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High yield bonds: focus on maturity over duration

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The CT (Lux) European Short-term High Yield Bond strategy focuses on maturity over duration to manage risk. This means lower interest rate sensitivity and less volatility growth

High yield bonds can offer a superior yield to investment grade credit and sovereign bonds such as German bunds and gilts – something that makes them an interesting investment opportunity, even in today's interest rate environment.

A majority of high yield bonds are "callable". This means that at predetermined points in time, before they ultimately mature, the issuer can "call" back the bond, repaying the bondholders, typically at a premium. For example, a bond with a maturity of 10 years might be callable after five years. The duration of such a bond is priced to the call date if there is an expectation that the bond will be called at that period in time.

But if interest rates are rising and the bond price falls below its call price, the issuer may choose not to call the bond. In practice, this can lead to an extension of the bond's duration or interest rate sensitivity just at the wrong time – in a falling bond market, where yields are rising. As a result, the fall in the bond's price can accelerate.

For this reason, we focus on a bond's maturity rather than duration when managing risk in the Threadneedle European Short-term High Yield Bond strategy. This removes the unpredictability of duration extension risk, giving this strategy lower interest rate sensitivity than a standard European high yield bond strategy.

Explaining duration extension risk

Callable (or redeemable) bonds give the issuer the right to redeem the bond prior to its scheduled maturity date, effectively shortening the bond's expected maturity and duration.

These bonds benefit issuers in that they give them the option to pay off the debt early and refinance at lower costs if interest rates fall.

So when bond yields are rising, during a sell off, the call dates on callable bonds become less likely to be triggered. In such a scenario, investors who thought they had a bond due to be redeemed at the call date in three years can, for example, suddenly find they are holding a bond that will likely remain in existence until maturity in five years with a corresponding impact on the bond's price.

This is exactly what happened in the 2022 market sell-off. Callable bonds were not called, which lead to a duration extension just when one least wanted it. For us, focusing on the bond's maturity date (and not the call date) from the outset made our strategy’s desired risk and performance profile more predictable. This allowed the fund to outperform the market by 180 bps (-4.3% versus -6%), as well as in 2023 during a falling yield market (+10.6% versus +10.3%).[1]

In 2023, and more recently in 2024, the call feature has been used by issuers, even at these higher refinancing costs. This is due to a focus on managing their maturity wall in order to prevent maturing debt from becoming current and potentially attracting the wrong kind of market attention.

Avoiding unexpected volatility

In an environment where falling yields are expected, investors are often lulled into a false sense of security, making little distinction between short duration and short maturity. It is only when volatility suddenly picks up, perhaps due to an uncertain environment, and a bond market sell off is possible – causing a callable bond’s duration to sharply extend – that the difference between short maturity and short duration is fully comprehended. By then, it is too late.

High yield may still offer an attractive source of return in today’s environment. But we believe that targeting callable bond maturity rather than duration is the best way to harvest this yield – and avoid any unexpected volatility and yield curve risk.

[1] Columbia Threadneedle/Morningstar EUR High Yield Bond, 2024

Threadneedle European Short Term High Yield Composite

GIPS Report

Columbia Threadneedle Investments EMEA APAC

Reporting Currency: EUR

Statement of Performance Results

Calendar Year	Gross-of-fees Return (%)	Net-of-fees Return (%)	Index Return (%)	Composite 3-Yr St Dev (%)	Index 3-Yr St Dev (%)	Internal Dispersion (%)	Number of Portfolios	Total Composite Assets (mil.)	Total Firm Assets (bil.)
2023	10.63	10.08	10.34	4.84	4.69	N.A.	≤ 5	70.3	110.85
2022	-4.27	-4.75	-5.97	7.30	8.90	N.A.	≤ 5	85.7	107.62
2021	2.71	2.20	3.23	N.A.	N.A.	N.A.	≤ 5	110.9	141.86
2020	2.73	2.22	0.62	N.A.	N.A.	N.A.	≤ 5	77.7	122.45
2019 *	1.03	0.82	1.48	N.A.	N.A.	N.A.	≤ 5	54.2	125.19

* For the period 07/31/2019 through 12/31/2019.

Annualized Trailing Performance as of December 31, 2023

Period	Gross-of-fees Return (%)	Net-of-fees Return (%)	Index Return (%)
1 Year	10.63	10.08	10.34
Inception	2.79	2.27	2.05

Inception Date: July 31, 2019

1. Columbia Threadneedle Investments EMEA APAC 'the Firm' claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS Standards. Columbia Threadneedle Investments EMEA APAC has been independently verified by Ernst & Young LLP for the periods 1st January 2000 to 31st December 2022. The verification reports are available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

2. The 'Firm' is defined as all portfolios managed by Columbia Threadneedle Investments EMEA APAC (prior to 1 January 2021, the firm was known as Threadneedle Asset Management) which includes Threadneedle Asset Management Limited, (TAML), Threadneedle International Limited, (TINTL), Threadneedle Investments Singapore (Pte.) Limited, (TIS), and Threadneedle Management Luxembourg S.A. (TMLSA), excluding directly invested property portfolios. The firm definition was expanded in 2015 to include portfolios managed by then newly established affiliates of Threadneedle Asset Management in Singapore. TAML & TINTL are authorised and regulated in the UK by the Financial Conduct Authority (FCA). TINTL is also registered as an investment adviser with the U.S. Securities and Exchange Commission and as a Commodities Trading Advisor with the U.S. Commodity Futures Trading Commission. TIS is regulated in Singapore by the Monetary Authority of Singapore. TMLSA is authorised and regulated in Luxembourg by the Commission de Surveillance du Secteur Financier (CSSF). On 1 July 2020, Threadneedle Asset Management Malaysia Sdn. Bhd (TAMM) was removed from the firm. Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies. Beginning 30 March 2015, the Columbia and Threadneedle group of companies, which includes multiple separate and distinct GIPS-compliant firms, began using the global offering brand Columbia Threadneedle Investments.

3. The strategy will seek exposure, directly or indirectly, to credit rated below Investment Grade, that is issued by companies domiciled in Europe or with significant European operations, or is denominated in EUR or GBP. A minimum of 80% of investments will be less or equal to 4 years of maturity. Derivative instruments may be used for efficient portfolio management and currency management. The primary use of derivatives is not designed to create a highly leveraged investment position. The composite was created July 31, 2019.

4. The gross-of-fees returns are time-weighted rates of return with cash flows at the end of the day. Returns reflect the reinvestment of dividends and other earnings and are net of commissions and other transaction costs. Returns are calculated net of non-reclaimable withholding taxes on dividends, interest, and capital gains and are shown before management and custodian fees but after the deduction of trading expenses. Composite returns are calculated by using underlying portfolio beginning of period weights and monthly returns. Periodic returns are geometrically linked to produce longer period returns. Net of fee returns are calculated by deducting the representative fee from the monthly gross return. Prior to 30th Sept 2022 the gross returns were calculated using daily authorised global close valuations with cash flows at start of the day, and were shown before management and custodian fees but after the deduction of trading expenses. Returns were gross of withholding tax. Policies for valuing investments, calculating performance, and preparing GIPS Reports, as well as the list of composite descriptions, list of pooled fund descriptions for limited distribution pooled funds, and the list of broad distribution pooled funds are available upon request.

5. The dispersion of annual returns is measured by the equal weighted standard deviation of portfolio returns represented within the composite for the full year. Dispersion is only shown in instances where there are six or more portfolios throughout the entire reporting period. The Standard Deviation will not be presented unless there is 36 months of monthly return data available.

6. The three-year annualised ex-post standard deviation measures the variability of the gross-of-fees composite and benchmark returns over the preceding 36-month period.

7. The following fee schedule represents the current representative fee schedule for institutional clients seeking investment management services in the designated strategy: 0.5% on the first £50m; 0.4% on the next £50m; negotiable thereafter. Gross of fee performance information does not reflect the deduction of management fees. The following statement demonstrates, with a hypothetical example, the compound effect fees have on investment return: If a portfolio's annual rate of return is 5% for 5 years and the annual management fee is 50 basis points, the gross total 5-year return would be 27.6% and the 5-year return net of fees would be 24.5%.

8. The ICE BofA 0-4yrs European Currency High Yield, BB-B, 3% constrained, excluding Subordinates is a custom Index that uses stocks from the ICE BofA European High Yield Index that have a maturity of no more than 4 years, a rating of BB-B and excludes Subordinates. The index is hedged 100% into Euro’s. Index returns reflect the reinvestment of dividends and other earnings and are not covered by the report of the independent verifiers.

9. Past performance is no guarantee of future results and there is the possibility of loss of value. There can be no assurance that an investment objective will be met or that return expectations will be achieved. Care should be used when comparing these results to those published by other investment advisers, other investment vehicles and unmanaged indices due to possible differences in calculation methods.

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