COLUMBIA THREADNEEDLE INVESTMENTS

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FUND COMMENTARY – Q2 2023

Threadneedle (Lux) European Social Bond

Tammie Tang
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 8*

Summary

- European investment-grade corporate bonds rose modestly over the second quarter.
- Gross of fees, the fund returned 0.30%, underperforming its benchmark.
- Our primary market purchases included green issues from several banks and a social bond from Japan's international development agency.

Market Background

As measured by the fund's benchmark, European investment-grade (IG) credit returned 0.41% for the second quarter (Q2). German Bund yields (which move inversely to price) rose, especially on shorter-dated bonds, but the impact of this on corporate bond prices was offset by tightening credit spreads (the yield premiums over risk-free' government bonds).

Core bond yields rose along with interest-rate expectations as the Federal Reserve, European Central Bank and Bank of England maintained their hawkish bias amid persistently high core inflation and tight labour markets in their respective economies. All three raised rates by 25 basis points (bps) in May but diverged somewhat thereafter.

The ECB ploughed ahead with another 25-bp hike in June and flagged the same again for its next meeting. In the interim it had emerged that the eurozone had fallen into technical recession in Q1. Purchasing managers' indices had also continued to highlight ongoing contraction in the manufacturing sector. Despite the weaker data, ECB policymakers appeared to have been more concerned by the bloc's mixture of high inflation – which was slowing but not quickly enough – and record low unemployment.

Inflation remained especially stubborn in the UK, where the core measure hit successive 31-year highs. Accordingly, the BoE was even more aggressive than the ECB, raising its base rate by a further 50 bps in June. By contrast, the Fed held fire after 10 straight hikes to leave more time to assess the impact of prior tightening. Nevertheless, policymakers lifted their 2023 interest-rate, core inflation and economic growth projections by more than expected.

Meanwhile, credit spreads tightened alongside a strong rally in equities, while volatility dropped to post-pandemic lows. Sentiment towards risk assets was bolstered chiefly by events in the US: the national debt ceiling was extended, after the customary brinkmanship; banking stress tests went well; inflation continued to cool; and the economy appeared surprisingly resilient, with Q1 GDP revised higher. Furthermore, the Q1 corporate results season was also better than feared – in Europe as well as the US.

In sustainability news, the G7 leaders met in Japan and reaffirmed their pledge to a "fully or predominantly decarbonised power sector" by 2035. However, they were criticised for failing to commit to a firm deadline for phasing out the use of coal and gas. Elsewhere, the European Commission provided more information on its Sustainable Finance Disclosure Regulation (SFDR). The guidance hinted that funds tracking Paris-aligned and climate-transition benchmarks could regain Article 9 status, which is reserved for funds targeting sustainable investing or a reduction of carbon emissions. In the UK, British water companies pledged investments of £10bn to modernise Britain's water systems and prevent further sewage overspills.

Labelled issuance was muted in the UK but very active globally, with over $0.5 trillion of issuance according to Bloomberg. Much of this was fuelled by governments raising funds for projects related to environmental and net zero pledges. This included a heavily oversubscribed $10.9bn green bond from Italy, which will be used to fund the country's transition to net zero by 2050.

*The Fund is categorised an Article 8 under the EU Regulation 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR) and promote environmental or social characteristics as an objective. 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 30 June 2023

	06/22-06/23	06/21-06/22	06/20-06/21	06/19-06/20	06/18-06/19	06/17-06/18
Fund (Gross) %	-1.00	-12.93	1.85	0.97	5.16	0.87
Index (Gross) %	-1.06	-12.51	2.42	0.07	4.79	1.08

Source: Columbia Threadneedle Investments as at 30/06/2023. 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.
Past performance does not predict future returns and future returns are not guaranteed.

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 0.30% over the quarter, trailing its benchmark by 11 bps.

The underperformance was due to credit strategies. A modest overweight in credit risk added value as spreads tightened, but industry positioning and credit selection hindered performance. As regards selection, detractors at the issuer level included NatWest, disability-transport provider Motability and data-centre REIT (real-estate investment trust) Digital Realty Trust. There were a handful of small positive contributors including Irish bank AIB, medical-device manufacturer Becton Dickinson and logistics REIT Segro.

Rates strategies were fractionally positive in aggregate. Curve positioning was beneficial and our slight overweight in duration also made a marginal contribution. Country positioning detracted due to our overweight in the UK as gilt yields rose further than their Bund equivalents.

Activity

We took part in a number of new issues over the period, including social bonds from French government agency CADES and French unemployment agency Unedic; and banking groups KBC and Intesa Sanpaolo. We bought green bonds from fellow financials Nordea, Co-operative Bank, ABN Amro and NN Group. We also participated in sustainability bond offerings from the Inter-American Development Bank and JICA, Japan's international development agency.

The sustainability bond from JICA is an international exposure within the fund's allowance that we have identified to be among the most impactful globally. The sustainability bond will target projects involving agriculture, forestry and fisheries, healthcare, education, water supply, improving access to finance for women, and other essential lending that will create a high social intensity within the regions the company services.

In the secondary market, we added further to CADES and initiated a position in Realty Income. Elsewhere, we topped up several existing positions including French sovereign wealth fund CDC, German real estate firm Vonovia, telco Orange and medical device business Becton Dickinson. We also added to the holdings in French lender BFCM and AFD, the French development agency.

We sold out of Italian utility Enel, cleaning and pest-management firm Rentokil and Rentenbank, Germany's agricultural development agency. We trimmed a number of positions including lenders Deutsche Kreditbank, Danske Bank, BNP Paribas, ING and Rabobank.

Outlook

The eurozone economy is expected to achieve modest growth this year, but restrictive monetary policy remains a clear threat to spread compression. We expect corporate health to deteriorate only marginally in the region, and from a strong starting point.

In valuation terms, euro IG – where spreads finished the month above their 5- and 20-year averages – remains relatively attractive, especially compared with its US-dollar counterpart. In addition, yields – another way of valuing the market – remain well above their 20-year mean. This is good news for those seeking income.

All things considered, our outlook on the current prospects for IG spreads is neutral to slightly positive. The fund retains its slight overweight in credit risk.

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.

Most bond and cash funds offer limited capital growth potential and an income that is not linked to inflation. Inflation is likely to affect the value of capital and income over time. 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 investment policy of the fund allows it to invest in derivatives for the purposes of reducing risk or minimising the cost of transactions.

The fund may exhibit significant price volatility.

All the risks currently identified as being applicable to the Fund are set out in the “Risk Factors” section of the Prospectus. Please read the Key Investor Information Document and the Fund Prospectus if considering investing.

Important information: Your capital is at risk. Threadneedle (Lux) is a Luxembourg domiciled investment company with variable capital ("SICAV"), managed by Threadneedle Management Luxembourg S.A.. This material should not be considered as an offer, solicitation, advice or an investment recommendation. This communication is valid at the date of publication and may be subject to change without notice. Information from external sources is considered reliable but there is no guarantee as to its accuracy or completeness. The SICAV´s current Prospectus, the Key Investor Information Document (KIID)/Key Information Document (KID) and the summary of investor rights are available in English and/ or in local languages (where applicable) from the Management Company Threadneedle Management Luxembourg S.A., International Financial Data Services (Luxembourg) S.A., your financial advisor and/or on our website www.columbiathreadneedle.com. These documents are available in Switzerland from the Swiss Representative and Paying Agent RBC Investor Services Bank S.A., Esch-sur-Alzette, Zurich branch, Bleicherweg 7, CH 8027 Zurich. Threadneedle Management Luxembourg S.A. may decide to terminate the arrangements made for the marketing of the SICAV. Pursuant to article 1:107 of the Act of Financial Supervision, the sub-fund is included in the register that is kept by the AFM. Threadneedle (Lux) is authorised in Spain by the Comisión Nacional del Mercado de Valores (CNMV) and registered with the relevant CNMV's Register with number 177. Past performance is calculated according to the BVI method in Germany.
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