INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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In Credit

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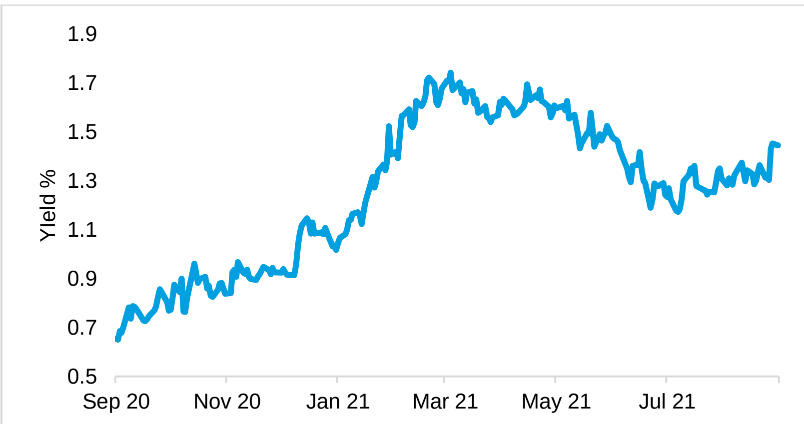
Jolly green giant Gilt.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	1.49%	12 bps	-0.7%	-2.2%
German Bund 10 year	-0.21%	7 bps	-1.2%	-2.7%
UK Gilt 10 year	0.96%	11 bps	-2.3%	-6.1%
Japan 10 year	0.06%	1 bps	-0.3%	0.0%
Global Investment Grade	89 bps	-1 bps	-0.5%	-0.4%
Euro Investment Grade	83 bps	0 bps	-0.5%	-0.2%
US Investment Grade	87 bps	-3 bps	-0.4%	-0.4%
UK Investment Grade	86 bps	0 bps	-1.3%	-2.5%
Asia Investment Grade	197 bps	0 bps	-0.4%	0.4%
Euro High Yield	303 bps	8 bps	0.2%	4.0%
US High Yield	305 bps	1 bps	0.3%	5.0%
Asia High Yield	739 bps	4 bps	-3.8%	-5.4%
EM Sovereign	320 bps	8 bps	-1.2%	-0.7%
EM Local	5.2%	6 bps	-2.5%	-5.4%
EM Corporate	299 bps	-1 bps	-0.3%	1.9%
Bloomberg Barclays US Munis	1.0%	5 bps	-0.2%	1.3%
Taxable Munis	2.2%	7 bps	-0.8%	1.5%
Bloomberg Barclays US MBS	30 bps	-2 bps	-0.3%	-0.6%
Bloomberg Commodity Index	212.74	1.5%	3.1%	26.8%
EUR	1.1707	0.0%	-0.8%	-4.1%
JPY	110.94	-0.7%	-0.7%	-6.7%
GBP	1.3702	-0.5%	-0.6%	0.1%

Source: Bloomberg, Merrill Lynch, as at 27 September 2021.

Chart of the week: 10-year US Government Bond Yield – YTD



Source: Bloomberg, Columbia Threadneedle Investments, as at 27 September 2021.

Macro / government bonds

The 'excitement' of an FOMC meeting, shenanigans at Evergrande, revised forecasts from the OECD and the German general election led to a rise in yields last week **(see chart of the week)**.

The US Federal Reserve presented a more hawkish view about the direction of interest rates last week. The so-called 'dot plot', which at the median had suggested the FOMC would not raise rates until 2023 in May was changed such that six members expect rates to rise once next year and three expect two hikes in the same period. It also seems as though tapering of assets will begin around November and end in the summer of next year, though no exact date was given. There was little market directional impact to the statement though the yield curve flattened as might be expected.

In other news, the OECD updated its global growth and inflation forecasts. For 2021 the organisation now sees inflation of 3.7% (+0.2% from May forecast), and 3.9% in 2022 (+0.5%). Global growth expectations were changed less to 5.7% in 2021 (-0.1%) and 4.5% for 2022 (+0.1%). The trend of issuing 'Green' government bonds reached the UK last week. The 12-year issue received an astonishing level of interest (of around £100bn) for what was the largest single-tranche green bond (£10bn). In what is likely be the first of a number of such issues, the UK will use the proceeds to fund eligible 'Green' Projects such as clean transportation, agriculture and animal husbandry and hydrogen (blue and Green).

The German election seems to have left the country in a degree of political limbo. The SPD scored the highest percentage of votes but not enough for a majority. We expect a period of coalition negotiations to be ongoing for weeks. There was little market reaction with German yields little moved.

Investment grade credit

Investment grade spreads were (again) largely unchanged last week which, as we keep mentioning, has been a feature of the market for a number of weeks now. The rise in government bond yields was shrugged off by markets. Valuation wise spreads remain through both short and longer-term averages. Issuance has also slowed somewhat, after a strong start to the month.

In a quiet week for specific issuer news, French state-owned La Banque Postale issued the lowest AT1 coupon ever (3%).

High yield credit

US high yield bond spreads were volatile this week as investors absorbed Monday's equity swoon in response to China's indebted property sector, as well as more hawkish outcomes than expected from the Bank of England and US Fed. On Monday, high-yield bond spreads widened 21bps alongside the largest decline in the S&P 500 since May, but ultimately retraced their largest setback since mid-July over the ensuing three days. The ICE BofA US HY CP Constrained Index returned -0.17% and spreads were 1bps wider. The index yield-to-worst was 10bps wider over the week, ending at 3.86%. After a slower than expected post-Labour Day period, primary market activity picked up over the week with $11bn pricing despite Monday's volatility. According to Lipper, the asset class reported a $536m inflow, the fourth over the last five weeks.

European high yield market gave back last week as spreads widened 8bps, to 303bps, and the asset class recorded a weekly negative performance, one of the rare few this year. This came on the back of China's Evergrande news; US Fed tapering talk; Bank of England mulling over rate hikes; and as euro area PMIs came in lower than expected and the euro yield curve bear steepened. Lower-rated credits still outperformed with CCCs returning an almost flat performance while BBs returned -24bps. Asset class flows returned to negative with €201m out, all from managed accounts as ETFs still experienced a positive net inflow. The primary market picked up more with €4.5bn, the highest weekly figure since end of June, with BBs dominating. This included the first new issue from Europcar since its 2020 restructuring. New issues were comfortably oversubscribed, with prices tighter from initial talk. In credit rating news, Coty was upgraded (Moodys, Caa1 to Ba2) on the back of good progress in deleveraging. This was offset by news that Grifols the blood plasma company was downgraded by the rating agencies (Moody's, Ba3 to B1 and S&P,BB to BB-). Last week's acquisition was cited as leverage will remain high for two years, as a result, and given uncertainty around recovery from the coronavirus impact.

In M&A news, Draftking (Gaming) announced a $22.4bn cash and stock offer for Ladbrokes; Silgan (packaging) announced the acquisition of US-based Gateway plastics for $485m; and Iliad (telecoms) said it will buy UPC Poland for PLN7.0bn (€1.5bn).

Supply disruptions issues are starting to hit guidance figures as more companies are lowering their outlooks. Axalta Coating Systems cut its Q3 outlook and withdrew FY 2021 guidance on supply chain/raw materials. Car suppliers, Faurecia and Kongsberg Automotive, also lowered their 2021 fiscal year guidance citing chip shortages and rising RM prices

Leveraged loans

Leveraged loans experienced less price volatility this week amid firm technicals and the heaviest issuance since June. For context, the $0.06 decline for loan prices (J.P. Morgan Leveraged Loan Index) on Monday was comparable to a $0.45 decline for the high index, and loan prices fully recovered by the end of the week. As with bonds, leveraged loan issuance was slow to manifest in September but rose to $23.5bn this week. Inflows continued for the asset class but moderated to $363m.

Asian credit

On 22 September, the regulators issued instructions to Evergrande Group to take all measures to avoid a near-term default on the dollar bonds and also to complete unfinished properties and repay retail investors. These retail investors, between them, have around $6.2bn of wealth management products that are due for payment. Evergrande Group has not paid the $83.5m of coupon due on a US dollar bond on 23 September. There is another coupon payment of $45m for another US dollar bond due on 29 September, while there is a 30-day grace period for the payment of the coupon. In the meantime, the regulators have also told local governments to brace themselves for a potential Evergrande collapse. According to some reports, the local governments are talking to various property developers to potentially take over some of Evergrande's projects.

Emerging markets

In China, power shortages have led to factory closures and energy rationing in the north-east. The squeeze has been driven by tight coal supplies and tougher emissions standards.

The bonds of Chinese real estate developer Sunac dropped in price following the company seeking support from the local government. The request cited tighter housing policies and negative sentiment in the housing market.

The Ukrainian government dismissed three supervisory board members at Naftogaz following the resignation of three independent members of the supervisory board earlier this month.

Commodities

Thermal coal rallied 7.2% closing close to all-time highs. Coking coal also rallied sharply despite China's ongoing cap on steel production. China recently banned Australian coal imports, the worlds fifth largest producer.

Brent crude oil prices rallied 3.5%, closing at $78, as Goldman Sachs raises its year end forecast to $90 a barrel. In response to panic buying at UK petrol pumps, industry bodies have insisted there's "no national shortage of fuel".

Tin prices rallied 7.7% and is still trading at all-time highs driven by disruptions in major producing countries and high demand for electronics.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

27th September 2021

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 worsening Delta variant is threatening global reopening/growth stories as case counts rise and restrictions return. In areas with high vaccination rates, low mortality rates may deter policy moves. ▪ Although credit spreads have widened slightly, they are still near all time tights and leave little room for the growth story to get derailed. Pockets of opportunity with deleveraging & upgrade activity exist. ▪ We are past the peak of central bank accommodation. The pullback in liquidity won't be aggressive, but it leaves opportunity for market volatility. ▪ Uncertainty is rising as Delta threatens the recovery, monetary & direct fiscal support wane, and unemployment benefits expire.	▪ Upside risks: the unique COVID recovery in fundamentals allow spreads to rocket past all-time tights. Spreads have spent extended periods near tights in other periods as well. ▪ Downside risks Delta variant cases worsen and restrictions return, threatening returns to schools, offices and travel Once spreads hit these extreme levels, future returns are rarely good Both fiscal and monetary stimulus are removed just as growth decelerates could cause a sell off
Duration (10-year) ('P' = Periphery)	P ¥ $ Short -2 -1 0 +1 +2 Long £ €	▪ Rangebound government bond market likely, with bias to lower yields ▪ Pandemic scarring keeps reflation credibility low ▪ Fed QE and high personal savings underpin demand for treasuries ▪ ECB likely to lean against rising financing rates ▪ Duration remains best hedge for further risk asset correction	▪ Permanent fiscal policy shift rebuilds reflationary credibility and raises r* ▪ Fiscal largesse steepens curves on issuance expectations ▪ Consumption rebound stimulates long-term inflation expectations ▪ Risk hedge properties deteriorate
Currency ('E' = European Economic Area)	¥ £ EM Short -2 -1 0 +1 +2 Long E A$ $	▪ US growth outperformance on back of fiscal stimulus boosts USD ▪ ECB increasingly sensitive to Euro appreciation	▪ Vaccine rollout in Europe improves and narrows growth gap ▪ US fiscal push fades
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	▪ Selective opportunities ▪ Still-favourable global liquidity conditions ▪ Dollar resilience may crimp scope for EMFX performance ▪ EM real interest rates relatively attractive, curves steep in places	▪ Central banks tighten aggressively to counter fx weakness ▪ EM inflation resurgence ▪ EM funding crises drive curves higher and steeper
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Dispersion in outlooks across EM is rising as the recovery begins at different paces. Countries with commodity exposure and better fiscal adaptability rise to the top. ▪ Index composition changes over the last 5 years have added a lot of duration to the sector, leaving especially IG EM vulnerable. We prefer HY EM (selectively). ▪ US growth outperformance is starting to cause weakness in EMFX, with the exception of countries aggressively hiking rates (like Russia and Brazil).	▪ A replay of 2013 occurs with a taper tantrum or swift appreciation of the USD ▪ Growth scars from COVID persist and hurt commodity prices & ability to grow out of deficits. ▪ There are even further delays in mass vaccination outside of developed markets.
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ US spreads are the tightest since 2005, when average credit quality was higher and duration was 50% lower. ▪ IG has been historically resilient in the face of inflation, even if other sectors may benefit more from it. ▪ Good fundamentals after most recent earnings, with strong balance sheet management and deleveraging from capital management & sales growth	▪ IG bonds further cement their place in global investors' portfolios as safe assets, replacing government bonds. ▪ M&A and shareholder returns remain in the backseat of management's priorities for an extended period of time.
High Yield Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads are nearly to all-time tights, although credit quality has improved through defaults and ample liquidity ▪ The best performing parts of these sectors have been the most volatile and lowest quality. ▪ Defaults are set to drop dramatically in 2021 in part due to the rapid recovery, but also due to an ability to remove near-term maturities by companies across the credit spectrum.	▪ The reach for yield continues to suppress spreads. ▪ Waves of ratings upgrade begin to occur this year. ▪ There are few exogenous shocks that shake the tight spread environment.
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ The Fed has been the 1000lb gorilla in this market since COVID hit, and it is progressively getting closer to tapering. The Fed will taper MBS alongside USTs, but tapering will still be a headwind to the market. Banks, the other major buyers, have slowed their purchases as well. ▪ With interest rates falling again, fundamentals worsen as prepayment speed will remain elevated. Changes to FHFA housing policies could also be marginally negative for fundamentals over time.	▪ Housing activity slows considerably and prepays move back down to normal levels, without denting households' ability to service mortgages. The Fed maintains or increases MBS purchases next year. ▪ The Fed maintains or increases MBS purchases next year.
Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Our preference remains for non-agency RMBS in this area. ▪ RMBS: Housing continues to outperform in the recovery as HH balance sheets are strong, demographics are positive, and supply is constrained. Valuations are less compelling, but can provide stable carry in de risking portfolios. ▪ CMBS: favored bonds are still 'story' bonds. A return to normal won't look 'normal' for sectors like office space or convention hotels and recently has lagged. ▪ Spread tightening looks somewhat excessive along the margins of credit quality.	▪ Changes in consumer behaviour in travel and retail last post pandemic ▪ Work From Home continues full steam ahead post pandemic (positive for RMBS, negative for CMBS). ▪ 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 Soybeans ▪ o/w Oil	▪ US China trade war ▪ Renewed Covid lockdowns