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FUND COMMENTARY – Q4 2023

CT (Lux) Pan European Small Cap Opportunities



Mine Tezgul
Fund Manager
Since: 01/12/2019



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Fund Manager
Since: 15/04/2019

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: MSCI Europe Small Cap Index

Inception Date: 23/01/2007

Fund Currency: EUR

Fund Domicile: Luxembourg

SFDR: Article 8*

Summary

- European equity markets delivered gains over the quarter.
- The fund outperformed its benchmark index on a gross basis.
- Key relative contributors included BE Semiconductor Industries and Ascential.
- Detractors included SIG and Verallia.

Market Background

European equities rallied strongly in the fourth quarter (Q4) as hopes mounted that interest rate cuts would be implemented in 2024. Falling inflation was a key theme, as tighter monetary policy took effect on businesses and consumers, and energy prices dropped. The fund's benchmark index rose by 9.8% in euro terms.

Early in the quarter, US economic data was surprisingly resilient, which led to fears that interest rates would remain higher for longer. Data in the eurozone and UK pointed to an economic slowdown and investors grew concerned that high interest rates may tip economies into recession. Conflict in the Middle East heightened risk aversion and temporarily pushed oil prices higher.

The Federal Reserve (Fed) kept interest rates on hold as expected but indicated an apparent pivot in monetary policy at its meeting in December. Chairman Jerome Powell laid the groundwork for cuts in 2024 by acknowledging that the Fed was happy with the progress achieved in bringing inflation down and noting the risk of keeping rates too high for too long.

The Bank of England (BoE) appeared to strike a more hawkish tone; it also left its base rate unchanged but warned that the fight against inflation was not yet over, leading to expectations that rates in the UK may stay higher for longer than in the US. However, equities received a boost from a larger-than-anticipated drop in UK inflation during November. BoE policymakers have forecast broadly flat GDP growth over the next few quarters. More positively, the UK's composite purchasing managers' index (PMI) of manufacturing and services activity returned to growth territory in November, and a keenly watched consumer confidence index rose to a three-month high in December.

The European Central Bank (ECB) also kept rates unchanged and, like the BoE, remained more hawkish in its messaging. Nevertheless, markets priced in a more accommodative monetary policy outlook amid encouraging inflation news and weak economic data. Annual inflation in the eurozone fell to within striking distance of the 2% target, and the ECB lowered its 2024 inflation forecast. Industrial production declined more than anticipated in October, while December's preliminary composite PMI indicated a steeper contraction.

Sweden and Finland led the outperformers in Q4, while Portugal and France were weaker. In sector terms, real estate benefited as investors anticipated interest rate cuts. Utilities and healthcare also performed well. The energy sector was affected by weaker oil prices and the relatively defensive consumer staples sector also lagged.

* 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).

Performance

12M Rolling Period Return in (EUR) - as at 31 December 2023

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

	12/22- 12/23	12/21- 12/22	12/20- 12/21	12/19- 12/20	12/18- 12/19	12/17- 12/18	12/16- 12/17	12/15- 12/16	12/14- 12/15	12/13- 12/14
Fund (Gross) %	12.78	-34.54	24.88	13.29	39.80	-10.55	25.94	0.09	30.67	11.83
Index (Gross) %	13.56	-22.89	23.41	7.78	29.30	-14.05	17.64	2.87	21.73	5.14

Source: Columbia Threadneedle Investments as at 31/12/2024. 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.

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

The fund outperformed its benchmark index on a gross basis over the quarter, boosted by favourable stock selection. Country allocation was beneficial too, especially the overweighting in Sweden.

Top relative contributors included BE Semiconductor Industries and Ascential. BE Semiconductor Industries performed well as investors' risk appetite improved; the company is well placed to gain from the rapid growth of artificial intelligence, cloud computing and the *Internet of Everything*. Ascential rose on news that it had agreed to sell its digital commerce and consumer research units.

Detractors included SIG and Verallia. SIG reported subdued trading conditions in the Americas but encouraging growth elsewhere, especially in the Asia Pacific region. The packaging firm continues to expand into fast-growing markets. Verallia was impacted by deteriorating market conditions and adjusted production accordingly. However, the glass packaging firm forecast that the downturn would be short-lived. The devaluation of the Argentine peso also affected a small portion of revenues. The company has issued reassurances regarding an investigation by Italian authorities into anti-competitive practices in the sector.

Activity

New positions included Diploma, Metso and Kardex. Diploma is a manufacturer and distributor of complex building components (such as control devices) and specialist seals. The company posted strong results and is expecting to increase its market share. We bought Metso on share-price weakness. The company is a market leader in aggregates mining equipment and processing solutions equipment. Metso also has good exposure to the mining of key battery metals. Kardex develops and produces automated retrieval systems in warehouses. The company has a growing market share in both Europe and the US.

Sales included Marel and MARR. We sold food processor Marel due to falling order volumes. We sold food distributor MARR to fund other purchases.

Outlook

The news over the past two years has been dominated by inflation and interest rate forecasting, as the long period of low inflation and low rates ended abruptly. As Covid restrictions reduced, demand picked up, the war in Ukraine intensified, supply chains came under pressure, and inflation rose sharply. While some drivers of this were temporary and supply chains have adjusted, inflation in the West has not yet returned to pre-Covid levels.

Central banks underestimated the inflation problem and had to raise interest rates at a faster-than-usual pace. Tighter monetary policy is now taking effect and inflation is falling, as are energy prices. European economic growth is weak with a backdrop of restrictive monetary policy: the manufacturing and services PMIs remain below 50 (the threshold for expansion), while faltering growth in China has also affected Europe's export-oriented economies. The economic picture in the UK has been similar, although there are nascent signs of recovery.

After larger-than-expected falls in inflation, the interest rate environment in both Europe and the US now looks more benign. Investors hope that a recession can be avoided, although this is a delicate balancing act for central banks. Tensions between China and Taiwan are a concern, as are conflicts in the Middle East and Ukraine, and the possible repercussions for energy prices.

In European equities, there are reasons to remain optimistic. Company valuations have been reset due to higher interest rates and, over the longer term, share prices tend to follow earnings. As a result, good companies can continue to grow, and their lower valuations have created opportunities in the current climate. In managing this portfolio, our focus is on stock selection, informed by macroeconomic and thematic views. We favour companies that have a competitive advantage and pricing power generated by brands, patented processes, regulatory barriers to entry and strong market positions.

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.

An investment style bias can impact a fund's performance relative to its benchmark in a positive or negative way. No investment style performs well in all market conditions. When one style is in favour another may be out of favour. Such conditions may persist for short or long periods. A fund exhibits a growth style bias relative to its benchmark if the majority of the fund invests in companies with above average growth rates, or good growth potential (based on indicators such as earnings and sales growth) relative to its benchmark. However, there is no guarantee that such companies will continue to show such characteristics in the future. A fund's investment style may also change over time.

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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