This is a marketing communication. Please refer to the prospectus of the UCITS and to the KIID / KID before making any final investment decisions.

FUND COMMENTARY – Q3 2023

Threadneedle (Lux) European Corporate Bond

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Since: 01/09/2022

Fund Information

You are investing in a fund that is actively managed in reference to the benchmark below. Please refer to the Prospectus and KIID for the Fund objective.

Fund Benchmark: iBoxx Euro Corporate Bond Index

Inception Date: 21/09/2018

Fund Currency: EUR

Fund Domicile: Luxembourg

Summary

- Euro investment-grade (IG) credit indices advanced modestly over the quarter.
- Gross of fees, the fund posted a positive return and outperformed its benchmark.
- Restrictive monetary policy and slowing economic growth are headwinds, but credit markets are underpinned by solid corporate fundamentals.
- In valuation terms, euro IG credit remains moderately attractive relative to historic averages and global IG.

Market Background

European IG credit advanced modestly over the third quarter (Q3), with the fund's benchmark returning 0.28%. The yields offered by German Bunds moved higher, but the impact of this on corporate bond prices was offset by tightening credit spreads (the gap in yields between corporate and 'risk-free' government bonds).

Worries about increased issuance of government debt put upward pressure on yields, especially at the long end of the curve. Nevertheless, the outlook for interest rates remained the primary driver of market direction. As rates neared their expected terminal levels in the eurozone, US and UK, the question preoccupying investors shifted from 'how high will rates go?' to 'how long will they take to come back down?'

On the policy front, the European Central Bank increased rates by 25 basis points (bps) twice during the quarter, but hinted that the second hike would be the last of the current cycle. The US Federal Reserve and the Bank of England each raised rates by 25 bps, in July and August respectively, before holding fire in September. All three central banks warned that rates would likely be 'higher for longer' than currently anticipated. Given the relative strength of the US economy versus the eurozone, however, markets gave most credence to the Fed. Traders moved to price in fewer rate cuts in the US next year but not in the eurozone, where expectations for two 25-bp cuts remained in place.

Overall, the yield on the 10-year German Bund rose 45 bps to 2.84%, while its US equivalent increased by 73 bps to 4.57%. Yields increased by less at the shorter end of the curve. This curve-steepening occurred across core bond markets in general, as governments announced plans to issue more bonds to pay for recent expensive fiscal policies, such as anti-Covid measures and energy subsidies.

Meanwhile, credit spreads edged gradually tighter over the period, supported by corporate results that were better than anticipated and relatively muted new issuance. The primary market succumbed to its usual summer lull and its return to life in September did not quite live up to fears of a deluge. Euro IG outperformed its US counterpart in risk-adjusted spread terms but trailed the sterling market. Within euro IG, real estate and bank spreads outperformed on a risk-adjusted basis, while consumer goods and telecoms were relatively weak.

Performance

12M Rolling Period Return in (EUR) - as at 30 September 2023

	09/22-09/23	09/21-09/22	09/20-09/21	09/19-09/20	09/18-09/19	09/17-09/18	09/16-09/17	09/15-09/16	09/14-09/15	09/13-09/14
Fund (Gross) %	4.58	-15.68	2.31	2.19	6.88	0.50	1.25	7.83	1.02	8.91
Index (Gross) %	3.65	-15.74	1.57	0.23	6.15	-0.03	0.47	7.36	-0.53	7.73

Source: Columbia Threadneedle Investments as at 30/09/2023. Gross of fee fund returns are time-weighted rates of return net of commissions transactions costs and non-reclaimable taxes on dividends interest and capital gains using pricing of investments which is either the last traded price or a bid basis. Cash flows are factored as of the end of the day and exclude entry and exit charges. Index returns include capital gains and assume reinvestment of any income. The index does not include fees or charges and you cannot invest directly in it. The return of your investment may change as a result of currency fluctuations if your investment is made in a currency other than that used in the past performance calculation.
Past performance does not predict future returns and future returns are not guaranteed.

The past performance information for the period prior to 21 September 2018 is from the European Corporate Bond Fund (a UK authorised UCITS fund launched on 22 October 2002), which merged into this Fund on 22 September 2018.

For detailed information on Fund Changes please see Significant Events - Threadneedle (Lux) Funds PDF available on www.columbiathreadneedle.com/en/changes

For the third quarter of 2023, the fund returned 0.56% (gross of fees), outperforming the benchmark 28 bps. Allocation effects added value fractionally. Our modest overweight in IG credit risk helped relative returns as spreads tightened. Industry positioning proved favourable, largely due to our overweight in real estate, but credit selection was a bigger driver of relative performance. Top contributors at the issuer level included BPCE (banking), Aroundtown (real estate), Credit Suisse and Netflix. Detractors at the issuer level included Alstria Office REIT (real estate) and HSBC.

Activity

Overall, the fund's credit risk was unchanged on the quarter, maintaining a small overweight to credit; within this, we continue to be overweight in regulated utilities, banks and select sub-segments of the real estate sectors.

We increased our positions in DS Smith (packaging), CRH (building materials) and Heathrow Airport via new issues, and also added to Honeywell (multiple industries), all of which closed the underweight in industrials. We also took part in new issues from BMW, Volkswagen and Renault-owned RCI Bank, reducing the underweight in the automobile sector. Against this, we reduced our position in Netflix and, as a result, the media sector. We lowered our exposure to RTE, Vier Gas, National grid, Enexis and EDF, against increases in fellow utilities Thames Water, Amprion and Engie (the last two via new issues), which resulted in a marginal reduction in our overweight to the sector.

Despite the reduction, utilities still represent the fund's largest sector overweight. As a group, utility companies enjoy a high degree of earnings visibility. Revenues and earnings are typically built into long-term contracts set by regulators, which makes their profitability and cashflows more stable (i.e. defensive) than those in most other industries; as a result, utilities tend to outperform in a recessionary or uncertain environment.

We also remain overweight in banks and real estate. Banking sector bonds are still trading at a discount to corporates, despite strong profitability and capital; within the sector, we are overweight in senior preferred issues (i.e. the top of the capital structure) but underweight in the senior non-preferred segment. Real estate, meanwhile, is trading at a discount to the broad euro IG market after a lengthy spell of underperformance, but it is not a homogenous sector. We find attractive, risk-adjusted opportunities in some subsectors, such as Northern European residential, logistics property and datacentres, which are fundamentally well positioned despite the headwind of higher interest rates faced by the sector as a whole.

Other activity included participation in new issues from Praemia Healthcare (real estate), Bayer (pharmaceuticals) and a number of banks, such as BNP Paribas, KBC, HSBC and AIB. Trades in the secondary market included starting a new position in Eurobank while increasing exposure to Banco Sabadell, broadband network operator NBN, and logistics property group Prologis. Notable sales included exiting ANZ Bank, Danske Bank, Kraft Heinz Foods, General Motors and Vodafone, among others, while reducing exposure to banking groups OP, BPCE and Crédit Agricole.

Outlook

As we enter the final quarter of the year, global IG market valuations (on a credit-spread basis) look reasonable rather than compelling. Within that, however, euro IG is relatively attractive on a spread basis. Spreads here finished September well above (i.e. cheaper than) their five- and 20-year averages. In addition, yields – another way of valuing the market – remain significantly above their 20-year mean. This is ‘good news’ for those seeking income without too much risk.

Over the coming year, our team of analysts expects corporate credit quality to remain strong. The banking sector faces headwinds in the short term but is very robust in terms of capital levels and profitability. Furthermore, the sector is trading at compelling spread levels versus corporate issuers with similar credit ratings.

All things considered, our outlook on the current prospects for euro IG spreads is neutral to slightly positive. The fund retains its slight overweight in credit risk, but by sector it remains tilted towards defensive areas of the market, such as regulated utilities, that we believe will best weather the current uncertain conditions.

Key Risks

The value of investments can fall as well as rise and investors might not get back the sum originally invested.

Where investments are in assets that are denominated in multiple currencies, or currencies other than your own, changes in exchange rates may affect the value of the investments.

The fund invests in securities whose value would be significantly affected if the issuer refused, was unable to or was perceived to be unable to pay.

The fund holds assets which could prove difficult to sell. The fund may have to lower the selling price, sell other investments or forego more appealing investment opportunities.

Most bond and cash funds offer limited capital growth potential and an income that is not linked to inflation. Inflation is likely to affect the value of capital and income over time.

Changes in interest rates are likely to affect the fund’s value. In general, as interest rates rise, the price of a fixed rate bond will fall, and vice versa.

The investment policy of the fund allows it to invest in derivatives for the purposes of reducing risk or minimising the cost of transactions.

The fund may exhibit significant price volatility.

The fund may invest in the China Interbank Bond Market (CIBM) via Hong Kong Bond Connect which is subject to regulatory, volatility and liquidity risk, as well as risks associated with settlement, default of counterparties and market suspension. Furthermore, the fund may incur significant trading, taxation and realisation costs.

All the risks currently identified as being applicable to the fund are set out in the “Risk Factors” section of the Prospectus Please read the Key Investor Information Document and the Fund Prospectus if considering investing.