This is a marketing communication. Please refer to the prospectus of the UCITS and to the KIID before making any final investment decisions.

FUND COMMENTARY – Q1 2022
Threadneedle (Lux) European Social Bond

Simon Bond
Fund Manager
Since: 23 May 2017

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 May 2017

Fund Currency: EUR

Fund Domicile: Luxembourg

SFDR: Article 8*

Summary

- European investment-grade credit delivered a negative return in the first quarter.
- Gross of fees, the fund returned -5.47%, underperforming the benchmark.
- We participated in new social bonds from Vonovia and the Asian Development Bank.

Market Background

The first quarter (Q1) of 2022 was a poor period for most financial markets. European investment-grade (IG) corporate credit returned -5.29%, as measured by the fund's benchmark. The negative return was driven both by a sharp rise in core government bond yields and a significant widening in credit spreads (the yield premiums above 'risk-free' government debt). Early in the period, stocks and bonds alike suffered losses as investors factored in tighter monetary tightening. Later, risk assets were further pressured as the focus turned to Russia's brutal invasion of Ukraine.

As inflation hit successive multi-decade highs in their jurisdictions, the Federal Reserve, European Central Bank and Bank of England all moved closer to 'normal' monetary policy. Back in December, the Fed's median 'dot plot' projection was predicting three rate hikes in 2022. By the end of Q1, the Fed had already implemented one 25-basis-point (bp) hike and was projecting six more over the remainder of the year. Many analysts expect at least two of these will be bumper 50-bp increases. In the UK, the BoE made two 25-bp hikes, but the second of these, in March, was accompanied by an expectedly dovish statement highlighting the risks to growth for net energy importers such as the UK. Meanwhile, the ECB surprised on the hawkish side, announcing a quicker tapering of its asset-purchase scheme. This opened the door for a possible rate hike in the second half of 2022, which ECB President Lagarde had previously described as 'very unlikely'.

Geopolitics took centre stage in February as Russia invaded Ukraine, drawing heavy Western sanctions. Core bond yields retraced some of their earlier rise, credit spreads widened and commodity prices soared on supply-disruption fears. Markets continued in this vein into the first half of March. Thereafter, risk appetite improved somewhat as fears of a wider conflict in Europe receded. Negotiations between Moscow and Kyiv yielded little solid progress and heavy fighting continued, but Ukraine said it may drop its pursuit of NATO membership, while Russia appeared to scale back its military aims.

Overall, the 10-year Treasury yield rose 83 bps to 2.34%, while the German equivalent rose 73 bps to 0.55%, in the process crossing the psychologically important zero level. The 10-year UK gilt yield rose 64 bps, its smaller rise in part reflecting the BoE's recent dovish shift. In credit spread terms, the euro IG market underperformed its sterling and dollar peers in Q1 amid worries about the likely impact of European overreliance on Russian energy.

*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 (EUR) - as at 31 March 2022

	03/21-03/22	03/20-03/21	03/19-03/20	03/18-03/19
Fund (Gross) %	-5.88	6.10	-0.80	2.22
Index (Gross) %	-5.75	6.50	-1.78	2.35

Source: Columbia Threadneedle Investments. Based on global close valuations with cash flows weighted at start of day and excluding entry/exit charges and ongoing charges, and net of transaction costs. The index does not include fees or charges and you cannot invest 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

In ESG news, the ECB suggested that inflation forecasts may need to remain higher for longer as the EU attempts to be the world's first carbon-neutral region by 2050. On the regulatory front, the European Banking Authority launched a list of reporting requirements for banks in the region to help provide clarity on their alignment with the Paris Agreement. Although yet to be approved, the new regulations mark a significant step forward in creating a common ESG language within the banking industry. Elsewhere, the European Commission launched a proposal for a directive on corporate sustainability due diligence. The new rules aim to protect human rights, advance the green transition and foster sustainable development. Later in the period, the EU announced plans to reduce reliance on Russian gas, which currently accounts for 40% of EU supply. The REPowerEU initiative aims to reduce reliance on Russian gas by two-thirds before the end of this year and achieve complete independence by 2030. The key focus will be on increasing imports of liquefied natural gas and accelerating the development of renewable sources.

Performance and Positioning

Gross of fees, the fund returned -5.47%, underperforming the benchmark, which returned -5.29%.

Rates strategies were the main driver of underperformance over the quarter, with duration, country and curve positioning all proving detrimental to relative returns. In the case of the latter, the underweight in the 5–10-year bucket detracted most. Elsewhere, credit strategies were neutral for relative returns in aggregate. Within asset allocation, the overweight in IG credit risk and off-index exposure to high-yield bonds were unfavourable as spreads widened. However, this was offset by positive credit selection, particularly the fund's lack of exposure to Gazprom, the Russian gas company. Other positive contributors at the issuer level included CNP Assurances, AXA and Wellcome Trust.

In terms of activity, although new issuance was low as we entered the new year, we were able to take advantage of the range of bonds available later in the quarter. These included social bonds from property company Vonovia and the Asian Development Bank; green bonds from utilities Iberdrola, Energias de Portugal (EDP) and management consultancy firm P3 Group; and a sustainability-linked bond from CPI Property Group.

Vonovia's €2.5 billion offerings – its first social bonds – will be used to finance social projects including rent-controlled and low-barrier housing. EDP plans to use the proceeds from its €1.5 billion bond to finance eligible wind and solar power projects, as established in its Green Bond Framework. The deal from the Asian Development Bank is a themed bond, linked to gender equality; proceeds will be used to finance projects promoting gender equality and women's empowerment in the Asia-Pacific region. This is the first time that we have been able to align the fund with UN Sustainable Development Goal (SDG) number 5 (gender equality).

On the sales side, we exited Anglian Water and residential property companies Vesteda and Akelius, while reducing issuers such as Carrefour, DWR Cymru (Welsh Water), Prologis and ABN Amro Bank.

Overall, the average social intensity score rose back up to a previous high of 19, with the proportion of the fund in (category A) impact investments in line with last quarter at 32%. With the proportion of the fund in the lowest social intensity bonds (C3 and C4) still well below the limit set by the social advisory panel, this marks another steady quarter of benefits to society through the bonds purchased by the fund.

More broadly speaking, the beta of the fund was maintained at a modest overweight. Our active duration position remained at a marginal underweight for most of the quarter.

Outlook

Looking ahead, the ongoing normalisation of monetary policy warrants attention, especially if central banks seek to move rates into contractionary territory. Over time, however, we still think that inflation – along with growth – should slow towards trend levels, reducing pressure on policymakers to raise rates aggressively.

As regards company fundamentals, earnings and balance sheets remain strong, with the commodities supercycle supporting related companies, and economic reopening lifting more cyclical businesses. Banks, too, seem to be enjoying a benign credit environment, rising margins, falling 'cost of risk' and relatively healthy investment banking conditions, all the while with robust capital ratios.

Turning to valuations, euro IG spreads started Q2 above their five-year and 20-year averages (fractionally so in the latter case); that said, such comparisons are complicated by the fact that duration in the market has risen significantly since the global financial crisis, while the average credit rating has fallen. On this basis, investors are getting similar spreads for more interest-rate risk and lower credit quality.

All things considered, then, we remain fairly neutral on the current prospects for IG spreads. The portfolio retains a small overweight in credit risk but remains tilted to defensive sectors that we think will weather the current uncertain economic conditions well.

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.

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