the basis of growth outperformance and high carry. Twin deficits indicate a weaker dollar longer term ▪ The convergence of policy rates is a material negative for the dollar, where carry advantage had kept it supported. Expect USD weakness vs safe havens.	▪ Federal Reserve moves away from ultra accommodative stance ▪ Investors reappraise US crisis/fiscal response as more likely to speed a return to normality then other regions
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	▪ Many EMs lack the policy space to offset demand destruction ▪ Currencies the likely pressure valve as central banks finance fiscal deficits ▪ EM real interest rates relatively attractive	▪ Further 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	▪ Balance sheets will be stretched by the fundamental COVID-19 shock, and exaggerated by DM financial turmoil, cheap oil, and a stronger USD. ▪ Valuations have become more attractive even in the more stable credits. ▪ Asia is close to returning to business as usual following COVID-19 curfews. The virus may return as this happens, but if the ramp up to normal continues, a key source of demand for many EM economies will be back.	▪ COVID-19 begins to spread rapidly in countries with poor health infrastructure, causing higher death rates. ▪ The US dollar remaining at all-time highs will regardless be a headwind ▪ Reversal of recent electoral trend towards market-friendly candidates.
Investment Grade Credit	Under-weight -2 -1 0 ■+1 +2 Over-weight	▪ IG sits at the confluence of 3 key positives 1) balance sheets the best equipped to handle economic pain, 2) Fed acting as a non-economic buyer and backstop, and 3) valuations that are attractive relative to history. ▪ Credit quality has nonetheless deteriorated, meaning credit spreads are less attractive versus historical comps.	▪ The Fed's purchases goal to maintain 'liquidity' are overwhelmed by economic deterioration. ▪ Foreign buyer flow stops for geopolitical, financial, or regulatory reasons. ▪ Downgrade pressures remain front and centre.
High Yield Credit	Under-weight -2 -1 0 ■+1 +2 Over-weight	▪ Though not as positive as IG, HY technicals have improved. Markets are functioning again. ▪ Fundamentals remain challenged for these lower-quality balance sheets, especially in the energy sector. There has been improvement in .. ▪ Valuations: the breakneck speed of the rally means spreads are much closer to fair, but still mildly attractive.	▪ Prolonged COVID-19 related slump in activity would hurt these companies most. ▪ Potential corporate QE lures investors to higher quality assets, instead of encouraging reallocation into lower quality credit.
Agency MBS	Under-weight -2 -1 ■0 +1 +2 Over-weight	▪ The Fed's QE including Agency MBS has been a significant tailwind for a sector with worse fundamentals, although fundamentals are better than expected ▪ But valuations are much more neutral now, and the Fed's purchases have been meaningfully tapered. ▪ However, forbearances have been better than expected, and are still relatively low (outside of GNMA, which has been hit hardest).	▪ Interest rates continue falling aggressively and volatility rises again. ▪ Bonds will underperform other spread product in a sharp risk-on move. ▪ Fed continues to taper purchases.
Non-Agency MBS & CMBS	Under-weight -2 -1 0 ■+1 +2 Over-weight	▪ Non-Agency MBS: fundamentals have held up better than expected into this crisis, and the housing market has quickly rebounded. New issues have begun, but at much wider spreads. ▪ CMBS: Non-payment by retail tenants, lockdowns on travel, and work-from-home have had serious fundamental worries to certain issuers and deals. ▪ The sector has been uniformly punished and there exist many opportunities to pick out attractive property profiles & structures.	▪ Consumer behaviour and employment are fundamentally changed by even a brief, successful 'social distancing effort. ▪ Housing prices begin to fall in contrast to current trend.
Commodities	Under-weight -2 -1 ■0 +1 +2 Over-weight	▪ o/w Copper vs Aluminium ▪ u/w Crude ▪ o/w Soybeans vs Corn ▪ u/w Cotton	▪ Oil production disruption

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