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) European Social Bond

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Fund Manager
Since: 30/06/2022

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: 50% ICE BofA Euro Non-Sovereign Index, 50% ICE BofA Euro Corporate Euroland Issuers Index

Inception Date: 23/05/2017

Fund Currency: EUR

Fund Domicile: Luxembourg

SFDR: Article 9*

Summary

- Euro investment-grade corporate bond indices edged fractionally higher over the quarter.
- In gross terms, the fund made a modest positive return and 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.
- Against this, valuations (credit spreads) have become stretched.

Market Background

Euro investment-grade (IG) credit indices generally posted modest gains over the first quarter (Q1). Underlying German Bund yields rose, but the impact of this on corporate bonds was offset by continued tightening in credit spreads (the yield difference between corporate and 'risk free' government debt of the same maturity).

In January, hopes for a March rate cut by the Federal Reserve receded as US GDP, jobs and inflation data came in hotter than expected; they all but evaporated in February as the Fed said more time was needed to confirm that the disinflationary trend was sustainable, and as US inflation once again surprised on the upside. Inflation also remained stubbornly above target in the eurozone and the UK, particularly in services. Despite the relative weakness of their respective economies versus the US, policymakers at the European Central Bank and Bank of England echoed the Fed's call for patience.

March saw core bonds recoup some of their earlier losses, helped by a perceived dovish shift at the key central banks. Fed rate setters raised their forecasts for US GDP and core inflation in 2024, but continued to project three 25-basis-point (bp) rate cuts this year. The ECB lowered its 2024 eurozone growth and inflation forecasts, and President Christine Lagarde suggested that the first ECB rate cut could come as early as June. Given the relative weakness of the eurozone economy, speculation mounted that the ECB might cut rates before the Fed.

Meanwhile, credit spreads ground tighter, as robust US economic data and forecast-beating corporate results bolstered sentiment. While new IG issuance picked up strongly, demand remained robust as investors looked to lock in elevated yields before the rate cuts expected later this year. In risk-adjusted spread terms, the euro IG market outperformed its US dollar and sterling counterparts.

In sustainability news, the European Parliament adopted a new anti-greenwashing directive that bans companies from using general or unproven environmental claims in their marketing. Lawmakers in the bloc also agreed an early version of the Net-Zero Industry Act, which aims to make it easier for green technology companies to set up and operate in Europe. Separately, Germany announced a €23 billion scheme to subsidise the use of less carbon-intensive processes in the country's industrial sector. Less positively, the European Union's Nature Restoration Law teetered on the brink of collapse in March after several member states withdrew their support. The law aims to restore 20% of Europe's land and sea to a natural state by 2030, but has faced heavy opposition from the agriculture sector.

*The Fund has a sustainable investment objective and is categorised as Article 9 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 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
Fund (Gross) %	6.64	-8.52	-5.88	6.10	-0.80	2.22
Index (Gross) %	6.18	-8.41	-5.75	6.50	-1.78	2.35

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.

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

Over Q1, the fund made a gross return of 0.43%, outperforming the benchmark index by 23 bps. Being slightly overweight in credit risk was beneficial for performance as credit spreads tightened. Credit selection proved marginally unfavourable overall. Detractors here included real estate names Vonovia, Digital Realty and Prologis. Positive contributors on a similarly modest scale included NatWest, the EU and Yorkshire Building Society. Industry positioning had a broadly neutral impact.

Rates-related effects were modestly positive, due chiefly to favourable curve positioning.

On the social side, the fund's average social intensity score ended Q1 at 20.4, with the proportion of the fund invested in category A impact investments standing at 43%. The proportion of the fund in the lowest social intensity bonds (C3 and C4) was still well below the limit set by the social advisory panel at 8%. Overall, this marks another steady quarter of benefits to society through the bonds purchased by the fund. The fund aligns each holding with one of the 17 United Nations Sustainable Development Goals. The fund's largest weighting is currently allocated to goal 11 (Sustainable Cities and Communities), goal 3 (Good Health and Well-Being) and goal 7 (Affordable and Clean Energy).

Activity

As mentioned, the primary market was busy and we were able to take part in a variety of new labelled issues. The biggest of these (in terms of position size) included new green bonds from Dutch lender ING, Norwegian state power grid operator Statnett and Spanish bank BBVA. ING's green bond framework aims to fund a green loan portfolio of eligible projects ranging from renewable energy to sustainable transport. ING has also committed to encouraging and helping its most carbon-intensive borrowers to achieve net zero by 2050.

Meanwhile, Statnett has issued several green bonds to ensure that Norway's grid network can be ready for the transmission of renewable power. BBVA is aiming for its loan portfolio to be net zero by 2050, with proceeds from its latest green bond to be used to finance eligible projects in areas such as renewable energy, clean transport, energy efficiency and sustainable resource management.

We also bought newly issued social bonds from BayernLB, a development bank focused on Germany's Bavaria region, and Dutch bank BNG, as well as a new sustainability issue from Belgium's autonomous Flemish community. Fund from the BayernLB issue will be used to finance low-interest loans for home ownership and renovations that increase energy efficiency. BNG makes loans to Dutch municipalities and social housing associations with the aim of improving access to housing, education, healthcare and renewable energy. The proceeds of the Flemish sustainability bonds will be used to provide affordable housing, increase the energy efficiency of buildings, reduce pollution and improve access to education.

Trades in the secondary market included adding to our positions in a green bond from grid operator Tennet and social bonds from bank-insurer KBC and real estate company Vonovia. On the sales side, we exited issuers including Deutsche Bank, auto components supplier Forvia, logistics property group VGP, Italian development bank CDP and Channel Tunnel operator Getlink, among others.

Outlook

Monetary policy should ease this year, which is welcome, but rates will likely stay restrictive for some time. Inflation is trending lower but remains above target in most regions, with services inflation especially sticky. The low but positive growth we expect across developed markets is actually a reasonable environment for IG issuers, particularly the less leveraged and less cyclical names. In terms of corporate health, we anticipate that credit quality will remain strong this year.

Euro IG spreads ended March further below (i.e. more expensive than) their five- and 20-year averages, though still cheaper on this basis than their US dollar counterparts. Furthermore, the yield on the market remains well above the long-run mean – an interesting entry point, we think, for those seeking income without too much risk. All things considered, our outlook for euro IG spreads remains fairly neutral.

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’s assets may sometimes be difficult to value objectively and the actual value may not be recognised until assets are sold.

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 aims to invest in assets that are deemed to be supporting and funding socially beneficial activities and development and utilises a Social Rating Methodology. This will influence the Fund’s exposure to certain issuers, industries, sectors and regions, and may affect the relative performance of the Fund positively or negatively.

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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