

In Credit

6 JANUARY 2020

Follow that!

Markets at a glance

| | Price / Yield / Spread | Change 1 week | Index MTD return | Index YTD return |
|-----------------------------|------------------------|---------------|------------------|------------------|
| US Treasury 10 year | 1.77% | -13 bps | -0.6% | 7.0% |
| German Bund 10 year | -0.30% | -6 bps | -1.3% | 3.1% |
| UK Gilt 10 year | 0.73% | -4 bps | -1.4% | 7.3% |
| Japan 10 year | -0.02% | -3 bps | -0.3% | 1.7% |
| Global Investment Grade | 103 bps | 2 bps | 0.2% | 11.5% |
| Euro Investment Grade | 95 bps | 0 bps | 0.0% | 6.3% |
| US Investment Grade | 103 bps | 3 bps | 0.3% | 14.2% |
| UK Investment Grade | 112 bps | 1 bps | -0.1% | 9.5% |
| Asia Investment Grade | 194 bps | 6 bps | 0.2% | 9.9% |
| Euro High Yield | 328 bps | -7 bps | 1.1% | 11.1% |
| US High Yield | 361 bps | 8 bps | 2.1% | 14.4% |
| Asia High Yield | 540 bps | -14 bps | 0.6% | 12.7% |
| EM Sovereign | 289 bps | 9 bps | 1.9% | 14.4% |
| EM Local | 5.2% | -1 bps | 4.1% | 13.5% |
| EM Corporate | 317 bps | 5 bps | 1.0% | 13.1% |
| Bloomberg Barclays US Munis | 1.7% | -8 bps | 0.3% | 7.5% |
| Taxable Munis | 2.9% | -11 bps | -1.0% | 14.3% |
| Bloomberg Barclays US MBS | 43 bps | 0 bps | 0.3% | 6.4% |
| Bloomberg Commodity Index | 174.13 | 0.3% | 5.0% | 7.7% |
| EUR | 1.1179 | 1.1% | 1.8% | -2.2% |
| JPY | 107.97 | 0.7% | 0.8% | 0.9% |
| GBP | 1.3118 | 2.4% | 2.6% | 3.9% |

Source: Bloomberg, Merrill Lynch, as at 31 December 2019.



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

Chart of the week: US Manufacturing ISM Index: 2000-2019



Source: Bloomberg, Columbia Threadneedle Investments, as at 6 January 2020.

Macro/Government bonds

We begin 2020 with many of the same challenges we faced this time last year.

Government bond yields remain incredibly low, in both nominal and real terms after a strong 2019. This year, however, credit markets are also starting to look more expensive after the material compression in spreads of the last 12 months. Together, this suggests we shall struggle to emulate the strong market returns seen in 2019 (see [Markets at a glance](#)).

We do not expect a normalisation of government bond prices this year, in the face of anaemic economic growth and little inflation in most developed markets. As such, central banks will not be in any rush to raise interest rates. That reality is already reflected in market implied expectations, which suggest low but largely unchanged interest rates will be a feature of the financial market landscape for the coming three years (see [table 1 below](#)).

Table 1: Market interest expectations

| Market | Present Rate | 3m expectations | 6m | 12m | 24 m | 36m |
|----------|--------------|-----------------|------|------|------|------|
| US | 1.625% | 1.6 | 1.6 | 1.5 | 1.5 | 1.5 |
| Eurozone | -0.50% | -0.5 | -0.5 | -0.5 | -0.4 | -0.3 |
| UK | 0.75% | 0.7 | 0.7 | 0.6 | 0.7 | 0.8 |

Source: Bloomberg, as at 2 January 2020.

Last week there were a few snippets of data to focus upon and also the escalating tensions between the US and Iran, which provided support for 'safe haven' assets.

In Europe, headline unemployment in Germany remained at 5% in December. In the US, the key ISM Manufacturing data came in at 47.2 – the weakest print since mid-2009 (see [Chart of the week](#)). The minutes of the 11 December meeting of the US Federal Reserve suggest the central bank is not going to do anything unless there is a material change in economic conditions.

Credit Market Review

Table 2: Credit market performance 2019

| Market | Spread 31/12/19 | Spread 31/12/18 | Change bps | Change % | 5yr Ave | 20yr Ave | 5yr Z Score | 20yr Z score |
|--------|-----------------|-----------------|------------|----------|---------|----------|-------------|--------------|
| \$ IG | 101 | 159 | -58 | -36% | 133 | 162 | -1.3 | -0.7 |
| € IG | 94 | 154 | -60 | -39% | 114 | 121 | -1.1 | -0.4 |
| GBP IG | 114 | 151 | -37 | -25% | 123 | 128 | -0.6 | -0.2 |
| \$ HY | 360 | 533 | -173 | -32% | 456 | 575 | -0.8 | -0.8 |
| € HY | 328 | 529 | -201 | -38% | 406 | 587 | -0.9 | -0.8 |

Source: Bloomberg / ICE BoAML, as at 2 January 2020.

As mentioned, it was a year of strong corporate credit market performance. Spreads ended December 2019 materially tighter than a year earlier (see [table 2](#)) and core government yields were lower.

On a risk-adjusted spread basis (percent change), European assets performed best (with both investment grade and high yield nearly 40% tighter), but this was only by a whisker as US credit markets were only a few percent points behind. With the uncertainty caused by Brexit UK credit underperformed - though spreads were still 25% tighter. At the margin, investment grade outperformed high yield markets.

Comparing present valuations (spreads) to shorter term (5-year) average spreads, markets look expensive with US investment grade now nearly 1.5 standard deviations rich. On a longer term (20-year) comparison, however, markets are not far from the average - though this period included the 'meltdown' experienced in the Global Financial Crisis when spreads were at historic wides.

Investment grade credit

The increased geopolitical tensions in the Middle East meant that markets were a little weaker in the first few days of the New Year. We are expecting to see the new issue market get up and running this week after the seasonal lull around Christmas and New Year.

In specific news in Europe, Moody's downgraded various companies owned by infrastructure giant Atlantia. This includes a downgrade to high yield for Italian toll road operator Autostrada.

In the US during 2019, Telecoms led industry returns on strong gains from AT&T and Verizon after both firms announced deleveraging plans during the first quarter. Laggards included Consumer Products and Leisure, though all industries delivered positive excess returns on the year. Technicals supported the asset class as gross supply dropped 3% from 2018 and demand came from foreign and domestic buyers alike.

High yield credit

The first week of the new year was a positive one for European high yield, even though several of the 'higher beta' names gave up some of their positive returns on the back of the geopolitical tensions in the Middle East.

In line with the seasonal norm, the corporate news front was quiet. A Christmas surprise was Aldesa, a Spanish construction company, which saw its bond rally after news that it will be acquired by China Railway Construction Corporation (CRCC). As investors are still returning from their end of year break, liquidity levels are low, and we are yet to see any new deals come through to the market.

Leveraged loans

Loan prices rose in December and led to gains of +1.6%, the strongest performance of the sector since January 2019.

In a reversal of trend, 'low quality' led the way with CCCs up 5%, single Bs up 2% and BBs up approximately 85bps. Overall, the asset class provided a +8.2% return in 2019, which underperformed high yield and investment grade bonds.

Loan issuance of \$38.0 billion gross in the month of December followed a 14-month high \$56.3 billion in November. Gross and net loan issuance were down 44% and 36% from a year ago.

Asian fixed income

M&A developments were in focus in Asia credits.

Adani Ports announced the acquisition of a 75% stake in Krishnapatnam Port Company Limited (KPCL) - the second largest private sector port in India. This transaction is expected to be completed within 120 days, subject to approvals.

During Bharti's Extraordinary General Meeting on 3 January 2020, shareholders approved the company's proposal to raise up to INR21 billion of funding. The capital raise will help Bharti address part of its funding

needs for the AGR (adjusted gross revenue) dues, of which Bharti may have to pay around \$4.8 billion by 24 January 2020.

The pipeline of new bonds this coming week is busy, notably with proposed issuances and roadshows by Chinese, Indian and Indonesian companies.

Emerging markets

Emerging markets also performed very well last year (+14%) as hard currency spreads were over 150bps tighter. The exclusion of Venezuela (very wide spreads) and the inclusion of several Middle Eastern countries (tight spreads) skewed the index spread changes.

In hard currency markets, the top performers last year were Ukraine, Senegal, Kenya, Costa Rica and Gabon. The reverse was true for Venezuela, Lebanon, Argentina and Zambia.

In local currency markets, Russia, Mexico, Hungary and South Africa performed well while Thailand, Zambia, Nigeria, Mongolia and Indonesia performed poorly.

Last week, emerging markets were also a little weaker given the geopolitical background though flows into the asset class remain healthy.

Commodities

Commodity markets had a reasonable 2019 with the Bloomberg index ending the year around 5.5% higher.

Precious metals were significantly higher and up around 15% supported by the negative yields offered in many areas of the bond market. Energy prices were also much higher (oil was strong, natural gas was weak) as supply discipline underpinned market confidence. The weak areas of the market last year were soft commodities, livestock (Lean hogs) and grain prices.

Last week oil and gold were beneficiaries of the increased tensions between the US and Iran.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

6th January 2020

| Strategy and positioning (relative to risk free rate) | Views | Risks to our views |
|----------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Overall Fixed Income Spread Risk | <ul style="list-style-type: none"> Global economic data continues to register at low or contractionary levels across many sectors and regions. There are modest signs of stabilization, however spread levels appear to reflect this already. Trade headlines continue to fly back & forth, but we see risks that are more fundamental than these. | <ul style="list-style-type: none"> Fast and fierce fiscal stimulus, especially in Europe or China. Reacceleration of growth trends |
| Duration (10-year) (P* = Periphery) | <ul style="list-style-type: none"> Global manufacturing remains in stagnation US trade policy undermines business investment at home and abroad US and global monetary policy continues to respond to softening macro backdrop | <ul style="list-style-type: none"> Global trade détente stimulates improvement in risk sentiment US economy stages consumption-driven cyclical upswing |
| Currency (E* = European Economic Area) | <ul style="list-style-type: none"> The Dollar is richly valued on the basis of growth outperformance and high carry. With the US economy catching down and the Fed cutting rates, the twin pillars of support should give way to the structural drag of the twin deficits An improvement in global risk sentiment due to progress on Phase 1 trade deal may undermine some of the dollar's 'safe haven' demand. | <ul style="list-style-type: none"> Further leg lower in global growth driven by increasing trade frictions. |
| Emerging Markets Local (rates (R) and currency (C)) | <ul style="list-style-type: none"> EM real interest rates still relatively attractive EM growth likely to outperform DM, while inflation benign Fiscal and external fundamentals still largely sound | <ul style="list-style-type: none"> Sharp escalation in global risk aversion Broad dollar strength |
| Emerging Markets Sovereign Credit (USD denominated) | <ul style="list-style-type: none"> Fundamentals have been not deteriorated as much as would have been expected given a strong USD and catering global trade While spreads have tightened much like other asset classes, pockets of valuations gaps have open-ended up The number of idiosyncratic blow-ups is increasing: first Argentina, now Ecuador and Lebanon are precipitously deteriorating | <ul style="list-style-type: none"> Oil & commodity rally will boost sentiment and current account balances. A rapidly weakening USD will ease financial conditions Reversal of recent electoral trend towards market-friendly candidates. |
| Investment Grade Credit | <ul style="list-style-type: none"> Broad valuations have become unattractive on an absolute basis, even before considering higher debt levels and decelerating growth Fundamentals don't show signs of imminent crisis, but several of the tailwinds are fading. Valuations look even more offside when considering this | <ul style="list-style-type: none"> A re-acceleration of growth especially in the more downtrodden European and Asian economies Beneficial technicals from low and negative yields globally continue to funnel cash to the market. |
| High Yield Credit | <ul style="list-style-type: none"> Valuations are unattractive relative to other asset classes. Forecasted default rates have started rising faster than expected earlier this year. Technicals remain positive as net supply remains very negative through rising stars & called bonds. | <ul style="list-style-type: none"> Oil quickly rebounds, likely from supply side shocks. US fiscal stimulus or unexpectedly large sentiment boost from trade war resolution boosts valuations. |
| Agency MBS | <ul style="list-style-type: none"> Prepayments have increased as a result of lower rates, however they have lagged expectations given the fall in Treasury yields. Spreads have widened to near post-GFC widths despite relatively muted prepayment activity. | <ul style="list-style-type: none"> Interest rates continue falling aggressively as they did through the summer Rate volatility increases. |
| Non-Agency MBS & CMBS | <ul style="list-style-type: none"> Fundamentals remain relatively strong as the Household balance sheet is strong and house price appreciation is still positive. Leverage trends within these sectors have continued to be contained, especially compared to rising asset valuations. Valuations in CMBS are notably less attractive than non-agency MBS. | <ul style="list-style-type: none"> Tightening in credit conditions for US consumer. Housing activity begins to contract. Stress in traditional mall-based retail becomes more entrenched across the board. |
| Commodities | <ul style="list-style-type: none"> o/w Cu vs Zinc o/w soybeans vs u/w corn/wheat o/w sugar o/w Brent vs WTI o/w Platinum vs Aluminium o/w Gasoline vs Distillates | <ul style="list-style-type: none"> Material China slow down, weighing on economic growth, metals & petrol |

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