IN CREDIT

WEEKLY FIXED INCOME MARKETS OVERVIEW

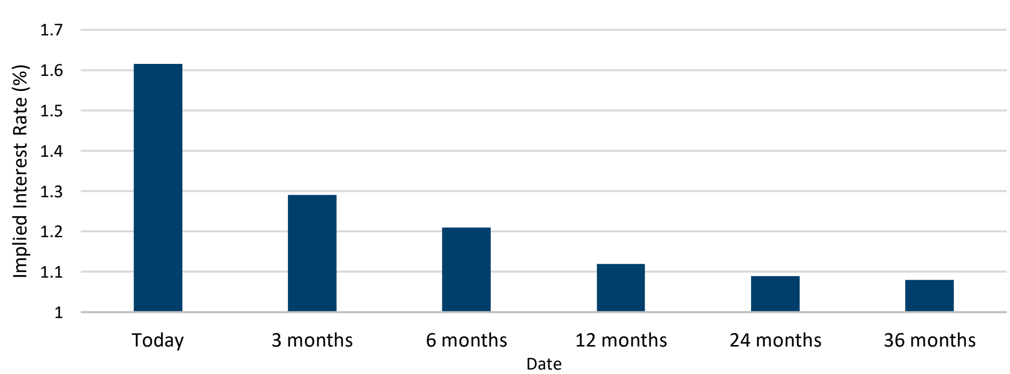
November 4, 2019

Global macro / Government bonds

The first reading of third-quarter U.S. GDP was issued last week. The economy grew stronger than expected at a 1.9% annualized quarterly rate (compared with an expected 1.6% rate and 2.0% growth in the second quarter). The economy remains propped up by a relatively buoyant consumer (+2.9%) while investment contracted (-1.5%). The year-over-year (y/y) rate of growth fell to 2.0%, the lowest rate of expansion since the fourth quarter of 2016. Meanwhile, the core personal consumption expenditure measure of inflation rose to 2.2% quarter-over-quarter (q/q) annualized, from 1.9% in the prior three months.

Interest rates were lowered last week. The Federal Open Market Committee (Fed) cut the federal funds target rate for the third time this year, by 25 basis points (bps; a basis point is 1/100th of a percent) to 1.5%–1.75%. This move was expected by the market, but bonds rallied on the news and the curve has flattened a little. Exhibit 1 plots where the market thinks interest rates will be over the course of the next three years. This would seem to be more dovish than the Fed itself, which has moved to a wait-and-see approach.

Exhibit 1: Market expectations of U.S. interest rates



Source: Bloomberg, ICE BofAML Global Investment Grade index, Columbia Threadneedle Investments, as of October 31, 2019.

In the eurozone, GDP increased by 0.2% q/q in the third quarter (0.2% in Q2). The annual rate of expansion fell to 1.1% (from 1.2% in Q2). The unemployment rate was unchanged at 7.5% in September, while inflation came in at 0.7% y/y (the core rate rose to 1.1% y/y).

Credit market review – October 2019

Market	Dec. 2018 spread (bps)	Sept. 2019	Oct. 2019	5-year average spread	20-year average spread	YTD spread change (%)
US IG	159	122	117	134	162	-26%
Euro IG	154	112	103	114	120	-33%
UK IG	151	129	122	123	128	-19%
US HY	533	402	415	459	576	-22%
Euro HY	529	389	396	408	586	-25%

Source ICE BoAML, Bloomberg, Columbia Threadneedle Investments – as of October 31, 2019.

Credit markets have enjoyed a strong year, as the table above illustrates. European investment grade stands out as the best risk-adjusted performer, reflecting the support provided by the European Central Bank in terms of asset purchases. On the other hand, the U.K. has lagged, as the uncertainty of Brexit weighs upon this market. U.S. and European high yield markets have moved in tandem.

From a valuation perspective, after this strong rally, spreads are now tighter than short-term (five-year) and long-term (20-year) averages in all markets, aside from U.K. investment grade, which is close to both measures.

Global investment grade credit

As mentioned above, it was another positive month for the investment grade market, as the ICE BofAML Global Investment Grade credit spreads finished October at 113bps. Spreads had closed the third quarter at 121bps and started the year at 158bps; they are approximately 28% tighter year-to-date (YTD).

In Europe, quantitative easing officially started again last week, but without any details being provided so far. It is expected to include corporate bond buying which should boost bond prices.

In specific news, General Electric reported better cash flow numbers. This once AAA-rated (now BBB) company's five-year credit default swap was trading as high as 265bps in late 2018 and has rallied strongly, to close to 115bps. For context, when the company was significantly better rated, the spread was in the low 30s (source: Bloomberg).

Global high yield credit

U.S. high yield bond prices were slightly lower over the past week as investors absorbed earnings, a Fed rate cut and a better-than-expected U.S. jobs report. The asset class reported inflows totaling +$940 million, according to Lipper. This was the sixth weekly inflow over the last eight weeks, with net inflows of $7.6 billion over the period (source: Lipper).

European high yield was flat over the month, with CCC outperforming. There has been evidence of a movement in the market from loans to senior secured financing, given the lower demand for loans. This weaker demand has been exacerbated by softness in the collateralized loan obligations market.

Leveraged loans

The theme of outflows continued for the U.S. leveraged loans market. For the month of October, prices declined $0.96 on average and the total return was -49bps for the Credit Suisse Leveraged Loan Index, underperforming both investment grade and high yield. The market is considerably bifurcated, with lower-rated issues priced at a significant discount to lower levels of investment grade. Defaults ticked higher to a 1.65% level. While this unwinds an earlier trend of lower defaults for the sector in 2019, it is essentially flat compared with the level of defaults in 2018.

The Credit Suisse Leveraged Loan index provided a +5.9% total return year-to-date, underperforming the ICE BofAML U.S. High Yield and the ICE BofAML U.S. Investment Grade indices.

U.S. municipal bonds

October tends to bring heavy new issue supply to the muni market, and this year was no different, as it provided the largest monthly total for the year. With that excess supply behind us, we expect municipal performance to firm up over coming weeks, especially if the rapid pace of inflows into the market continues. According to Lipper, last week marked the 43rd straight week of inflows into municipal bond funds, totaling over $73 billion. Lower supply levels, coupled with persistent inflows and the new dynamic of increased taxable supply, lead us to be relatively constructive on the municipal market in the near term.

Last week, S&P commented on Chicago's recent budget proposal, indicating that it would need to see a "credit path to structural balance." Chicago's budget aims to close a $838 million budget gap, which is roughly 22% of forecast revenue. Therefore, we expect near-term volatility for Chicago-related credits.

Asian fixed income

Asia credit delivered total returns of 0.3% last week, helped by the U.S. Treasury rally, which offset the modest spread widening.

Fitch placed Bharti Airtel's BBB- rating on "watch negative" (from the previously stable outlook) to reflect the uncertainty over the amount and timing of the regulatory dues. S&P has also placed Bharti Airtel's BBB- rating on 'watch negative' (previously negative outlook) because the company has negligible financial headroom to absorb the pay-out. If Bharti is focused to pay out in line with the DoT's claims, S&P will lower the rating by one notch.

Emerging markets

Lebanon had a tough week as banks were kept closed for over a week, and the prime minister resigned as street protests persisted. The situation continues to worsen. Anti-government protests in Chile also continued, resulting in the last-minute move of the UN climate change conference from Chile to Spain.

South Africa had a strong finish last week, winning the Rugby World Cup and avoiding a downgrade by Moody's, for the moment. Though the investment grade rating was maintained, the credit rating agency put the country's credit rating on negative outlook (the minimum the market expected). The agency cited the country's rising debt and the deteriorating economy story. Moody's is the last agency to have South Africa still rated investment grade since 2017, when it was downgraded by S&P and Fitch. One of the big worries is how the country will manage state-owned energy company Eskom—ZAR289 billion has already been allocated by the government to the company. However, many consider that more funding will be needed. This comes following another market disappointment regarding the South African budget, with expectations that gross debt to GDP will rise to 71.3% by 2022 (60.8% this year) and 80.9% by 2027. The bonds and currencies staged a relief rally on the news of the avoidance of a credit rating downgrade.

Rate decisions this last week included Brazil (a -50 bps cut), with messaging that a further rate cut could be expected for December; Botswana kept rates on hold at 4.5%.

Inflation figures continues to soften as Turkey cut inflation expectations to 12% (down from 13.9%) by the end of this year.

BOND MARKET INDEX RETURNS

Through November 1, 2019

	Price / Yield / Spread	Change 1 week	Index MTD return	Index YTD return
U.S. Treasury 10-year/ICE BofAML	1.76%	-3 bps	-0.2%	7.7%
German Bund 10-year/ICE BofAML	-0.36%	1 bps	-0.2%	4.6%
U.K. Gilt 10-year/ICE BofAML	0.70%	2 bps	-0.5%	9.2%
Japan 10-year/ICE BofAML	-0.18%	-4 bps	0.4%	2.8%
ICE BofAML Global Investment Grade	114 bps	1 bps	-0.1%	11.1%
ICE BofAML Euro Investment Grade	102 bps	0 bps	0.0%	6.5%
ICE BofAML U.S. Investment Grade	116 bps	2 bps	-0.2%	13.5%
ICE BofAML U.K. Investment Grade	121 bps	-2 bps	-0.2%	9.5%
JP Morgan Asia Investment Grade	201 bps	-2 bps	0.2%	9.6%
ICE BofAML Euro High Yield	393 bps	6 bps	0.0%	8.8%
ICE BofAML U.S. High Yield	409 bps	20 bps	0.1%	11.9%
JP Morgan Asia High Yield	576 bps	-4 bps	-0.1%	11.4%
JP Morgan EM Sovereign	317 bps	-8 bps	0.2%	12.7%

JP Morgan EM Local	5.1%	0 bps	0.4%	11.5%
JP Morgan EM Corporate	337 bps	2 bps	0.0%	11.6%
Bloomberg Barclays U.S. Munis	1.8%	-4 bps	0.0%	6.9%
Bloomberg Barclays U.S. Taxable Munis	2.9%	-7 bps	-0.4%	15.2%
Bloomberg Barclays U.S. MBS	47 bps	-4 bps	0.0%	6.0%
Currency Exchange Rates				
U.S. Dollars per Euro	1.1154	0.8%	0.1%	-2.6%
Japanese Yen per U.S. Dollar	108.39	0.5%	-0.1%	1.3%
U.S. Dollars per British Pound	1.2932	0.9%	0.0%	1.5%

Source: Bloomberg, Merrill Lynch, JP Morgan, Bloomberg Index Services Limited as of November 4, 2019. Indices shown are unmanaged and do not reflect the impact of fees. It is not possible to invest directly in an index. **Past performance does not guarantee future results.**

Index notes

ICE BofAML US Treasury Index

ICE BofAML U.S. Treasury Index tracks the performance of U.S. dollar denominated 10-year Treasury sovereign debt publicly issued by the U.S. government.

ICE BofAML German Government Index

ICE BofAML German Government Index tracks the performance of euro-denominated 10-year sovereign debt publicly issued by the German government in the German domestic or eurobond market.

ICE BofAML U.K. Gilt Index

ICE BofAML U.K. Gilt Index tracks the performance of GBP denominated 10-year sovereign debt publicly issued by the U.K. government in its domestic market.

ICE BofAML Japan Government Index

ICE BofAML Japan Government Index tracks the performance of JPY denominated 10-year sovereign debt publicly issued by the Japanese government in its domestic market.

ICE BofAML Global Corporate Investment Grade Index

ICE BofAML Global Corporate Index tracks the performance of investment grade corporate debt publicly issued in the major domestic and eurobond markets.

ICE BofAML Euro Corporate Index

ICE BofAML Euro Corporate Index tracks the performance of EUR denominated investment grade corporate debt publicly issued in the eurobond or Euro member domestic markets.

ICE BofAML U.S. Corporate Index

ICE BofAML U.S. Corporate Index tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the U.S. domestic market.

ICE BofAML Sterling Non-Gilt Index (U.K. Corporate)

ICE BofAML Sterling Non-Gilt Index tracks the performance of sterling-denominated investment grade non-sovereign debt publicly issued in the eurobond or U.K. domestic market, including quasi-government, corporate, securitized and collateralized securities.

J.P. Morgan Asia Investment Grade Index

The J.P. Morgan Asia Investment Grade Index consists of liquid U.S. dollar denominated debt instruments issued out of Asia ex-Japan by Asia-domiciled sovereigns, quasi-sovereigns and corporates.

ICE BofAML European Currency High Yield (Excluding Subordinated Financials) Constrained Index

ICE BofAML European Currency High Yield Constrained Excluding Subordinated Financials Index (HPS2) contains all securities in The ICE BofAML European Currency High Yield Index excluding subordinated securities of Financial issuers, but caps issuer exposure at 3%.

ICE BofAML U.S. High Yield Index

ICE BofAML U.S. High Yield Index tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market.

J.P. Morgan Asia High Yield Index

The J.P. Morgan Asia High Yield Index consists of liquid U.S. dollar denominated debt instruments issued out of Asia ex-Japan by Asia-domiciled sovereigns, quasi-sovereigns and corporates.

J.P. Morgan Emerging Markets Global Bond Index (Sovereign)

The JP Morgan EMBI-Global index (Sovereign), an unmanaged index, is based on U.S. dollar-denominated debt instruments issued by emerging market sovereign and quasi sovereign entities, such as Brady bonds,

J.P. Morgan Emerging Markets Global Bond Index (Local)

The JP Morgan Emerging Markets Global Bond Index (Local), an unmanaged index, is based on local currency denominated debt instruments issued by emerging market sovereign bonds.

J.P. Morgan Corporate Emerging Markets Bond Index (Corporate)

The J.P. Morgan Corporate Emerging Markets Bond Index is an unmanaged index of USD-denominated emerging market corporate bonds.

Bloomberg Barclays Municipal (Muni) Bond Index

The Bloomberg Barclays Municipal Bond Index is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year.

Bloomberg Barclays U.S. Taxable Municipal (Muni) Bond Index

The Bloomberg Barclays Taxable Municipal Bond Index is considered representative of the broad market for investment grade, taxable municipal bonds with a maturity of at least one year.

Bloomberg Barclays Mortgage-backed Securities (MBS) Index

The Bloomberg Barclays Mortgage-backed Securities Index is a market value-weighted index which covers the mortgage-backed securities component of the Bloomberg Barclays U.S. Aggregate Bond Index. The index is composed of agency mortgage-backed passthrough securities of the Government National Mortgage Association (Ginnie Mae), the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac) with a weighted-average maturity of at least 1 year.

There are risks associated with **fixed-income** investments, including credit risk, interest rate risk, and prepayment and extension risk. In general, bond prices rise when interest rates fall and vice versa. This effect is usually more pronounced for longer term securities.

References to specific securities are not intended as a recommendation to buy, sell or hold.

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