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 – Q1 2024

CT (Lux) American Smaller Companies

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Since: 01/02/2024

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Since: 23/10/2018

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: Russell 2500 Index

Inception Date: 23/10/2018

Fund Currency: USD

Fund Domicile: Luxembourg

SFDR: Article 8*

Summary

- The Russell 2500 index returned 6.9% in dollars in the first quarter (Q1).
- Gross of fees, the fund returned 1.3%, underperforming its benchmark by 524 basis points (bps).
- Key detractors included the new holding in iRobot, along with FIGS and Conmed. Impinj was the top contributor.
- As well as iRobot, new positions included Generac, MarketAxess, Victoria's Secret and Peloton Interactive.

Market Background

After a strong final quarter of 2023, US small-cap equities delivered further gains in Q1 of 2024, with the Russell 2500 index returning 6.9% over the period. However, small-cap equities trailed their large-cap equivalents after a slow start to the year. The large-cap S&P 500 index ended the period up 10.6% and registered a series of new highs along the way.

The asset class got off to a rather muted start in early January as market participants moderated their expectations for both the timing and extent of Federal Reserve's (Fed's) 2024 interest-rate cuts. But the rally gathered momentum over the quarter as economic data remained resilient and concerns about inflation eased. This raised hopes for a "soft landing" for the US economy. Sentiment was additionally bolstered by a positive quarterly earnings season. Notably, stellar results from AI-chip producer Nvidia boosted the market and helped sustain enthusiasm for AI-related stocks, with the company passing the $2 trillion valuation milestone in early March. Worries about narrow market leadership by large-cap tech stocks also eased over the period as, given optimism about the economic outlook, the rally broadened to include cyclical sectors.

Markets ended 2023 expecting that the Fed's long-awaited pivot from raising rates to cutting them was imminent, perhaps as early as March. However, these hopes were dashed early in the quarter as the minutes of the Fed's December 2023 meeting (released in early January) revealed uncertainty among policymakers as to when, or even if, the three rate cuts previously set out in the "dot plot" for 2024 might occur. Fed Chairman Jerome Powell also stated that it was unlikely policymakers would have sufficient confidence that inflation was trending towards the 2% target by March. Nevertheless, while policymakers held interest rates at a 22-year high of 5.25%–5.5% when they met in January and March, as expected, they also retained the guidance for three 25-bp rate cuts in 2024. Moreover, while Powell did not set a timeline on the expected rate cuts, he did indicate that the "policy rate is likely at its peak for this type of cycle". Despite signalling three rate cuts as likely in 2024, Fed officials also raised the outlook for US growth and inflation, while lowering unemployment expectations.

US economic data remained resilient for the most part. According to the Bureau of Economic Analysis, annualised GDP growth for Q4 2023 was 3.4%, while retail sales for February and March came in above consensus expectations. In addition, a widely watched gauge of business activity showed manufacturing accelerated sharpy in March, although, on the other side, growth in services activity softened to the weakest pace in three months. Signs of cooling continued to appear in the labour market: while non-farm payrolls were generally robust, the unemployment rate ticked up and average hourly earnings growth softened. Consumer price inflation came in above expectations in February, as did producer price inflation, causing some commentators to question whether the Fed might delay rate cuts longer than expected.

Amid the broad-based rally, most sectors in the Russell 2500 index registered positive returns on the quarter. Industrials and energy led the pack: both delivered double-digit gains, with energy supported by rising oil prices and strong earnings. The consumer sectors, technology and utilities also outperformed the broader index. At the other end, communication services and real estate were the only sectors to finish the quarter in the red; real estate was hurt by uncertainty about the outlook for rate cuts. Healthcare, materials and financials also lagged materially, albeit while posting robust positive returns.

Issued March 2024 | Valid to end July 2024

*The Fund promotes environmental or social characteristics and is categorised as Article 8 under the EU Regulation 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR). Please refer to www.columbiathreadneedle.co.uk for further disclosures. The decision to invest in the promoted fund should take into account all the characteristics or objectives of the promoted fund as described in its prospectus.

Performance

12M Rolling Period Return in (USD) - as at 31 March 2024

Past performance does not predict future returns and future returns are not guaranteed.

	03/23-03/24	03/22-03/23	03/21-03/22	03/20-03/21	03/19-03/20	03/18-03/19	03/17-03/18	03/16-03/17	03/15-03/16	03/14-03/15
Fund (Gross) %	17.10	-6.67	2.99	110.60	-17.88	6.61	9.04	23.88	-7.41	14.91
Index (Gross) %	21.43	-10.39	0.34	89.40	-22.47	4.48	11.57	20.92	-3.60	12.19

Source: Columbia Threadneedle Investments as at 31/03/2024. 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.

The past performance information for the period prior to 23 October 2018 is from the American Smaller Companies Fund (a UK authorised UCITS fund launched on 14 November 1997), which merged into this Fund on 24 November 2018.

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

Gross of fees, the fund returned 1.3%, underperforming the benchmark Russell 2500 index by 524 bps.

Security selection drove the relative underperformance, with picks in consumer discretionary, technology, materials and industrials weighing most on relative returns; however, choices in real estate and communication services were modestly supportive. Meanwhile, sector allocation was slightly beneficial in aggregate, primarily due to the helpful underweights in financials and real estate, although the underweight in energy detracted.

At the stock level, key detractors included the new holding in iRobot. Shares initially fell in early January on reports that the European Commission intended to block Amazon's planned takeover of the company. The stock then declined further later in the month after iRobot and Amazon announced that the deal was being pulled due to there being "no path to regulatory approval in the European Union". In February, moreover, the firm's results disappointed, with Q4 and full-year 2023 revenue down. However, management also confirmed "turnaround focused" changes to its management team and unveiled an operational restructuring plan to support a return to profitability.

FIGS also weighed on relative returns. Shares in the healthcare apparel and scrub maker fell at the end of February and into March as the firm's Q4 and full-year 2023 results came in below analysts' estimates, with Q4 revenues flat. The firm's 2024 guidance was also weaker than expected. Nevertheless, the company's full-year net revenues rose year on year. Management also noted an increase in the number of active customers.

Surgical device manufacturer company Conmed was another notable detractor. The stock price weakened after the firm's Q4 earnings fell short of analysts' expectations at the end of January. However, management reported robust growth in year-over-year earnings and revenue, adding that Q4 and full-year 2023 revenue had risen to record levels.

More positively, the top contributor was Impinj. Shares rose early in the period, when the manufacturer of radio-frequency identification devices (used to connect everyday items to the "internet of things") released expectation-beating Q4 results and raised its outlook for the current quarter. The stock then rose further in March after Impinj settled a patent dispute with NXP Semiconductors. The settlement released both companies from liability for past patent infringements and included an agreement for the companies to license their patents to one another, as well as for NXP to make an up-front payment and pay yearly licensing fees to Impinj.

Activity

In a busy quarter for activity, along with the aforementioned iRobot, new positions included Generac, MarketAxess, Victoria's Secret and Peloton Interactive.

iRobot is a consumer robotics company focused on developing human-robot interaction, smart home devices for cleaning, and mapping and navigation devices. In 2022, iRobot had reached an agreement to be acquired by Amazon; however, as mentioned above, regulatory scrutiny resulted in Amazon pulling out of the deal, causing iRobot's stock to fall. Nevertheless, we viewed this as an attractive entry point to initiate a position, as we believe there is potential for the firm's new management to improve operational execution and profitability.

Generac is a leading designer and manufacturer of backup power generators and other engine-powered products. The market for home standby generators is growing as the aging power grid infrastructure, unpredictability of supply from renewable energy sources and increasingly frequent freak weather events drive demand. Generac has a dominant share in this market and, with its acquisition of Ecobee and investment in Wallbox, is positioning itself as the core at-home energy solutions company. The significant energy requirements of data centres may also increase demand for alternative or additional power sources.

MarketAxess is a fixed-income electronic marketplace for institutional investors. The company stands to benefit from increasing electronification of investment and could grow through further penetrating its core markets, expanding into new geographies, broadening its trading protocols and enhancing the monetisation of its information and post-trade services businesses. Increasing automation may also help MarketAxess grow its market share as it integrates real-time data and pre-trade analytics into its offerings. The company's revenue growth tends to be cyclical due to how interest rates affect transaction pricing and trading volumes. Therefore, during periods of declining interest rates (as expected in the second half of 2024), MarketAxess should be well positioned to benefit from higher fee rates and increasing new issuance and volumes.

Victoria's Secret is a specialty retailer focused on intimate apparel, casual sleepwear, athleisure, swimwear, fragrances and body care. The firm is at the early stage of a turnaround following the departure of its founder and CEO. There are signs that the company's products and marketing are increasingly resonating with consumers, and there is potential for further improvements to be driven by additional store rationalisation and remodelling. This, along with freight-related tailwinds, market-share stabilisation and improving traffic trends, has the potential to support margins going forward. Moreover, free cashflow is strong at Victoria's Secret, and the company's valuation is attractive when compared with its mall-based specialty retailer peers.

Peloton Interactive is a producer of home fitness products, supported by live and interactive classes delivered on its app. Since its initial public offering in 2019, Peloton has suffered from a confluence of headwinds, including poor management, a significant "pull forward" in demand due to Covid-19, and supply-chain, quality and inventory issues. These challenges ultimately led to the entire senior management team being replaced in 2022. The new management team has since made material progress towards reducing expenses and strengthening the balance sheet by outsourcing costly logistics and customer services, renegotiating supply agreements with Taiwanese partners, reducing the store count and generally restructuring the fixed cost base. This has dramatically improved the profitability of Peloton's hardware. While the firm will continue to deplete its cash reserves over the first half of 2024, management has guided to end 2024 with a flat or even slightly positive free cash flow.

Other new positions included Hanesbrands (clothing and footwear), Albemarle (lithium production), BILL (web-based business automation services), Tandem Diabetes Care (medical devices), Under Armour (athletic apparel, footwear and accessories), Natera (genetic testing), Nkarta (biotechnology) and Cullinan Oncology (cancer therapeutics). We also received shares in Arcadium Lithium in exchange for our holding in Livent after the company merged with Allkem in January, but we subsequently sold out of the stock. In addition, we added to our holdings in Rapid7, Avista, Shift4 and Glaukos, among others.

As well as Arcadium Lithium, sales over the period included Morningstar, Burlington Stores, Amkor Technology, Catalent and Wingstop. We also trimmed our holdings in Boston Properties, FTI Consulting and Altimmune.

Outlook

We remain constructive on the outlook for US equities in 2024 as inflation has fallen to a much lower rate, while the labour market and consumer spending continue to hold up relatively well, increasing the likelihood of a "soft landing" for the economy. Financial conditions have tightened considerably in the last 24 months due to the Fed's aggressive two-pronged monetary regime, characterised by increasing interest rates and unwinding its vast accumulated balance sheet. Although the Fed has not declared victory over inflation, the fall in headline consumer prices and recent signs of a loosening in the labour market have provided some reassurance that monetary tightening is having an effect. This has allowed the Fed to pause its interest-rate hiking cycle and pencil in an easing in monetary policy in 2024 – although the risk remains that the terminal federal funds rate could stay elevated for longer than expected. Furthermore, persistent, entrenched inflation still poses a risk, and there could be further downside should the economy enter a mild recession.

2023 was a strong year for financial markets, with inflation more than halving and growth remaining resilient, all while avoiding a much-feared economic recession. While there is still risk of a recession in 2024, concerns of a severe downturn have tempered. Inflation in 2024 is expected to continue its downtrend on fading energy pressure and softening labour markets as monetary tightening starts weighing on the growth outlook. Earnings and top-line growth estimates for Q1 of 2024 have shown some level of deceleration, with estimates coming down (though remaining positive) in aggregate since the end of 2023. This reflects slowing growth in the US economy and some easing economic tailwinds. Despite lingering concerns of a possible economic slowdown or recession, analysts have not lowered estimates below historic averages. However, negative earnings forecasts issued by companies are running above historic averages for Q1 of 2024.

Looking ahead to earnings over the rest of the year, the picture is becoming incrementally more positive; technology, communication services and healthcare companies are expected to deliver the strongest year-over-year earnings growth. Energy and materials are the only sectors forecast to see earnings growth decline in 2024 as they continue to be pressured by lower energy prices and weakness in the metals and mining, chemicals, and containers and packaging subsectors. Margins have started to recover as companies are seeing labour pressures and material inflation ease. On a year-over-year basis, the market is looking for a strong increase in earnings growth for 2024 as stocks face easier comparisons with 2023 and as the easing inflation picture is supported by a robust labour market and consumer spending.

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 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.

The Fund may invest in derivatives (complex instruments linked to the rise and fall of the value of other assets) with the aim of reducing risk or minimising the cost of transactions. Such derivative transactions may benefit or negatively affect the performance of the Fund. The Manager does not intend that such use of derivatives will affect the overall risk profile of the Fund.

The Fund applies a range of measures as part of its consideration of ESG factors, including the exclusion of investments involved in certain industries and/or activities. This reduces the investable universe, and may impact the performance of the Fund positively or negatively relative to a benchmark or other funds without such restrictions.

The fund typically carries a risk of high volatility due to its portfolio composition or the portfolio management techniques used. This means that the fund’s value is likely to fall and rise more frequently and this could be more pronounced than with other funds.

The risks currently identified as applying to the Fund are set out in the "Risk Factors" section of the prospectus.

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CTEA6136676.1 (12/2023)