COLUMBIA THREADNEEDLE INVESTMENTS

Your success. Our priority.

In Credit

5 OCTOBER 2020

David Oliphant
Executive Director,
Fixed Income

Contributors

David Oliphant
Macro / Government bonds, Investment Grade Credit

Angelina Chueh
Euro High Yield Credit, Emerging Markets, Commodities

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

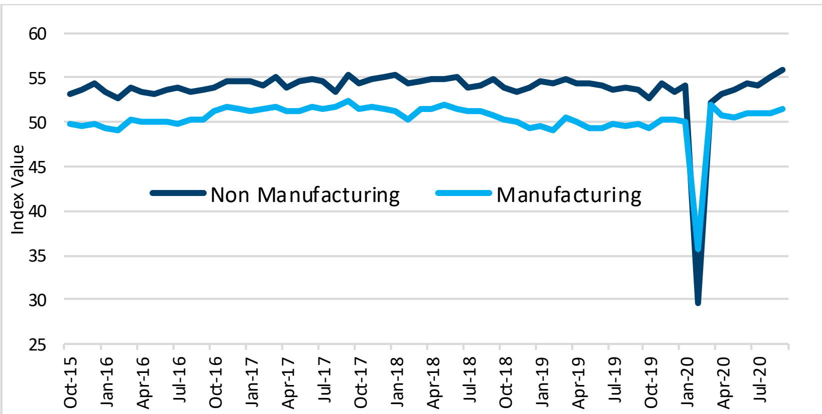
Onwards and upwards.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	0.71%	6 bps	-0.2%	9.0%
German Bund 10 year	-0.54%	-1 bps	0.1%	2.7%
UK Gilt 10 year	0.25%	6 bps	-0.6%	7.5%
Japan 10 year	0.03%	2 bps	0.0%	-0.8%
Global Investment Grade	137 bps	-3 bps	-0.0%	4.9%
Euro Investment Grade	116 bps	-3 bps	0.2%	0.9%
US Investment Grade	143 bps	-3 bps	-0.1%	6.5%
UK Investment Grade	128 bps	-2 bps	-0.2%	4.4%
Asia Investment Grade	258 bps	0 bps	0.0%	5.1%
Euro High Yield	485 bps	-21 bps	0.3%	-2.3%
US High Yield	538 bps	-26 bps	0.1%	-0.2%
Asia High Yield	687 bps	-15 bps	0.2%	2.3%
EM Sovereign	397 bps	-8 bps	0.0%	0.4%
EM Local	4.5%	1 bps	0.2%	-6.1%
EM Corporate	402 bps	-4 bps	0.1%	2.7%
Bloomberg Barclays US Munis	1.3%	4 bps	-0.1%	3.2%
Taxable Munis	2.2%	5 bps	-0.1%	9.9%
Bloomberg Barclays US MBS	59 bps	-6 bps	0.0%	3.6%
Bloomberg Commodity Index	150.22	-1.2%	-1.5%	-13.4%
EUR	1.1753	0.7%	0.0%	4.5%
JPY	105.62	0.3%	0.1%	3.2%
GBP	1.2946	1.5%	0.1%	-2.4%

Source: Bloomberg, Merrill Lynch, as at 5 October 2020.

Chart of the week: Chinese business conditions, 2015-20



Source: Bloomberg and Columbia Threadneedle Investments, as at 5 October 2020.

Macro / government bonds

Government bonds tried in vain to break out of the tight range that has been the key market characteristic for a number of months now, but ended up slap bang in back in the middle of that range. As mentioned the bond market has traded in this range essentially since the end of March.

The biggest news story was the revelation that President Trump had tested positive for Covid-19. Meanwhile, cases continue to grow elsewhere such as in the UK and other parts of Europe.

Data wise there were a series of better than expected releases that did litlle to awaken the market from its inertia. Most notably the key monthly employment report showed that the unemployment rate continues to fall. It came in at 7.9%, which was lower than last months 8.4% and expectations (8.2%). There was little change in wages with average hourly earnings rising 0.1%.

In Europe, inflation or lack of inflation was the biggest news. For the region as a whole inflation came in -0.3% year-over-year in September, from -0.2% in August, undershooting the consensus (-0.2%). The core rate also fell by 0.2%, to 0.2% year-on-year.

Investment grade credit

Investment grade credit spreads also tried to break higher last week and at one point the global index offered a spread of 140bps over government bond yields. However, as we ended the week spreads tightened by a few basis points. Euro-denominated credit has been the outperformer in the last few weeks with US dollar and sterling markets lagging somewhat (see table below). Interestingly, while equity markets are close to the year's highs, credit markets remain well wide of levels seen at the start of the year.

There was little specific company news to comment on.

Market	Q3 Spread Change (%)	2020 Spread Change (%)
US Investment Grade	-11%	+43%
Euro Investment Grade	-20%	+26%
GBP Investment Grade	-12%	+26%
Global Investment Grade	-14%	+37%
US High Yield	-17%	+50%
Euro High Yield	-11%	+50%
EM US$ Sovereigns	-8%	+44%

Source ICE BofAML / JP Morgan, as at 30 September 2020.

High yield credit

US high yield bond prices rebounded over the past week, alongside a rally in equities, positive Chinese data early in the week and optimism over prospects for a new US fiscal stimulus package.

However, continued global economic concerns, uncertainty surrounding a pick-up in virus cases, and the contentious US election just a month away remain persistent themes moving forward. The ICE BofA Cash Pay High Yield Constrained Index returned 0.88% over the week and spreads were 26bps tighter, ending at +541bps. While inflows resurfaced late in the week, the asset class experienced a $4.2 billion outflow over the period, according to Lipper. Meanwhile, new issue activity has been slow to recover after slowing down over the second half of September.

European high yield performance returned to being positive last week, after a negative print by the end of September, and post five straight months of positive returns. Flows continued to be negative at -€449 million for last week and with net outflows of -€108 million for the month as a whole.

The primary market remained brisk with bond issuance from OCI (Dutch chemicals firm), Volvo (who issued a green bond), El Corte Ingles, the Spanish department store chain, and National Bank of Greece.

In specific news, Rolls Royce announced capital raising of around £2 billion. Agreements are in place for a new £1 billion, 2-year term loan as well as an increase of the government guarantee loan by £1 billion. This highlights the extent of the potential liquidity problem some firms are facing.

Responsible investments

This year has seen a record number of ESG-related issues enter the market. We have seen double the amount of social bonds issued so far in 2020 than has been issued in any previous year. Covid-19 has certainly accelerated the interest in the social and environmental bond market and, going forward, we expect to see even more issuance with a focus on ESG.

US leveraged loans

Leveraged loan prices (referencing the J.P. Morgan Leveraged Loan index) declined $0.07 w/w to $94.60 and remain down $0.66 since 16 September, while the average price for BB loans decreased -$0.11 to $97.18; Single B loans decreased -$0.12 to $96.33; and Split B/CCC increased +$0.03 to $80.82. Yields and spreads (3-year) increased 4bps apiece during the week to 5.96% and 572bps, which compare to recent lows of 5.69% and 545bps on 16 September. Leveraged loans managed to post gains in September despite losses in high yield bonds and equities. Aiding the loan asset class was a firmer technical environment, as outflows moderated and CLO origination reached a 17-month high. Meanwhile, outflows averaging $152 million over the past four weeks represents a low since June. The leveraged Loan index provided a +0.63% gain in September, outperforming the HY index by 139bps, the largest outperformance by the Loan index since October 2018.

Structured credit

Agency MBS outperformed its US treasury counterparts as rates ‘bear steepened’ on improved prospects for a stimulus package. GSEs, Fannie and Freddie, announced an extension of the trigger for when single-family delinquent loans are purchased out of the pool from four months to 24 months. Overall, this is a slight positive for the market. In non-QM, prices held firm last week on limited supply. Investors remain comfortable with pre-Covid-19 origination as fundamentals remain strong. In CMBS, spreads continued to tighten. Overall, delinquencies remained stable-to-lower as granted forbearances rose. This was particularly the case in conduit hotels, where forbearance rose to over 16% from 9.5%.

Emerging markets

Hard currency spreads finally returned to tightening mode last week. This was the same for corporate debt. Local bonds returned 0.8% largely due to strengthening of EM, which benefited from the weakness of the US dollar, on the back of increased uncertainty in the US.

Primary markets were also strong in EMD, with issuance by Anglogold with books over $2 billion for a 500 million issue size. Egypt also issued a five-year green bond. In country specific news, Brazil local bonds suffered last week on the proposal of the government to comply with the spending cap in 2021.

In China, the recovery continues with both manufacturing and non-manufacturing PMIs expanding faster in September – see '**Chart of the Week'**. In particular, new export orders returned to expansion for the first time this year. The export resilience is set to continue as activities rebound and stimulus comes through in major economies, while the PMIs for SMEs and services also improved significantly. 'Golden Week' – starting from tomorrow and the next big holiday period after Chinese New Year – will be an important catalyst for retail sales (finally back to positive territory in August) and tourism given pent-up demand, government promotions and restrictions on overseas travel (people will have to travel and take vacation within China). Wages are also starting to be increasingly less negative.

Saudi Arabian bonds rallied last week due to the Debt Management Office announcement that it would not be issuing any more bonds this year (this takes away $3 to $5 billion of issuance which was expected for rest of this year). Instead, it plans to raise funds domestically. In currency news, Argentina announced that it will allow the peso to devalue further.

Asian fixed income

Vedanta Ltd has received 'in-principle' approval from the Bombay Stock Exchange and National Stock Exchange of India Ltd for the delisting offer from Vedanta Resources. The company also provided the timeline for the delisting process. The reverse book-building process will run from 5-9 October, following which Vedanta Resources can propose a counter offer by 13 October. The last date for the announcement of the exit price is 16 October. For the privatisation of Vedanta Ltd, Vedanta Resources has raised around $3.15 billion in debt (including the $1.4 billion of VEDLN '23s bonds). This excludes the potential $600 million that Vedanta Resources reportedly raised in September, as additional funds (source: Bloomberg). In the scenario that the privatisation is valued at $3.75 billion, this implies an exit price of around INR146/share for Vedanta Ltd.

Fitch downgraded Modernland Realty from "C" to "RD" because the company has not paid the coupon on the $150 million senior unsecured notes 2021 during the 30-day grace period. S&P and Fitch have also lowered ratings for Alam Sutera to "CC" and "C" respectively, because the debt exchange offer for the 2021 and 2022 bonds are viewed as distressed exchange.

Commodities

The index was down 1.25% last week, due to the sharp fall in energy prices as crude oil and products fell almost 8%. Only natural gas returned double digits on the back of the weather conditions. Both base and precius metals were stronger. Gold touched back to $1900/oz, while iron ore benefited from renewed Chinese demand for steel. In agricultural, grain prices continued to strengthen as Chinese orders remained strong for corn, soybeans and wheat.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

5th October 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	■ The spread tightening of the last 5 months leaves valuations much closer to long-term averages, and a more modest overweight to credit risk is warranted. There are still enough attractive opportunities to build a portfolio that is overweight credit risk, although some sectors are offer little upside. ■ Technicals are positive across the board. The Fed's new strategy underlines lower for longer and targeting easy financial conditions. The demand for credit products remains high. ■ Fundamentals continue improving, even if slower than in the summer. Vaccine progress is coming steadily.	■ The Feb garbles its messaging in how it will carry out its new policy framework ■ Cooler weather leads to virus acceleration and school closures hamper labour productivity. ■ The damage done to the labour market is deep & long-lasting. ■ Vaccine development slows.
Duration (10-year) ('P' = Periphery)	P ¥ $ Short -2 -1 0 +1 +2 Long € £	■ Recovery pace to slow as government support wanes, consumption rebound fades ■ Reflation credibility still low, despite Fed framework review ■ Fed QE and high personal savings underpin demand for treasuries ■ Policy to aim for lower, flatter curves ■ Duration remains best hedge for further risk asset correction	■ Unexpected medical advance allowing full, rapid economic re-opening ■ Permanent fiscal policy shift rebuilds reflationary credibility ■ Fiscal largesse steepens curves on issuance expectations ■ Risk hedge properties deteriorate
Currency ('E' = European Economic Area)	£ E EM Short -2 -1 0 +1 +2 Long A$ ¥ $	■ Recent USD weakness has come as a result of relatively worse interest rate, Covid and fiscal dynamics. This is now largely priced and we expect a pause in the downtrend. ■ Longer term, expensive valuations and twin deficits presage a weaker Dollar	■ A second Trump term could lead to USD strength through more aggressive trade policy ■ Reimposition of Covid restrictions in Europe
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	■ The stable/weaker USD over the last 4 months has eased fundamental and technical pain. ■ EM IG has tightened inside long-term averages versus US IG, but EM BB/B remains attractive versus US BB/B. ■ The peak in defaults and restructurings has passed and the landscape of EM is relatively stable. ■ The wave of global liquidity is reaching EM, but after it ran through developed market credit.	■ The USD strengthens. ■ 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 valuations were the most directly affected by the Fed and normalized most quickly. Valuations are now at long-term medians, but the index duration is 30% longer. ■ Fundamentals have been more positive than expected. Leverage has risen, but so too has cash. ■ With Treasury yields likely very low for an extended period of time, technicals favour IG as a safe asset substitute.	■ The Fed does not renew its Corporate Credit Facilities. ■ Foreign buyer flow stops for geopolitical, financial, or regulatory reasons. ■ The cash stockpiles taken out at the depths of the crisis are deployed on large-scale M&A instead of deleveraging.
High Yield Credit	Under-weight -2 -1 0 +1 +2 Over-weight	■ Spreads & new issue supply underline that companies with sounds economics have no issue accessing financing. Valuations are mostly back in line with long-term ranges and are moderately attractive versus IG, but less compelling than earlier in the recovery. ■ The ability to access financing has dramatically improved the prospects for many companies, and the impact of COVID on companies with bonds >$80 is manageable.	■ Prolonged COVID-19 related slump in activity would hurt these companies most. ■ The sector most sensitive to changing financial conditions.
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. ■ But valuations are much more neutral now, although the Fed's quantity of buying is overwhelming the market. ■ Forbearances have been better than expected, and are still relatively low (including GNMA, which has been hit hardest).	■ Fed reallocating MBS purchases towards Treasuries. ■ Bonds will underperform other spread product in a sharp risk-on move. ■ Renewed interest rate or curve volatility.
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 is the strongest sector in the economy thanks to low interest rates and desire for more space for continued WFH. CMBS: Retail tenant payments & hotel occupancy are improving. Office is still struggling but valuations reflect this. ■ Valuations vary wildly, but are broadly attractive. Given performance, trimming some riskier positions & doubling down on conviction credit is due.	■ 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 ■ u/w Crude, u/w natural gas ■ o/w Soybeans vs Corn ■ o/w refining margins (o/w products, u/w Brent)	■ Oil production disruption

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 05.10.2020, unless otherwise stated.

The 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. This is an advertising document. 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. Your capital is at risk. This means that an investor may not get back the amount invested. The 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.
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.
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.
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