

FUND COMMENTARY – JUNE 2025

CT HIGH YIELD BOND FUND



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Summary

- European high-yield (HY) bonds made further positive progress in June.
- Gross of fees, the fund outperformed its benchmark over the month¹.
- Zero weights in Kem One, Mobico and Altice International aided relative performance.
- Detractors included Ineos and Antolin.
- We took part in new issues from Darling Ingredients, TeamSystem and FiberCop, among others.

Market Background

European high yield (HY) bonds delivered a third consecutive month of gains in June augmenting the asset class's positive return for the year-to-date. The fund's benchmark returned 0.66% in June. As in May, a modest rise in underlying German Bund yields was outweighed by coupon income, while spreads in the benchmark narrowed by 15 basis points (bps).

Investor sentiment remained surprisingly resilient in the face of escalating geopolitical tensions, persistent tariff uncertainty and some softer economic data in the US. The month's most notable development was Israel's major airstrike campaign against Iran on 13 June. The attack, designed to knock out the country's nuclear capabilities, led to a sharp rise in oil prices and a sell-off in equities. Retaliatory strikes from Iran ensued, before both sides launched further attacks. The US eventually joined the conflict, attacking three Iranian nuclear facilities. Iran's token retaliation and subsequent ceasefire with Israel helped risk sentiment to rebound, while oil gave back most of its earlier gains. Towards month-end, sentiment was further supported by reports that the US and China had signed a deal regarding rare earth exports.

In the US, some hotter-than-expected US jobs data weighed on rate-cut hopes. Non-farm payrolls in May were slightly above expectations but down sequentially from April's total; additionally, March and April's figures were revised down. Annual inflation in the US, per the consumer price index (CPI), rose for the first time in four months, but the print was still lower than expected. Other data indicated a cooling in activity: the S&P Global US composite purchasing managers' index remained in expansionary territory in June according to a preliminary reading but showed a modest softening as service sector output slowed slightly. First-quarter (Q1) GDP was revised down, reflecting a larger contraction. The Federal Reserve left interest rates unchanged, as expected, despite President Trump once again ramping up public pressure on Chair Jerome Powell. Fed policymakers raised their inflation forecast for this year, and downgraded growth forecasts for this year and next.

In the eurozone, CPI inflation dipped below the European Central Bank's target in May. As expected, the ECB then lowered interest rates by 25 bps in early June, the central bank's eighth rate cut since June 2024. However, President Christine Lagarde noted that the monetary policy easing cycle had "nearly concluded". Consequently, investors scaled back expectations for additional cuts this year to just one.

In the UK, GDP shrank more than expected in April, the first month to include the effect of the government's tax increase on employers. Unemployment also rose to a multi-year high in the three months to April, while wage growth slowed more than

¹ Past performance does not predict future returns. Please refer to the KIID document found on our website for further information on the fund performance.

anticipated over the same period. May retail sales figures also undershot forecasts. While the weaker tone of the data reinforced expectations that the Bank of England would make two further interest-rate cuts this year, a reduction in June was not anticipated. Annual CPI for May came in higher than forecast, unchanged versus April (once the latter figure is adjusted for a data error). At its policy meeting the next day, the Bank left rates on hold as expected, though three of the nine rate-setters voted for a cut – a more dovish vote split than anticipated.

The European HY market decompressed in June; higher rated credits outperformed the broad market and delivered positive total returns, while CCCs underperformed materially and registered a negative return. After turning positive in May, flows into the European HY funds continued in June, tailing off towards the end of the month. Inflows were driven largely by managed accounts. Net inflows for the full month were €1.7 billion, bringing the year-to-date total to €2.9 billion, including €3.1 billion gross from managed accounts.

Primary market activity remained robust in June; the third week saw a new record set for primary issuance in a single day, and was the fifth busiest week of corporate issuance since 2010. Overall, June's net new issuance totalled €19.5 billion – beating the previous monthly high set in June 2021. New bonds were mostly rated single B or BB, and experienced strong demand, with books typically three or four times oversubscribed and the bonds going on to perform well post launch. The strong primary supply is expected to continue in the coming weeks, before tailing off into the summer holiday season. For the year to date, gross issuance is €68.5 billion.

Performance

Gross of fees, the fund modestly outperformed its benchmark in June. We maintained a cautious risk profile relative to the fund's benchmark. In our view, a cautious outlook for HY remains prudent at this stage given the risks posed by geopolitical uncertainty, high interest rates and weak economic growth. Our positioning has become more defensive; we are targeting an underweight stance in both core HY and distressed HY, remaining underweight in CCCs. However, we acknowledge that the European HY market offers an attractive yield of 6.0%. Technicals have been supportive of the market and should remain so, in our view.

At the sector level, selections and the underweight in transportation boosted relative performance, as did the overweight and choices in real estate. Selections in telecoms also added value. On the other side, the below-benchmark stance and picks in energy detracted modestly.

At the issuer level, the zero weights in France-based PVC producer Kem One, transport operator Mobico and telco Altice International aided relative performance. Sentiment towards Kem One remained weak following recent downgrades by rating agencies S&P and Fitch and as demand for PVC remained sluggish. Meanwhile, Moody's downgraded Mobico's rating to B2 from Ba2, citing lower-than-expected proceeds from the issuer's sale of its North American school-bus operations, which would extend the timeline for overall debt reduction. The lack of exposure to Altice International was advantageous as rating agency Moody's downgraded the issuer to Caa2 from Caa1, citing worries about the firm's ability to maintain its capital structure due to the rising cost of financing and weakening financial performance.

On the other side, the zero weight in Eutelsat detracted. The bonds rallied following a €1.35 billion capital injection from the French government. The deal made France the largest shareholder in the satellite operator, which aims to challenge Elon Musk's Starlink. An overweight in chemical maker Ineos also detracted. Fitch downgraded Ineos Quattro to B+, citing concerns about oversupply in the chemicals market, weak demand and possible hits to earnings from global trade tensions. The above-benchmark position in car-interiors maker Antolin was also unhelpful. At the end of May, the firm reported a return to net profit, driven by cost reductions achieved as part of its transformation plan initiatives. However, quarterly sales fell and debt levels increased.

Activity

In a busy month for the primary market, we participated in several new issues, including funding for the acquisition of shoemaker Skechers. In autos, we bought new bonds from component makers Benteler, Clarios, Forvia, Mahle and ZF. In other sectors, we participated in offerings from waste management company Urbaser, energy metering company Techem and agricultural recycling processor Darling Ingredients. Other deals included drugmaker Cheplapharm, software developer TeamSystem and Italian network operator FiberCop. We also bought and sold new bonds from healthcare services provider Mehiläinen.

In the secondary market, we boosted exposure to real-estate companies Aroundtown and Vivion, telcos Virgin Media O2 and Ziggo, payment provider Shift4 and consumer health company Opella.

On the sales side we pared holdings in telco Telefonica and car-rental agency Avis Budget.

Outlook

Headline inflation continues to ease towards central-bank target levels in many countries. Still, inflationary pressures linger, and the macroeconomic outlook has become more clouded due to shifting US tariff policies.

Trade tensions have eased since Trump's April "Liberation Day" announcements, amid reported progress in bilateral trade talks, most recently with China. However, uncertainty around US tariff policy remains high as we approach Trump's July deadline on implementing "reciprocal" tariffs. As such, the Federal Reserve has adopted a data-driven approach to interest-rate decisions and indicated increased uncertainty regarding its monetary-easing path, leading market participants to moderate their expectations regarding the timing of interest-rate cuts this year. US trade tariffs, if maintained, are expected to weigh on international trade and disrupt supply chains, driving up inflation. This has prompted fears of "stagflation" – low economic growth, high inflation and high unemployment. For now, the US labour market remains healthy but is showing signs of cooling, while we are also seeing some weakening of other economic indicators and expect to see more over the second half of the year. Additionally, the US Senate is preparing to vote on Trump's new spending plan, which would add \$3.3 trillion to the US debt burden, prompting concerns about the sustainability of the country's fiscal position.

While the growth outlook in Europe has improved due to German stimulus measures, concerns remain about the impact of US tariffs on the eurozone economy. There are suggestions that the European Central Bank will continue to ease policy further this year. In China, economic activity remains subdued as the property sector continues to struggle, and domestic demand remains weak. China's government continues to roll out stimulus measures to boost the economy and offset tariff impacts. Away from economic data, elevated geopolitical risks add to the uncertain outlook, including the conflict between Israel and Hamas, and the war in Ukraine.

Company earnings releases have shown that many corporates remain in good financial shape, with robust balance sheets and liquidity following a period of strong issuance in recent years and well received refinancings. Reported Q1 2025 corporate earnings mostly met or exceeded expectations. Leverage is improving, specifically for BB and B rated issuers. However, companies in some industries – notably chemicals and packaging – remain weak but stable. We still see a mixed outlook among cyclical industries, such as automotive and aerospace, further weighed down by tariff announcements. In the autos sector, manufacturers and original equipment manufacturers (OEMs) had already begun to mark down their guidance (or in some cases remove guidance) for 2025 due to the uncertain European market; the introduction of a 25% levy on imports of cars to the US will add further to the pressures on the sector. We have also seen pockets of balance-sheet strain, and, among over-leveraged corporates, some issuers have undertaken liability management exercises (LMEs). While the negative sentiment surrounding these has eased somewhat, we continue to see an increased risk in balance-sheet restructuring activity in the shorter term (due to specific names already well known). There have also been signs of a modest pick-up in activity related to mergers and acquisitions (M&A) and leveraged buyouts (LBOs) in recent weeks. Overall, we therefore forecast that defaults will rise from low current levels to moderate levels over the next 24 months, but note this is largely already reflected in market pricing.

The default rate increased through 2024 and, after a pause in the early part of 2025, the 12-month trailing default rate rose to 4.2% by the end of May. Still, if distressed exchanges were excluded, the rate would be 2.85%. The recovery rate rose to 65%, far above the historical average of 45%. We view the longer-term outlook for defaults as moderate; our default forecast of 5.1% for the 12 months from May 2025 has risen from our October 2024 forecast of 3.8%, due to names which have been well flagged for some time. The deterioration in our headline forecast is largely driven by already-known restructuring exercises drawing closer to a conclusion. It also reflects a more conservative view across many of the more cyclical sectors, given the prevailing tariff-related uncertainties.

After a slow start to 2025, primary market activity has picked up significantly and is expected to be brisk in 2025. While we have seen an increase in new issues related to corporate activity (LBOs, M&A and distributions to shareholders) in recent weeks, refinancings continue to dominate and new issues are being met with strong demand. This is enabling even challenged issuers to access the primary market. That said, we have seen greater dispersion in demand in recent weeks across ratings and sectors. For example, demand for defensive credits has been robust, while demand for cyclicals and names perceived to be most sensitive to tariffs has softened. In addition, the expansion in new-issue activity related to M&A or LBOs, IPOs and other corporate activity witnessed in late 2024 has now tailed off. Corporates have adopted a wait-and-see approach given the macroeconomic uncertainty. Nevertheless, we have continued to see new issuers coming to the high-yield (HY) market over the year to date with a robust pipeline expected for the coming weeks.

In 2024, the European HY market was supported by net inflows, credit upgrades and flows from tenders, maturities and coupons. The asset class also benefited from a significant number of rising stars, which outpaced the number of fallen angels. So far this year, this trend has continued (for example, Nexi recently received a rating upgrade), while market flows picked up strongly in June with €1.7 billion added to the asset class via both ETFs and managed accounts. As 2025 progresses, we expect fallen angels to begin to outpace rising stars. We still anticipate some fallen angels among property names, given the significant recent stress within the real estate sector due to higher financing costs and structural changes, including reduced

commercial demand. However, the number of potential fallen angel candidates among property names has declined as sentiment towards the sector has improved on the back of falling interest rates and the start of asset disposals.

Spreads are still inside the long-term average, but yields remain near historical highs. Additionally, the higher coupons offered on newly issued bonds have enhanced breakeven rates (how much spreads can rise before the total return of a bond becomes negative), offering a meaningful cushion in the event of spread widening. Nevertheless, we acknowledge that current valuations price in little room for error from escalating geopolitical tensions or an economic downturn, and that market volatility has risen and is likely to remain elevated, at least in the near term. We believe the elevated default risk for over-leveraged credits is largely reflected in market pricing. Overall, until we get more certainty on the tariffs and how they will affect different sectors, we will be cautious on the overall market, preferring opportunities that are least sensitive to tariff-related risks.

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 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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