INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

Your success. Our priority.

In Credit

23 MARCH 2020

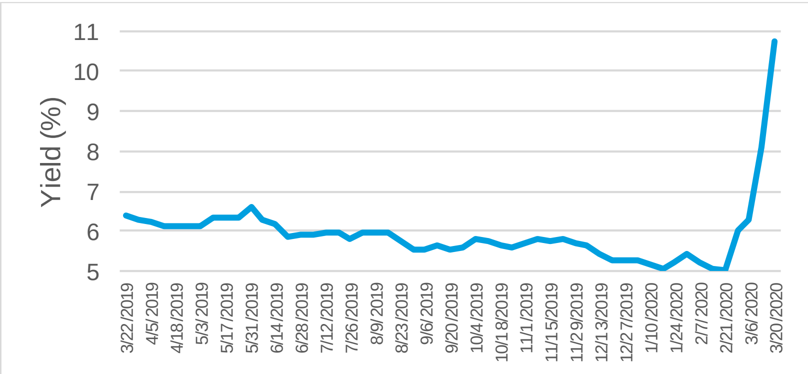
The return of yield.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	0.74%	-22 bps	1.4%	6.9%
German Bund 10 year	-0.36%	18 bps	-1.6%	1.8%
UK Gilt 10 year	0.46%	5 bps	0.6%	5.8%
Japan 10 year	0.07%	2 bps	-2.0%	-0.8%
Global Investment Grade	329 bps	120 bps	-11.0%	-8.5%
Euro Investment Grade	231 bps	58 bps	-7.1%	-6.4%
US Investment Grade	387 bps	158 bps	-13.6%	-10.4%
UK Investment Grade	217 bps	54 bps	-7.2%	-4.9%
Asia Investment Grade	291 bps	35 bps	-3.8%	-1.1%
Euro High Yield	873 bps	214 bps	-16.8%	-18.2%
US High Yield	1009 bps	278 bps	-17.5%	-18.7%
Asia High Yield	979 bps	220 bps	-14.2%	-13.5%
EM Sovereign	618 bps	133 bps	-16.4%	-15.6%
EM Local	5.9%	42 bps	-13.5%	-17.5%
EM Corporate	606 bps	142 bps	-13.0%	-11.6%
Bloomberg Barclays US Munis	3.5%	143 bps	-10.3%	-7.5%
Taxable Munis	2.8%	39 bps	-9.4%	-0.5%
Bloomberg Barclays US MBS	115 bps	10 bps	-0.8%	0.9%
Bloomberg Commodity Index	130.76	-6.4%	-13.9%	-24.2%
EUR	1.0774	-3.8%	-3.1%	-4.7%
JPY	110.69	-2.7%	-2.4%	-1.9%
GBP	1.1629	-5.3%	-9.3%	-12.3%

Source: Bloomberg, Merrill Lynch, as at 23 March 2020.

Chart of the week: US High Yield – Yields LTM



Source: Bloomberg, Columbia Threadneedle Investments, as at 23 March 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

Macro / government bonds

Government bonds struggled for real direction last week.

Clearly the downdraft in equity prices and the widening in spread markets ought to provide support to these 'risk free' markets. However, concern at the scale of debt issuance facing these markets, as well as liquidity-seeking investors selling, is weighing on bond prices.

Measures enacted by the European Central Bank (to buy bonds) helped Italian and Spanish government bonds outperform and spreads to tighten to the German curve.

Most commentators expect a severe economic downturn in most economies. Current economic data is being largely ignored as irrelevant against the rapidly changing COVID-19 outbreak.

Investment grade credit

Credit spreads remain under considerable pressure.

The US market is underperforming its euro and sterling cousins. This reflects the supportive effects of ECB buying in Europe. How soon before the US Federal reserve starts buying corporate bonds? Investment grade markets are also underperforming high yield in risk-adjusted terms.

Meanwhile, liquidity remains very challenging indeed. We note short-duration US credit spreads have widened by over 350bps this year. That is a 560 percent widening. While liquidity is very poor it will only take a shift from 'terrible' to 'very bad' in the market background for spreads to tighten. Liquidity is a double-edged sword and while it is challenging to sell at present the reverse will surely occur when we get through this phase.

Market valuations are very compelling indeed. The global index is back to the widest level since May 2009. However, it is some ways away from the wide print of 469bps in December 2008, though at present levels we are just under 3 standard deviations wide to the long run (20-year) average spread.

High yield credit

Pressure on US high yield bond prices intensified in the past week as the COVID-19 outbreak quickly morphed into an economic crisis. US high yield bond spreads rose 225bps over the past week to +1000bps and are now 595bps wider since 21 February. This has meant that yields have risen materially – **see chart of the week.** Remarkably, five of the six largest daily high spread widenings in history have now occurred in the past two weeks. The asset class reported $2.9 billion of outflows over the week, according to Lipper, which represented a moderation from the previous three weeks' $4.9 billion, $5.1billion and $4.2 billion outflows. However, the past four weeks net outflow of $17billion is the most on record over such a period.

European high yield experienced €2.35 billion outflows of which €435 million were in ETFs as spreads widened 215bps over the week. Spreads have now risen 445bps from the start of the year to the current level of 873bps. The ETF discount also grew, reaching 8% at one point. Trading continued to be challenged as bid-offer spreads were wide at 4 to 8 points compared to 70bps under normal market conditions), with bid prices more indications rather than necessarily a tradeable price.

Emerging markets

The asset class continued to be challenged last week as the' risk off' tone remained.

Hard currency spreads widened +133bps (27%) to 620bps. This is up 340bps from the start of the year spread of 280bps and only 150bps away from the high of the 2015-2016 crisis. Lack of market liquidity was the case for the first half of the week, though this improved, somewhat, by Thursday and Friday. This was indicative in the volatility of the EM ETF discount which, at its widest for the week at 7.3% but finished Friday at 1.3%. Local EM was down 7.5%, of which 5% was due to currency.

Rate cuts around the world continued last week with cuts of 50bps (Brazil, South Korea), 75bps (Qatar, UAE, Saudi Arabia, Bahrain, and 100bps (Kuwait). There have now been 38 countries around the world who have cut rates since the start of February 2020.

In country specific news, Argentina is gearing up for debt restructure. The IMF has indicated a need for up to US$ 85 bn in debt relief.

Asian fixed income

Moody's put several Asian gaming companies on a "review for downgrade". The negative ratings action reflects the sharp decline in visitation and the gaming revenue in the casinos. Fitch revised the outlook on the state-owned oil companies PTT and PTTEP from 'positive' to 'stable'. This follows Fitch's revision of the Thailand sovereign outlook to 'stable' (previous: positive) to reflect the impact of the COVID-10 outbreak on Thailand's economy and the ongoing uncertainty in Thailand's political environment on the back of the transition to civilian rule.

The Fung family, together with GLP Pte Ltd, has made an offer to privatise Li & Fung. Li & Fung has implemented various strategic measures to adapt to the digital disruption in the retail industry, but the company's financial performance has continued to underperform. In justifying the privatization move, the Fung family believes that the restructuring of the company could be more effectively implemented away from the public equity markets. Following the privatization, the Fung family will hold 60% of the voting shares and 32.33% of the total shares. GLP will hold a 40% voting stake.

Commodities

Commodities were down 6.4% for the week, lead by energy as crude oil prices continued to fall sharply (WTI down 31% to $23.41; Brent down 26% to $27.43). Base metals were lower by 8.9%, led by Copper, which fell 11% as demand fell for raw materials, coupled with worries of a manufacturing slowdown. Agriculture was the one bright spot with news of China making soybean and wheat purchases.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

23rd March 2020

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	■ COVID-19 has begun to wreak havoc on the economy- even if only temporary. Uncertainty is the word on fundamentals, but large fiscal stimulus could stem the tide. In tandem with monetary measures this could make the situation 'less bad' enough to improve markets ■ Valuations have cheapened from elevated levels to compensate for a 'normal' recession. Overall, spread risk looks attractive on a medium term horizon, however caution is warranted due to uncertainty being at or above Financial Crisis levels.	■ Major economies cannot 'flatten the curve' of COVID-19 and 'recession' becomes 'depression' ■ Fiscal and monetary stimulus is extremely successful and buoying demand and there is significant innovation on the medical fight against COVID-19
Duration (10-year) ('P' = Periphery)	Short -2 -1 0 +1 +2 Long P ¥ $ € £	■ Disinflationary global recession now a base case ■ Central bank accommodation back in play; flatter, lower curves a policy goal ■ Duration remains best hedge for further risk asset correction ■ Phase One trade deal fulfilment unrealistic	■ Global trade détente stimulates improvement in risk sentiment ■ Rapid levelling off of virus infection rate ■ Fiscal/monetary policy inspires consumption-driven cyclical upswing
Currency ('E' = European Economic Area)	Short -2 -1 0 +1 +2 Long E EM 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 disappoints the market's expectations for policy easing.
Emerging Markets Local (rates (R) and currency (C))	Under-weight -2 -1 0 +1 +2 Over-weight R C	■ COVID-19 threatens global risk sentiment and populated EM positions ■ Investor capitulation has left EM real interest rates relatively attractive	■ Further sharp escalation in global risk aversion ■ Broad dollar strength
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	■ Technicals in other credit markets are exaggerated in EM, leaving the current market extremely challenged. ■ Many oil exporters use the proceeds to fund their government and/or maintain currency valuations, which are now under pressure ■ 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 continues, a key source of demand for many economies will be back	■ COVID-19 begins to spread 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	■ Fundamentals have worsened, like in all credit sectors, but not as uniformly as spreads have widened. But, companies still have levers to pull to prevent the most dramatic of credit deterioration. ■ Valuations are as attractive as anytime since since 2009. ■ The potential for Corporate QE in the US & expansion in Europe is beginning to be discussed and would be a significant technical tailwind.	■ The existing Fed credit facilities do not alleviate the market's liquidity problems. ■ Prolonged recession begins to weaken even the strongest business models and balance sheets.
High Yield Credit	Under-weight -2 -1 0 +1 +2 Over-weight	■ HY remains an energy-heavy sector, and these energy companies are extremely vulnerable to prolonged periods of WTI crude <$50. HY companies are rated as such because of their vulnerability to recession. This gives us caution. ■ Valuations imply a 9% default rate, and it may get worse in the short term. But historically, these spread levels imply strongly positive returns 6-12 months in the future	■ Prolonged COVID-19 related slump in activity would hurt there 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 quickly deteriorating fundamentals ■ The precipitous decline in mortgage rate + weaker household balance sheet leads to worse fundamentals	■ Interest rates continue falling aggressively ■ Bonds will underperform other spread products in a sharp risk-on move
Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	■ Households entered 2020 in a relatively healthy pace, but they are being put to the test relatively quickly with unemployment expected to rise sharply. ■ Direct fiscal stimulus (checks to households) during 'social distancing' may not bring back service jobs, but it can lessen the blow and prevent widespread delinquencies and bankruptcies ■ The CMBS market is understandably taking a hit from less shopping and travel, however valuations are widening to match these expectations. Many of these structures have robust credit enhancement and are attritive high quality assets	■ Consumer behaviour and employment are fundamentally changed by even a brief, successful 'social distancing' effort. ■ Housing – which was set up for a great 2020 – starts to feel pressure
Commodities	Under-weight -2 -1 0 +1 +2 Over-weight	■ o/w Cu vs Zinc ■ o/w Brent vs WTI ■ o/w Silver	■ Severe global recession

Important information: For investment professionals only, not to be relied upon by private investors. Source for all data and information is Bloomberg, unless otherwise stated. Past performance is not a guide to future performance. 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. This means that an investor may not get back the amount invested. This material 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, or to provide investment advice or services. The mention of any specific shares or bonds should not be taken as a recommendation to deal. The analysis included in this document has 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. This material 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.

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. TAML has a cross-border licence from the Korean Financial Services Commission for Discretionary Investment Management Business. 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 to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058. Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. 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. This document should only be distributed in Australia to "wholesale clients" as defined in Section 761G of the Corporations Act. TIS is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), Registration number: 201101559W which differ from Australian laws. Issued by Threadneedle Asset Management Malaysia Sdn Bhd, Unit 14-1 Level 14, Wisma UOA Damansara II, No 6 Changkat Semantan, Damansara Heights 50490 Kuala Lumpur, Malaysia regulated in Malaysia by Securities Commission Malaysia. Registration number: 1041082-W. 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