

In Credit

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Calm after a storm.

Markets at a glance



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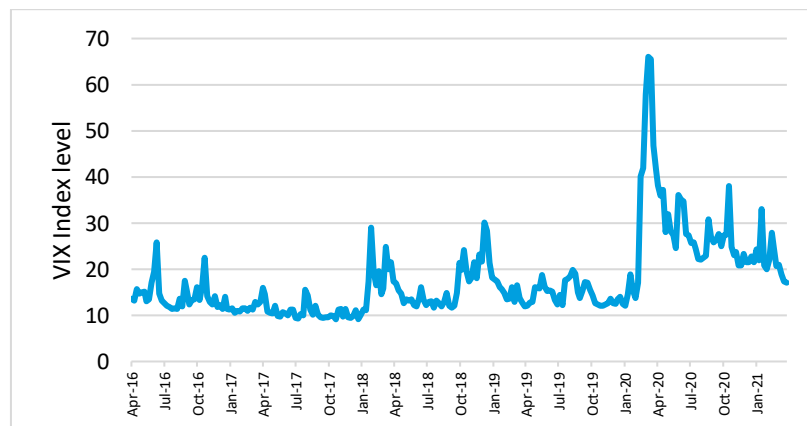
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	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
US Treasury 10 year	1.66%	-7 bps	0.6%	-4.1%
German Bund 10 year	-0.32%	1 bps	0.0%	-2.4%
UK Gilt 10 year	0.78%	-2 bps	0.9%	-6.6%
Japan 10 year	0.11%	-2 bps	0.0%	-0.4%
Global Investment Grade	95 bps	-1 bps	0.7%	-2.7%
Euro Investment Grade	87 bps	-3 bps	0.2%	-0.5%
US Investment Grade	94 bps	-1 bps	0.9%	-3.6%
UK Investment Grade	94 bps	-1 bps	0.7%	-3.5%
Asia Investment Grade	211 bps	12 bps	-0.4%	-1.2%
Euro High Yield	311 bps	-9 bps	0.5%	2.0%
US High Yield	324 bps	-9 bps	0.7%	1.6%
Asia High Yield	541 bps	6 bps	0.3%	0.5%
EM Sovereign	320 bps	-5 bps	0.9%	-3.9%
EM Local	4.9%	-7 bps	1.3%	-5.5%
EM Corporate	299 bps	2 bps	0.3%	-0.5%
Bloomberg Barclays US Munis Taxable Munis	1.1%	-7 bps	0.5%	0.1%
	2.4%	-4 bps	1.2%	-3.3%
Bloomberg Barclays US MBS	11 bps	-3 bps	0.3%	-0.8%
Bloomberg Commodity Index	179.31	0.2%	0.7%	7.7%
EUR	1.1900	1.2%	1.4%	-2.6%
JPY	109.35	1.0%	1.0%	-5.8%
GBP	1.3749	-0.9%	-0.6%	0.3%

Source: Bloomberg, Merrill Lynch, as at 9 April 2021.

Chart of the week: VIX equity market volatility, 2016-2021



Source: Bloomberg, Columbia Threadneedle Investments, as at 9 April 2021.

Macro / government bonds

There has been a degree more stability or calm in core government markets over the last couple of weeks. This comes after a very difficult start to the year, especially in the US.

Markets have been digesting a period of exceptionally resilient business and consumer sentiment data. All the while, the key US employment report continues to report sizeable job gains and a decline in the unemployment rate. This has led to fears of rising inflation and pushed yields higher. Ameliorating concerns that this strength might lead to a tapering of the current ultra-accommodative monetary policy conditions, the US Federal Reserve was at pains to present a dovish outlook. This was well received by the market and the trend higher in yields has paused at least this last three weeks. The Fed note there will be a temporary blip higher in inflation that it will look through in terms of policy conditions.

It was a light week for economic news though US initial jobless claims bucked the recent trend of stronger data, rising to 744k. This week brings US retail sales (expected to be strong); CPI inflation data; and the Beige Book. In Europe, there is also retail sales data and industrial production.

Investment grade credit

Credit spreads continue to grind slowly tighter. The Global index now offers 95bps over government bonds, which is some 8% tighter than at the end of last year. US credit is outperforming so far in 2021. Investment grade credit is lagging its high yield cousin this year; however, where global spreads are over 10% tighter. For context the global investment grade spread is now well below the short-term average (five years) and around 0.6 standard deviations tighter than the long term (20-year average). So, the market is fully valued.

The dovish rhetoric displayed by the Fed in the US, and the increased pace of asset purchases in Europe added to ultra-low or negative interest rates, are supportive for the market; however, as signs of an improvement in economic output. We note the IMF upgraded global GDP forecasts for 2021 to 6% from 5.5%. Meanwhile, our credit analysis team expects credit quality to return to the same state it was in at the end of 2019 by the end of this year. Lastly, low and falling volatility is typically supportive for all 'risk markets' – the [chart of the week](#) plots one measure of market volatility: the VIX index. You can see volatility has fallen to its lowest level in 12 months.

In company specific news, Credit Suisse has suffered from exposure to a US hedge fund as well as Greensill; the company's bonds have underperformed in this period of tightening. KPM the Dutch telco company has also seen spreads widen on rumours of private equity interest in a takeover.

High yield credit

US high yield bond yields continued to decline over the past week amid dovish FOMC Minutes, a multi-week low for 10-year US treasury yields and the largest retail inflows in five months. The ICE BofA US HY CP Constrained index returned 0.52% and spreads were 9bps tighter. The yield-to-worst of index declined 20bps to 4.02%, only 12bps wide of all-time lows seen in February. Issuers continue to capitalise on the low yield environment. Weekly new issue volume totalled nearly \$12bn. According to Lipper, the asset class reported a \$3.8bn inflow over the week. This was the largest inflow for high yield since November and also the third inflow over the last four weeks and leaves year-to-date net flows at -\$6.5bn.

European high yield had a strong April start given the further spread contraction, with spreads are inside pre-Covid tight levels of 2020. Flows into the asset class were light but positive at €129m, and all from ETFs, a reversal of the direction seen much of Q1,2021. Single Bs and CCCs outperformed as Covid-19 sensitive names shrugged off any negative news.

The primary market was light last week with only two deals: TI Fluid Systems (auto parts and a first-time issuer), and Organon the Dutch pharmaceutical spin off from Merck. The latter's €1.25bn offering came in tighter than price talk and was also upsized €400m. Issuance pace is expected to pick up next week with 20 deals of €10bn already in the market pipeline.

In other news, Synlab, the lab testing business announced plans to IPO in Frankfurt, sometime in Q2,2021 with the aim of raising €400m. Some of the proceeds are expected to go to debt repayment. In M&A news, CCK (Crown) has agreed to sell 80% of European Tinplate business to KPS Capital Partners for €2.25bn (10x EBITDA). The business produces food cans, aerosol cans, metal closures and promotional packaging business in 17 countries. Crown will receive €1.9bn from the transaction and net proceeds will be used for debt reduction.

Leveraged loans

Leveraged loan prices increased steadily over the week, with the average price of the J.P. Morgan Leveraged Loans index rising \$0.26 to \$98.33. There was little differentiation in price change by rating. Meanwhile, loan yields and spreads (3-year) decreased 11bps and 8bps over the past week to 4.78% and 432bps, which compare to February's low of 4.66% and 430bps. Inflows continued with a \$1bn contribution to the asset class over the week. This was the 13th consecutive weekly inflow for the asset class and leaves year-to-date net flows at approximately \$11bn.

Asia fixed income

S&P has revised the ratings outlook on China National Chemical Corp Ltd (ChemChina) and Syngenta from stable to positive. Recently, the Chinese government approved the restructuring of ChemChina and Sinochem under a new holding company, which will be the largest state-owned chemical company in China and will likely have a stronger credit profile compared with the current ChemChina. Syngenta's ratings outlook was lifted to positive given the scope for stronger support from the new holding company and Syngenta itself is a strategically important subsidiary of ChemChina. Furthermore, Syngenta generated solid cash flow in H2,2020, thanks to volume growth and cost control.

Moody's has affirmed Saka Energi's ratings at B2 and revised the outlook to negative from ratings under review. This favourable ratings action reflects Moody's view that the imminent risk to Saka's liquidity position has been partly cushioned by its plan to see judicial review of its \$127.7m tax dispute. Moody's also expects Saka Energi to generate higher FCF over the coming year, thanks to higher oil prices, lower capex and tax refunds.

Over the last two weeks, the volatility in the Chinese investment grade sector was driven higher by the developments at China Huarong Asset Management Company (Huarong). Huarong delayed the release of its FY20 results and it has reportedly submitted a financial restructuring and recapitalisation plan to the Chinese government. Subsequently, Bloomberg reported last week that Huarong is preparing to sell non-core and loss-making entities in its effort to restore profitability

and avoid a debt restructuring or government recapitalisation. The delay in the release of the FY20 results was reportedly attributed to Huarong's disposal plan.

Axiata is holding advanced discussion to merge its 100%-owned Malaysian telecom operations (Celcom) with Digi, which is 49% owned by Telenor. The two companies had earlier proposed the merger of its Asian operations in 2019, which did not materialise.

Emerging markets

In Ecuador former banker Guillermo Lasso beat socialist candidate Correa in the country's presidential election run-off. Lasso is seen as market friendly and has vowed to honour Ecuador's \$6.5bn IMF financing arrangement. Elsewhere on the continent Peru's presidential election run-off is more tightly contested. The current frontrunner Pedro Castillo is a community organiser and union leader whose anti-establishment charm has won him support in rural areas.

In Brazil, president Bolsonaro has been critical of Petrobras for passing on increases in oil prices to the consumer. This comes as local distributors have seen a 39% increase in natural gas prices. The company's 2016 pricing policy means that domestic fuel prices are kept at parity with international imports. Bolsonaro recently nominated a former army general as CEO following his sacking of the previous CEO.

Commodities

In energy markets Brent fell by 3.0% following OPEC'S April fool's day meeting. The cartel aims to bring almost 2.3 million barrels a day back online by the end of July. Bloomberg estimates OPEC has 9.2 million barrels per day of spare capacity.

In Agriculture, corn and wheat had a strong week rallying 3.2% and 4.5% respectively, following the release of the WASDE report. Corn was supported by ending corn stocks declining by 150 million bushels largely driven by enhanced exports to China. Wheat stocks also dropped, with a 5.7 million tonne decline. Exports have been driven by China replacing corn with wheat as a feedstock to reduce costs.

Responsible investments

We recently passed through the one-year mark of the world dealing with the coronavirus pandemic. Although in some parts of the world we've been seeing re-opening and normalisation, in other areas we're seeing higher cases and third waves. With this has come more support in the method of pandemic bonds, two recent issues coming from the European Union. A further two Covid-19 Pandemic bonds, totalling \$15.9bn, were issued at the end of March to help further support healthcare and various recovery projects across the bloc. This has taken year-to-date global pandemic bond issuance to \$68.7bn. In other areas of the ESG credit space, Green Bond issuance stands at \$155bn, social bond issuance is at \$101bn, sustainability bonds are at \$50bn and, almost already at double of last year's total issuance, sustainability-linked bonds are at \$16bn.

After announcing a few weeks ago that EDF was to close its last coal plant in Britain, the company has now sold its last gas-fired power station. This now means EDF will cease to have any fossil fuel-fired power stations in Britain. This leaves only renewable and nuclear plants in its UK range and is part of its aim to become a low carbon generator as well as divesting to control debt.

Summary of fixed income asset allocation views

Fixed Income Asset Allocation Views

12th April 2021



Strategy and positioning (relative to risk free rate)	Views	Risks to our views
Overall Fixed Income Spread Risk 	<ul style="list-style-type: none"> 2021 data is shaping up to be noisy once again, but in a much different way than 2020. This time, growth is going to be robust, especially in the US. In addition, issuers on the whole are coming into this environment better than they went into the pandemic. Valuations in most areas of credit provide much less cushion for volatility. But compared to similar spread levels in the decelerating global economy pre-COVID, we still prefer to carry more credit risk in today's accelerating economy. Question marks on the sustainability of super easy financial conditions, inflation, & the labour market widen the range of outcomes for spreads in one year's time. 	<ul style="list-style-type: none"> Rapidly rising Treasury yields tighten financial conditions or make all in yields of credit less attractive. A recovering economy propels spreads to all-time highs, especially if vaccinations accelerate quickly Geopolitical tensions rise above a simmer, particularly in the US China relationship, which has not meaningfully improved with a new US Administration.
Duration (10-year) ('P' = Periphery) 	<ul style="list-style-type: none"> Valuations suggest lower yields likely Pandemic scarring keeps ratings 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 	<ul style="list-style-type: none"> Permanent fiscal policy shift rebuilds inflationary 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) 	<ul style="list-style-type: none"> US growth outperformance on back of fiscal stimulus boosts USD ECB increasingly sensitive to Euro appreciation 	<ul style="list-style-type: none"> Vaccine rollout in Europe improves and narrows growth gap US fiscal push fades
Emerging Markets Local (rates (R) and currency (C)) 	<ul style="list-style-type: none"> Favourable advanced economy policy settings support EM assets in near term EM real interest rates relatively attractive, curves steep 	<ul style="list-style-type: none"> Sharp escalation in global risk aversion, leading to higher EM inflation via fx EM funding crises drive curves higher and steeper
Emerging Markets Sovereign Credit (USD denominated) 	<ul style="list-style-type: none"> The long leash markets gave EMs in 2020 is not extending into 2021. Questions about fiscal stability are rising again (see Brazil). Index composition changes over the last 5 years have added a lot of duration to the sector, leaving it vulnerable. US growth outperformance is starting to cause weakness in EMFX, and financial conditions for EMs is tightening. 	<ul style="list-style-type: none"> 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. Governments show little willingness to address deficits post-COVID.
Investment Grade Credit 	<ul style="list-style-type: none"> Index spreads are back to pre-COVID levels, but the duration of US indices have also lengthened by ~10%. Issuer balance sheets still look remarkably strong, and cash reserves remain very high. Our base case is that a fair amount of deleveraging can occur with this cash, but as the economic recovery accelerates and COVID moves to the rear-view mirror, the spectre of M&A and shareholder return still looms. IG has been historically resilient in the face of inflation, even if other sectors may benefit more from it. 	<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> Spreads are inside LT averages, even adjusting for the better quality of today's index. But spreads are still wider than pre-COVID. Access to capital remains easy even through more volatile markets of late, and a return to normalcy disproportionately benefits low-quality credits. The positive effects of easy financial conditions hit HY later than higher quality sectors, and tighter conditions will hit HY first. 	<ul style="list-style-type: none"> Upside risks include: intensified reach for yield keeps drawing new investors, 2020's downgrade cycle turns quickly into an upgrade cycle. Downside risks include: travel & leisure habits slowly revert to pre-COVID, commodity sell-offs, or financial conditions suddenly tightening.
Agency MBS 	<ul style="list-style-type: none"> Fed buying has overwhelmed highly negative fundamentals, as seen by the near-zero spreads in bonds the Fed buys and poor performance elsewhere. Fed buying cannot be expected to increase in 2021, exposing negative fundamentals and valuations Duration in the sector is now rising quickly as mortgage rates move higher. 	<ul style="list-style-type: none"> 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.
Non-Agency MBS & CMBS 	<ul style="list-style-type: none"> 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 pockets of value still exist. CMBS: a return to normalcy won't look 'normal' for sectors like office space or convention hotels, but pockets of value still exist in these and other areas (but there are simply fewer opportunities than 6 months ago) Our preference remains for non-agency RMBS in this area. 	<ul style="list-style-type: none"> Changes in consumer behavior 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 	<ul style="list-style-type: none"> o/w Copper vs Aluminium o/w Lead vs Zinc o/w Soybeans u/w Livestock o/w Softs 	<ul style="list-style-type: none"> US China trade war

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