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 – Q4 2023

CT (Lux) European Corporate Bond

Christopher Hult
Fund Manager
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

SFDR: Article 8*

Summary

- Euro investment-grade (IG) credit indices posted strong gains for the quarter.
- Gross of fees, the fund outperformed its benchmark.
- The headwind of restrictive actual and expected monetary policy appears to be easing, and credit markets are underpinned by solid corporate fundamentals.
- Euro IG credit spreads ended the year close to historic averages but above (i.e. cheaper than) the US dollar and sterling IG markets.

Market Background

Most asset classes enjoyed strong performance in the fourth quarter (Q4), and euro IG corporate bonds were no exception. As measured by the fund's benchmark index, euro IG bonds returned 5.61% for the period. German Bunds rallied in sympathy with US Treasuries, while corporate bond prices were further lifted by a significant tightening in credit spreads.

The chief impetus for the rally – which swept up risk assets and safe havens alike – was a growing belief that the Federal Reserve would start to cut interest rates sooner than previously thought, putting pressure on other central banks to do the same. The Fed continued to keep rates on hold during the quarter, and its commentary became increasingly dovish. The Fed's December policy meeting was widely seen as a turning point. Chair Jerome Powell acknowledged slowing growth and progress on inflation, and the Federal Open Market Committee reduced its median rate projection for the end of 2024 from 5.1% to 4.6% – 75 basis points (bps) below the current level. Markets were more optimistic still; by the end of the month they were pricing in more than twice that level of cuts before 2025, with the first seen arriving in March.

As in the US, key measures of inflation fell more than expected in Europe; unlike in the US, however, eurozone GDP growth was reported to have contracted in Q3. The European Central Bank also held rates steady, but kept up its 'higher for longer' rhetoric, even after the Fed's dovish pivot. The ECB also announced a faster roll-off of the bond portfolio acquired under its pandemic emergency programme, which will now be reduced by €7.5bn per month from July onwards. Commenting on the bank's December meeting, ECB President Christine Lagarde insisted that there had been no discussion of rate cuts at all. Nevertheless, markets appeared sceptical – perhaps reflecting the relative weakness of the eurozone economy. Bund yields continued to fall over the remainder of the quarter and traders priced in more aggressive ECB rate cuts in 2024.

Credit spreads widened in October as the terrible events in Israel and Gaza weighed on sentiment, but tightened thereafter as anticipation of rate cuts and easing fears of escalation in the Middle East bolstered investor appetite for risk. Corporate bonds were further supported by encouraging Q3 corporate results, which continued to beat expectations in aggregate. Of the three main regional IG markets, euro IG was the laggard in spread terms, but spreads in the benchmark still tightened by 16 bps.

*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 (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) %	9.37	-14.06	-0.66	4.87	7.26	-0.77	3.01	6.08	0.17	8.96
Index (Gross) %	8.19	-14.17	-1.08	2.73	6.29	-1.30	2.38	4.73	-0.66	8.24

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.

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 Q4 of 2023, the fund returned 6.00% (gross of fees), outperforming the benchmark by 36 basis points. Having slightly more duration (sensitivity to changes in interest rates) than the index helped performance. Credit strategies also added value, largely due to selection effects. Positive contributors at the issuer level included Grand City Properties, fellow real estate business P3, and banking groups Deutsche Bank and HSBC. Detractors included grid operator Stedin and French banks BPCE and BNP Paribas. Industry positioning detracted marginally. An overweight in real estate and underweight in retail helped performance but unfavourable underweights in automotive and financial services had a slightly bigger impact.

Activity

As credit spreads tightened towards historic averages, we cut the fund's modest overweight in credit risk (as measured by duration times spread) to its lowest level since before the pandemic. The slight overweight in duration was maintained virtually unchanged.

Moves at the sector level included reducing our overweights in utilities, real estate and – especially – banks. We also widened the underweight in personal and household goods, cut the small media overweight to neutral and moved fractionally underweight in both basic resources and industrial goods and services. On the other side, we added exposure to healthcare and, to a lesser extent, construction and telecoms, closing the underweights in all three. We also narrowed the underweight in financial services.

In terms of individual credits, purchases included new issues from pharmaceuticals Roche and Bayer; banks BNP Paribas, Santander and Bank of Ireland; and insurers Bupa and ASR Nederland – the latter being a green bond. Elsewhere, we took part in new issues from Nestlé, Carrier Global (heating, ventilation, air conditioning and refrigeration) and Ford, which regained its IG rating during the quarter.

Among trades in the secondary market, we started positions in Berkshire Hathaway (investment), AbbVie (pharmaceuticals) and Stellantis (vehicle manufacturing), while increasing exposure to NBN (broadband networks), Experian (consumer credit rating), Diageo (alcoholic drinks) and Amgen (pharmaceuticals), among others. On the sales side, we reduced the position in UBS and exited Honeywell (multiple industries), Anglo American (mining), Imperial Brands (tobacco) and Forvia (vehicle interiors).

Outlook

One of the chief impediments to tighter spreads has been restrictive monetary policy. This headwind appears to be easing thanks to the Federal Reserve's dovish pivot, which will put pressure on the European Central Bank to follow suit. The eurozone may slip into recession in 2024 but any such downturn will likely be mild. In any case, we expect credit quality to remain strong.

As regards valuations, euro IG spreads ended December very close to their five- and 20-year averages, though still cheaper on this basis than their sterling and dollar counterparts. Furthermore, the yield on the market remains well above the long-run average – an interesting entry point, in our view, for those seeking income without too much risk.

All things considered, we see the outlook for euro IG spreads as neutral to slightly positive. The fund retains a small overweight in credit risk, albeit the lowest since before the pandemic and tilted to sectors we think will best weather the current uncertain conditions, such as regulated utilities.

Despite the modest reduction mentioned above, 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.

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.

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 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 may exhibit significant price volatility.

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

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