

# In Credit

18 JANUARY 2021

## All change, all change.

Markets at a glance



**David Oliphant**  
Executive Director,  
Fixed Income

### Contributors

**David Oliphant**  
Macro / Government bonds,  
Investment Grade Credit

**Angelina Chueh**  
Euro High Yield Credit,  
Emerging Markets

**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

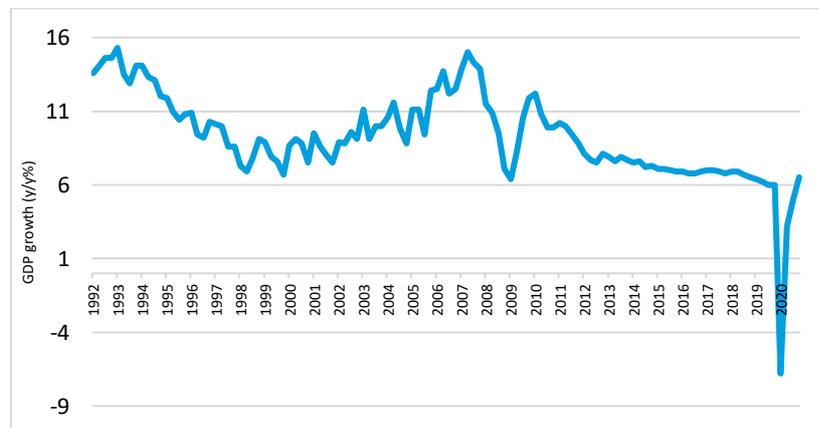
**Charlotte Edwards**  
Responsible Investments

**Jake Lunness**  
Commodities

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	1.08%	-3 bps	-1.2%	-1.2%
German Bund 10 year	-0.53%	-1 bps	-0.1%	-0.1%
UK Gilt 10 year	0.30%	1 bps	-1.5%	-1.5%
Japan 10 year	0.06%	2 bps	-0.1%	-0.1%
Global Investment Grade	100 bps	-1 bps	-0.7%	-0.7%
Euro Investment Grade	91 bps	3 bps	0.1%	0.1%
US Investment Grade	100 bps	-2 bps	-1.1%	-1.1%
UK Investment Grade	98 bps	1 bps	-0.7%	-0.7%
Asia Investment Grade	235 bps	-1 bps	-0.5%	-0.5%
Euro High Yield	356 bps	5 bps	0.5%	0.5%
US High Yield	374 bps	-2 bps	0.4%	0.4%
Asia High Yield	585 bps	-2 bps	-0.4%	-0.4%
EM Sovereign	329 bps	12 bps	-1.6%	-1.6%
EM Local	4.3%	3 bps	-0.9%	-0.9%
EM Corporate	325 bps	5 bps	-0.3%	-0.3%
Bloomberg Barclays US Munis	1.1%	-2 bps	0.0%	0.0%
Taxable Munis	2.2%	-6 bps	-0.6%	-0.6%
Bloomberg Barclays US MBS	19 bps	-3 bps	0.0%	0.0%
Bloomberg Commodity Index	171.77	1.0%	3.1%	3.1%
EUR	1.2062	-1.1%	-1.1%	-1.1%
JPY	103.76	0.1%	-0.5%	-0.5%
GBP	1.3546	0.2%	-0.6%	-0.6%

Source: Bloomberg, Merrill Lynch, as at 15 January 2021.

### Chart of the week: Chinese GDP growth (1992-2020)



Source: Bloomberg, Columbia Threadneedle Investments, as at 18 January 2021.

## Macro / government bonds

It is Martin Luther King Day today and on 20 January Joe Biden will be inaugurated as the 47<sup>th</sup> and oldest ever President of the United States.

There was a degree of stabilisation in rates markets last week after the inflation fears led a sell off. The benchmark 10-year US government note peaked in yield at 1.15% on 11 January before ending the week at 1.08%. Both US and GBP government bond markets are in negative return territory this year, while euro and yen markets are fairly flat.

In terms of data, Chinese GDP impressed with 6.5% growth in 2020 led by strong exports and industrial output ([see chart of the week](#)). In the US, consumer price inflation (ex-food and energy) remains well under control at 1.6%/y. In Europe, industrial production came in at 2.5% m/m, though this was pre-lockdown.

In Covid-19 news, the rollout of vaccinations continues with the UK showing some leadership, having inoculated around 6.5% of the population so far. European countries have been slower to follow.

## Investment grade credit

Global investment grade spreads ended the week at 100bps, barely tighter on the week. Markets are now between 2-3% tighter so far this year. Though we expect this year to be light of primary activity it was a busy start to the year in terms of new issuance.

US bank results last week (JP Morgan, Citibank and Wells Fargo) were characterised by credit writebacks, stabilising margins and strength from markets businesses and adequate capital ratios. Meanwhile, the cost of US telecom spectrum auctions continues to rise to over \$90 billion. This sets back the deleverage plans of Verizon and AT&T. Carrefour, the French retailer, ended 'join up' talks with Couche Tard the Canadian retailer. Food retailers themselves appear to be enjoying strong sales through the lockdown as illustrated by Tesco in the UK. Meanwhile retailers with a strong online presence are eclipsing the results of those without. In the auto sector, 2020 was terrible in terms of deliveries though higher end companies outperformed (eg, BMW).

## High yield credit

US high yield bond prices were largely unchanged over the week amid volatility in rates and stocks, coupled with a heavy new-issue calendar. The ICE BofA US HY CP Constrained Index returned 0.13% and spreads were 1bps tighter. The index has returned 0.35% in January with CCCs (+1.50%) continuing to outperform B (+0.11%) and BB (+0.25%) issuers. Energy has been a large outperformer with gains totalling 2.53% month-to-date. The primary market reopened in a meaningful way this week, with 16 deals totalling \$16 billion pricing, the busiest week since September 2020. According to Lipper, the asset class reported its fourth outflow over the last five weeks with \$1.3 billion of withdrawals from retail funds over the week.

The European high yield market slightly softened in the second week of 2021 following the first week's quite positive tone. Spreads widened 5bps while flows into the asset class were a relatively modest \$143 million, all into managed funds as ETFs saw a small outflow.

The primary market picked up strongly, largely on refinancings, after the previous week's single offering with €5.2 billion of issuance, all in BB rated paper. New issuance included Autostrada, Jerrold Finco, Telecom Italia, and two hybrids (Wintershall and Abertis). Investors proved more discerning given that while there was good demand with tightening from initial price talk, both Autostrada and Abertis came in at or very close to the initial price talk with low oversubscription. Also in the news last week was Europcar, which had gone into a lock-up to restructure last year, experiencing a 100% recovery in the CDS auction. This meant that anyone who bought protection via CDS, was paid zero after auction as the bonds were valued at 100%, even while the bonds were pricing at 72 cents.

In the auto sector, Moody's joined S&P in upgrading Fiat Chrysler to BBB, confirming this rising star will leave the high yield universe at the end of January. At Renault, the new strategic plan, 'Renaulution' was announced, focusing on reducing costs and overhauling brands.

In M&A news, Telefonica confirmed it would be selling its Telxius Tower division to American Towers for €7.7 billion. This will help the firm reduce net debt by €4.6 billion.

## Leveraged loans

Leveraged loan prices continued to rise over the week as the asset class benefits disproportionately from a rise in rates in response to expectations for additional stimulus. The average price of the J.P. Morgan Leveraged Loan index increased \$0.45 to \$98.12 over the past week with the average price for BB loans increasing \$0.29 to \$99.69, Single B loans increasing \$0.42 to \$99.41, and Split B/CCC increasing \$1.14 to \$88.53. Notably, the percentage of the index trading above par (46.3%) is at its highest level since February 2020. Lastly, the asset class posted its largest weekly inflow since March 2017, totalling \$1.1 billion.

## Emerging markets

Emerging markets pulled back last week as both EM hard currency sovereigns and corporates experienced spread widenings of 5bps and 3bps, respectively. Despite this weakness, the asset class continued to experience the start of the year's strong inflows with \$2.9 billion this week, largely into local currency (\$2.1 billion). Interestingly, hard currency ETFs experienced small outflows.

The primary market continued its strong trend with issuance from the likes of Korea Development Bank (\$1.5 billion); Oman, Colombia; SK Hynix (South Korea semi-conductors); Dominican Republic; Marfrig Global Food (Brazil food company); and Mexico (in euros).

In central bank news, Peru kept rates unchanged at 0.25% saying that it is appropriate to maintain an expansionary monetary stance for a 'prolonged period'.

In country specific news, the US International Development Finance Corporation announced an agreement with Ecuador to help the country repay billions of US dollars in loans to China, in exchange for excluding Chinese companies from its telecom networks. Finally, the continuing saga of which Chinese companies will be added next to the US Department of Defence 'banned' list, saw Xiaomi as this week's surprise addition. Of the nine new names added to the list only Xiaomi, which produces low cost mobile phones, issues bonds in US dollars. This was followed by the news that the US administration had notified some companies that their export licenses to Huawei have been revoked; this is especially an issue for Intel, which sells its chips to Huawei.

## Commodities

The commodity index rallied by 1% last week, bringing year-to-date returns to 3.1%. This has been driven by a combination of supply constraints, supportive liquidity and enduring demand. In energy, WTI rallied 2.4%, finishing the week just above \$52. The market remains in backwardation despite exuberance surrounding near term contracts. Global spare capacity is currently high with over 8 million barrels of OPEC+ capacity offline.

Performance in metals was mixed. Zinc declined by 4% on the back of lower seasonal demand and production issues in China, and nickel rallied by 2%. Metals have been supported by better than expected GDP growth from China at the start of this week. Gold and silver further extended their declines, with gold falling by 4.5% and silver by 8.7%.

In agriculture, the market digested the US Department of Agriculture's crop report. Notably inventories dropped even further than market expectations. Additionally, production in Argentina and Brazil was also revised downwards; agricultural commodities rallied by 4.2% largely as a result of this.

## Summary of fixed income asset allocation views

### Fixed Income Asset Allocation Views

18<sup>th</sup> January 2021

Strategy and positioning (relative to risk free rate)	Views	Risks to our views
<b>Overall Fixed Income Spread Risk</b> 	<ul style="list-style-type: none"> <li>Recent performance is entirely justifiable based on better fundamentals &amp; balance sheets, and the arrival of a vaccine.</li> <li>Despite this outlook, valuations matter. After a monster month of returns, most spreads are well within long-run average.</li> <li>We have likely already seen peak liquidity in financial markets. We do not expect material tightening in financial conditions next year, but it is certainly a risk worth watching.</li> </ul>	<ul style="list-style-type: none"> <li>Moving to neutral, risks are two-sided.</li> <li>A recovering economy propels spreads to all-time highs.</li> <li>The recovery gets bungled by vaccine delays, geopolitical interruptions, or a limping</li> </ul>
<b>Duration (10-year)</b> ('P' = Periphery) 	<ul style="list-style-type: none"> <li>Renewed virus concerns and economic disruption to keep nominal growth subdued</li> <li>Reflation credibility still low, although risks from fiscal policy</li> <li>Fed QE and high personal savings underpin demand for treasuries</li> <li>ECB bond buying scheme supports Eurozone market</li> <li>Duration remains best hedge for further risk asset correction</li> </ul>	<ul style="list-style-type: none"> <li>Vaccine development pace exceeds expectations, permitting rapid normalisation</li> <li>Permanent fiscal policy shift rebuilds reflationary credibility</li> <li>Fiscal largesse steepens curves on issuance expectations</li> <li>Risk hedge properties deteriorate</li> </ul>
<b>Currency</b> ('E' = European Economic Area) 	<ul style="list-style-type: none"> <li>A Biden presidency should see a weaker dollar through the reduction of trade war risk premium.</li> <li>Longer term, expensive valuations and twin deficits presage a weaker Dollar</li> </ul>	<ul style="list-style-type: none"> <li>Fiscal gridlock continues in the US, which undermines growth and risk sentiment</li> <li>Extension of Covid restrictions in Europe and accommodative ECB policy</li> </ul>
<b>Emerging Markets Local (rates (R) and currency (C))</b> 	<ul style="list-style-type: none"> <li>Favourable advanced economy setting support EM assets near term</li> <li>EM real interest rates relatively attractive, curves steep</li> </ul>	<ul style="list-style-type: none"> <li>Sharp escalation in global risk aversion</li> <li>EM funding crises drive curves higher and steeper</li> </ul>
<b>Emerging Markets Sovereign Credit (USD denominated)</b> 	<ul style="list-style-type: none"> <li>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 slow down will likely exacerbate these 'back burner' issues.</li> <li>Valuations are still a slight benefit to EM, particularly HY credits.</li> <li>Low yields, lots of liquidity, and global recovery still could provide tailwinds for EM in 2021.</li> </ul>	<ul style="list-style-type: none"> <li>The USD strengthens.</li> <li>Growth scars from COVID persist and hurt commodity prices &amp; ability to grow out of deficits.</li> <li>Governments show little willingness to address deficits post-COVID.</li> </ul>
<b>Investment Grade Credit</b> 	<ul style="list-style-type: none"> <li>IG companies continue to adapt well to the economic environment, given that they are the best-in-class operators in their industries.</li> <li>Outside of the sectors most affected by COVID, IG spreads are close to all-time highs, and the duration of the asset class has increased 1 full year YTD. Long-end bonds may have more room to flatten, but there is little juice left in lower duration bonds.</li> <li>The end of the Fed credit facilities has had little impact on the market.</li> </ul>	<ul style="list-style-type: none"> <li>Foreign buyers slow for geopolitical or regulatory reasons.</li> <li>The cash stockpiles taken out at the depths of the crisis are deployed on large-scale M&amp;A instead of deleveraging.</li> <li>Yields remain low and TINA (There Is No Alternative) pushes buyers to IG instead of Treasuries.</li> </ul>
<b>High Yield Credit</b> 	<ul style="list-style-type: none"> <li>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.</li> <li>The ability to access financing has dramatically improved the prospects for many companies, especially for COVID-affected industries.</li> <li>The effects of easy financial conditions hit HY later than higher quality sectors, and tighter conditions will hit HY first.</li> </ul>	<ul style="list-style-type: none"> <li>Prolonged COVID-19 related slump in activity would hurt these companies most.</li> <li>The sector most sensitive to changing financial conditions.</li> <li>The combination of policy support, vaccine, positive technical, and economic recovery takes spreads well-inside averages</li> </ul>
<b>Agency MBS</b> 	<ul style="list-style-type: none"> <li>Fed buying has overwhelmed highly negative fundamentals for most of 2020, but on-the-run spreads have reached 0.</li> <li>Fed buying cannot be expected to increase in 2021, exposing negative fundamentals and valuations</li> <li>Prepays remain and will remain high, with &gt;80% of mortgages having incentive to refinance.</li> </ul>	<ul style="list-style-type: none"> <li>Housing activity slows considerably and prepaids move back down to normal levels.</li> <li>The Fed maintains or increases MBS purchases next year.</li> </ul>
<b>Non-Agency MBS &amp; CMBS</b> 	<ul style="list-style-type: none"> <li>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.</li> <li>CMBS: vaccine news reminded investors that a post-COVID world will exist, and CMBS short covering has been fast &amp; furious.</li> </ul>	<ul style="list-style-type: none"> <li>Changes in consumer behaviour in travel and retail last post-pandemic.</li> <li>Work From Home continues full-steam-ahead post-pandemic.</li> <li>Built-up savings from fiscal stimulus/enhanced unemployment benefits are drawing down and mortgage forbearance increases.</li> </ul>
<b>Commodities</b> 	<ul style="list-style-type: none"> <li>o/w Copper vs Aluminium</li> <li>o/w Lead vs Zinc</li> <li>o/w Soybeans vs Corn and Wheat</li> <li>o/w refining margins (o/w products, u/w Brent)</li> <li>u/w Sugar</li> <li>u/w WTI</li> </ul>	<ul style="list-style-type: none"> <li>Oil production disruption</li> </ul>

**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 18.01.2021, 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](http://columbiathreadneedle.com)**