COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

11 APRIL 2022

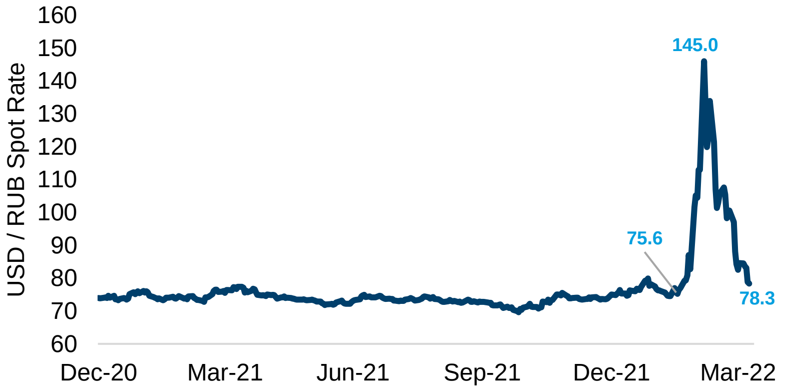
Recovering Ruble

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return	Index YTD return
US Treasury 10 year	2.75%	37 bps	-2.2%	-7.6%
German Bund 10 year	0.77%	21 bps	-1.2%	-6.3%
UK Gilt 10 year	1.80%	19 bps	-1.4%	-8.8%
Japan 10 year	0.24%	2 bps	-0.3%	-1.8%
Global Investment Grade	124 bps	0 bps	-1.8%	-8.5%
Euro Investment Grade	130 bps	1 bps	-0.8%	-6.1%
US Investment Grade	120 bps	0 bps	-2.3%	-9.9%
UK Investment Grade	119 bps	0 bps	-0.8%	-6.9%
Asia Investment Grade	199 bps	-11 bps	-0.8%	-6.1%
Euro High Yield	410 bps	2 bps	-0.4%	-5.1%
US High Yield	357 bps	17 bps	-1.6%	-6.1%
Asia High Yield	708 bps	-48 bps	1.7%	-9.3%
EM Sovereign	345 bps	-3 bps	-2.0%	-11.1%
EM Local	6.4%	16 bps	-1.6%	-8.0%
EM Corporate	312 bps	-15 bps	-0.5%	-9.3%
Bloomberg Barclays US Munis	2.8%	17 bps	-0.8%	-7.0%
Taxable Munis	3.8%	28 bps	-3.5%	-12.8%
Bloomberg Barclays US MBS	31 bps	7 bps	-2.1%	-7.0%
Bloomberg Commodity Index	269.59	2.1%	1.6%	27.6%
EUR	1.0909	-1.5%	-1.7%	-4.3%
JPY	125.24	-1.4%	-2.1%	-7.4%
GBP	1.3023	-0.7%	-0.9%	-3.7%

Source: Bloomberg, Merrill Lynch, as at 11 April 2022.

Chart of the week: Russian ruble / US dollar spot rate



Source: Bloomberg, Columbia Threadneedle Investments, as at 8 April 2022.

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Macro / government bonds

Core government bond yields rose sharply higher and yield curves steepened last week. The greatest and most extreme was for US treasuries, which saw 7-year and longer-dated maturity yields rise as much as 30bps across the curve while the US 2-year treasury yield rose only 5bps. UK gilt yields experienced a more gradual steepening as yields rose 12-15bps across the curve. In contrast, the German bund yield curve had a more parallel shift as the yield rose 15bps across the curve from 3-year and out with the German 2-year moving only a slightly smaller 12bps higher. This came with the continued hawkish talk from US Federal Reserve speakers last week, in some case indicating the greater likelihood of 50bps hike at the next upcoming meeting. At the European Central Bank, officials mentioned that they were working on a crisis tool/backstop to be used in the event of a sharp rise in the bond yields of weaker eurozone countries due to market stress caused by outside shocks. Deutsche Bank became the first bank to call for a recession in 2023.

France had its first round of presidential elections over the weekend. As expected, the gap between President Macron and National Rally's Marine Le Pen has narrowed substantially from their previous race in 2017. This time the difference was only 4.2% (27.6% vs 23.4%) in the first round. Macron is seeking further EU integration (ex. common EU defence policy) and making some welfare benefits conditional on training. Le Pen's campaign focuses on the cost-of-living crisis with key policies including cutting the minimum retirement age to 60 (if started work before 20), scrapping income tax for under 30's, a VAT cut on energy to 5.5% from 20% and raising the salaries of teachers and hospital workers. The second-round vote will be on 24 April.

Investment grade credit

There was very little spread movement in investment grade markets last week, with most markets either unchanged or wider by a few basis points. Issuance is still muted and not expected to pick up until after the Easter holidays.

With yield curves flattening, investors are moving into shorter-dated credit as longer-dated credit begins to offer less value in comparison and central banks are raising rates to control inflation. According to Bloomberg, around 65% of issuance in April so far has been for bonds with a maturity of five years or less. This contrasts with only 26% of total issuance this year being short dated.

High yield credit & leveraged loans

US high yield bond yields rose 33bps to 6.36% over the week and spreads widened 17bps (+370bps) off the Tuesday low alongside a 32bps w/w rise in 10-year US treasury yields as Wednesday's minutes expectedly reveal a hawkish Fed that is rapidly pivoting to a more front-loaded policy tightening this year. Primary market activity picked up following the recent market rally with nearly $10bn issued over the week. According to Lipper, the asset class reported a modest retail fund inflow of $296m. This was the second consecutive weekly inflow following an eleven-week outflow streak and leaves YTD net flows at $26.3bn. Meanwhile, leveraged loans continue to outperform other fixed income with the average price of the J.P. Morgan Leveraged Loan Index increasing $0.36 over the week to $98.01. This week's inflow of $1.95bn was the fourth largest weekly inflow on record and leaves YTD inflows at $21.1bn.

European High Yield (EHY) started Q2 with a week of negative performance, largely due to rising core government bond yields as credit spreads widened only 2bps in the first week of April. Net flows were marginally positive (+€25m), for once, coming into the asset class via ETFs as managed accounts were still experiencing small outflows. The corporate HY primary market remained closed last week as the market moved into the pre-Easter holiday period. It has been noted that the EHY market has not seen such a long shutdown period (56 days) since late 2011, more than 10 years ago. The market is not expected to re-open until after Easter.

On the M&A front, Telecom Italia's board has refused KKR's request to do a due diligence on the company, potentially ending the private equity's dance around the telecom company. While at Atlantia, the Italian infrastructure company, a report that the Benetton family may be starting discussions with private equity group, Blackstone, to take over Atlantia, with an offering of more than €22/share, helped to push bond prices lower. This is happening just as the Benetton family rejected a takeover bid for Atlantia from Global Infrastructure Partners and Brookfield. All this is happening as Atlantia's credit rating was raised by Moody's to Ba2, from Ba3, bringing it in line with S&P's BB rating. In conjunction, Autostrade's rating was raised to Ba1, ahead of S&P's current rating of BB, and one notch closer to moving back to investment grade.

Anecdotally, recent reports show that corporates have been able to manage the higher inflation costs (raw materials, energy etc) with a reduced lag on pass throughs to clients or due to hedging of energy costs (ex. Kloeckner Pentaplast, the plastics manufacturer, and Constellium, the aluminium processor).

Asian fixed income

The Macau gaming sector saw a difficult March 2022 with gross gaming revenue at MOP 3.67bn (-56% y/y, -53% m/m). The GGR was negatively affected by COVID-19 outbreaks in Guangdong cities such as Zhuhai and Shenzhen which led to tighter controls on inbound travellers to Macau.

In the Chinese property sector, S&P lowered the outlook on Country Garden's BB+ ratings from positive to stable due to weaker property demand and slow deleveraging over the next 12 months. S&P also downgraded the credit ratings of Guangzhou R&F from CC to SD. The CC ratings of R&F HK is affirmed. Guangzhou R&F completed the maturity extension on its onshore corporate bond, which is viewed as a distressed restructuring. Zhenro Properties did not make the coupon payment on two US dollar bonds within the 30-day grace period and the company also indicated that it may be unable to pay a combined $32.6m of coupons due on three other US dollar bonds within the grace period (between 10 April and 14 May 2022). Despite the delay in coupon payment, Zhenro Properties intends to make the coupon payments no later than 31 May 2022.

Adani Enterprises Ltd (AEL) announced that Abu Dhabi-based International Holding Company (IHC) will invest $2bn (INR154bn) which will be split across Adani Green (25%), Adani Transmission Ltd (25%) and Adani Enterprises Ltd (50%). The Cyberspace Administration of China (CAC) will start to implement the regulation to tighten the oversight of algorithms for the internet platform companies till early December 2022, which is a culmination from the draft guidelines (Internet Information Service Algorithm Recommendation Management Regulations) that were first announced in August 2021.

Emerging markets

After depreciating to 145.0 against the US dollar following the invasion of Ukraine, the Russian ruble now trades at 78.3, within touching distance of pre-invasion levels **(see chart of the week)**. Russia's economy is still expected to fall by 10%+ this year, and rating agencies have downgraded sovereign debt and expect imminent default. The Russian ruble recovery comes on the back of continued Russian exports while imports have fallen sharply, resulting in an unprecedented trade surplus which has aided the currency's recovery. At the same time, the government is forcing Russian exporters to exchange their foreign reserves for rubles. The US has levied energy sections, but this has failed to dent the bulk of energy exports. Russia has also banned foreigners from selling assets they own, which has prevented western companies looking to exit their Russian operations from selling Russian property.

In Pakistan, Prime Minister Imran Khan had his call for a snap election invalidated by the supreme court on Friday. He has now been ejected from his position after losing a vote of no confidence on Sunday. Pakistan's central bank has just delivered a 250bps base rate hike (the highest since 1996) to defend its currency, which has fallen 5% against the US dollar in the past month.

In China, the Caixin services PMI disappointed at 42 vs 49.7 expectations, the sharpest decline since the onset of covid. Transportation, hotels and catering were hurt the most following the lockdown of Shanghai. The manufacturing PMI also disappointed at 48.1, the lowest level since February 2020. Residents in Shanghai have now been locked in for over two weeks as daily infections hit 26,087 in the city on Sunday. Elsewhere in China, the southern city of Guangzhou is ramping up restrictions after 20 cases were found last week. China's consensus GDP growth estimate is now 5%, below the 5.5% government target. China will announce the medium-term lending facility rate on 15 April, with the market expecting a 10bps cut.

Kuwait's Prime Minister has submitted his resignation to the country's crown prince. This marks Kuwait's third government resignation in the last year. Kuwait has 8.5% of the world's oil reserves but posted a record deficit in 2020/21.

In Sri Lanka, President Rajapaksa revoked a five-day old state of emergency following 42 MP's walking out of his coalition. He now faces a minority in parliament. One of the walkouts, finance minister Ali Sabry (who has just taken office), would have been a vital member of the team negotiating with the IMF.

Commodities

The commodity index continued to rally, with agriculture and grains delivering the highest return at 5.1% and 6.3%, respectively. The USDA WASDE report showed 30% of winter wheat in good or excellent condition, the lowest level in decades. The report also marked down global corn export estimates, further reducing expected Ukrainian exports.

Energy markets rallied 1.9%, driven by a rise in US natural gas (+9.8%), while European natural gas prices now trade at a five-time premium to US prices. WTI fell by 1% as the IEA announced a 60 million inventory release in coordination with the previously announced US SPR release.

Responsible investments

Social bond issuance was down 64% in Q1 of this year, compared to the same quarter last year. According to Bloomberg, both social and Green bond issuance was down this year so far as covid-related spending dwindled and companies turned to work on their sustainability targets, as well as an overall slowdown in corporate issuance. In contrast, sustainability-linked bonds were up on the quarter around 140% YoY, as we saw Chile become the first sovereign to issue a sustainability-linked bond. Similarly, sustainable bonds were up almost 22% YoY.

In Canada, Prime Minister Justin Trudeau announced the largest single industrial tax incentive to assist the country's major oil and gas companies with their carbon capture projects. (Carbon capture involves permanently storing carbon emissions as an output of various manufacturing processes before they reach the atmosphere and contribute to climate change.) The tax break will hopefully help towards the government's 2030 emissions-reduction targets and help make quicker improvements in the energy sector, currently 10% of Canada's economy.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

11th April 2022

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	▪ Credit spreads have widened during recent volatility, which has been paired with neutral to worsening technicals and stable fundamentals in most sectors. This has created more pockets of opportunity, along with the deleveraging & upgrade stories. ▪ We are past the peak of economic growth, with first hike announced at the March FOMC meeting and expectations for many more. Pullback in forecasted liquidity created opportunity for market volatility. ▪ Uncertainty remains elevated due to fears surrounding pace of central bank hiking, inflation, recession probabilities, and the Russian invasion of Ukraine.	▪ Upside risks: lowered volatility once expansionary environment is established as the new normal ▪ Downside risks: more spillover from Russian invasion, sanctions difficult to remove post-conflict. More Covid variants emerge. Supply chain disruptions and inflation persist to H2 2022. Simultaneous low unemployment, hiking and slowing growth could cause a recession. Persisting commodity shocks
Duration (10-year) ('P' = Periphery)	P ¥ $ Short -2 -1 0 +1 +2 Long £ €	▪ Carry offered by front end yields now attractive ▪ Longer yields continue to be capped by long-run structural downtrends in real yields ▪ Inflation likely to normalize over medium term ▪ Hiking cycles to be shortened by easing inflation and moderating demand	▪ Inflationary dynamics become structurally persistent ▪ Labour supply shortage persists; wage pressure becomes broad and sustained ▪ Fiscal expansion requires wider term premium ▪ Long run trend in safe asset demand reverses
Currency ('E' = European Economic Area)	¥ EM A$ Short -2 -1 0 +1 +2 Long $ £ E	▪ The invasion of Ukraine will hit global growth, hinder risk markets and lend a bid to the Dollar ▪ The associated impact of higher inflation on central banks is uncertain, but is more likely to see a dovish repricing of the ECB than the Fed, we turn neutral on the Euro	▪ The ECB becomes concerned around potential second round effects and presses on with policy normalisation
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	▪ Russia/Ukraine conflict cautions against aggressive positioning ▪ Aggressive Fed pricing may now open the door to selective EMFX performance ▪ EM real interest rates relatively attractive, curves steep in places	▪ Negative sentiment shock to EM fund flows ▪ 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	▪ Valuations are getting more attractive, although for reason ▪ Russian invasion is primary story, as pressure from commodity price shocks, retail fund outflows, spread widening spillover and general uncertainty is felt across EM. ▪ Market-wide shock has created opportunities as some widening cannot be justified by fundamentals (esp. energy) ▪ DM tightening financial conditions will unevenly impact EM credit and EMFX as many countries have already responded to inflation through hikes	▪ Continued spillover from Russian invasion: local inflation (esp. food & commodity), slowing growth ▪ A replay of 2013 occurs with a taper tantrum or swift appreciation of the USD ▪ Persisting COVID growth scars hurt economies & fiscal deficits ▪ Weakening technicals with large fund outflows and slower supply
Investment Grade Credit	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ US and EMEA spreads have crept significantly wider, creating buying opportunities for favored sectors ▪ Robust new issue supply is seeing large concessions, despite absence of credit quality concerns ▪ IG has been historically resilient in the face of inflation, which has been broadly supported by earnings. ▪ Good fundamentals with strong balance sheet management, M&A and deleveraging from capital management & sales growth	▪ Iinvestors return to government bonds from IG as their risk/return preference for safe assets is changing in new environment ▪ Russian Invasion worsens operating environment globally ▪ M&A and shareholder enhancing activities pick up, but most are leverage neutral.
High Yield Bonds and Bank Loans	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads have widened relative to 2021, creating buying opportunities for high conviction/quality and rising star trades. Expect volatility to continue. ▪ Risks for EMEA HY are heightened because of proximity to and economic impact of Russian invasion ▪ Bank loans are still attractive despite recent market softening as we expect tailwinds will pick back up: positive retail fund flows, strong issue calendar, demand from CLO formation. ▪ Defaults are set to continue near historic lows	▪ Waves of ratings upgrade continue into this year. ▪ Russian invasion significantly rattles US bond loan/market as already seen in EMEA from commodities.
Agency MBS	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ The risk/reward mix in MBS Basis approaching fair value. ▪ Specified Pools and CMOs have cheapened into market sell-off with fair fundamentals: buy opportunities. ▪ Valuations have widened since November, recently stabilizing in wider range like 2018-2019 levels. Elevated 2022 supply projections remain a headwind.	▪ Housing activity slows and rising rates move prepays to normal levels without hurting mortgage servicing rates. ▪ Uncertainty with the Fed hiking schedule and long-term position within the Fed balance sheet
Structured Credit Non-Agency MBS & CMBS	■ Under-weight -2 -1 0 +1 +2 Over-weight	▪ Our preference remains for Non-Agency RMBS and CLOs as spread widen and liquidity worsens ▪ RMBS: Housing continues to perform well but expect normalization coming from heavy supply and extension concerns. Selectively adding to positions at wider spreads. ▪ CMBS: Most segments maintain strong but new issue marker is slowing into spread weakness. ▪ CLOs: Spreads wider across cap structure, but sector is still reval attractive. New issue deals are slowing as investors look for discounts in the secondary market ▪ ABS: US consumer remains well positioned, although headwinds mounting. Select opportunities in de-levered structures in consumer loans or subprime auto	▪ Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening ▪ Changes in consumer behavior in travel and retail fail to return. ▪ Work From Home continues full steam-ahead post-pandemic (positive for RMBS, negative for CMBS). ▪ SOFR deals slows CLO new issuance ▪ 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	▪ Global Recession