

FUND COMMENTARY – Q1 2025

CT EUROPEAN BOND FUND



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Summary

- German and UK government bonds had mixed fortunes over the quarter.
- Gross of fees, the fund returned 0.44% in sterling, broadly in line with the benchmark¹.

Market Background

The performance of German and UK government bonds diverged in the first quarter of 2025. The former declined as yields rose sharply. However, gilts managed to post positive returns thanks to coupon income; yields also rose here, but more modestly than those on German Bunds. Meanwhile, yield curves generally steepened amid a softening near-term global economic outlook and expectations that US import tariffs could add upward pressure on inflation.

Having largely taken directional cues from US Treasuries for much of the quarter, German Bunds suffered their worst sell-off in decades in early March. The trigger was an agreement by German parliamentary parties on a substantial fiscal spending package and amendments to the country's constitutional debt brake as the US administration signalled it would reduce military aid to its allies. Separately, EU leaders agreed an €800 billion plan to bolster military capabilities across the bloc's member states.

Gilts were caught up by the sell-off in German Bunds; they were also impacted by concerns over the UK's own stretched fiscal finances as the government outlined more defence spending and military aid to Ukraine.

As the quarter drew to a close, and President Trump's so-called 'Liberation Day' of sweeping reciprocal tariffs approached, Bund and gilt yields gradually trended lower – but not by enough to reverse their earlier increases.

Overall, the 10-year gilt yield rose by 11 basis points (bps) over the quarter to 4.68%, while the German equivalent was up 37 bps to 2.74%. The rise in Bund yields led to a tightening in eurozone peripheral spreads, as did optimism around the boost to growth from the aforementioned stimulus measures and some encouraging data on the eurozone economy. In March, for example, manufacturing output returned to growth, according to a keenly watched purchasing managers' index.

These factors also resulted in a tightening in euro investment-grade (IG) spreads over the quarter, though they widened amid the tariff-driven volatility of March. In total-return terms, euro IG credit was little changed over the quarter as the spread-narrowing and coupon income were offset by the sharp rise in Bund yields. Sterling IG credit fared better in total-return terms, posting a modest gain, even though spreads here widened over the quarter.

Performance

Gross of fees, the fund returned 0.44% in sterling over the quarter, broadly in line with the benchmark¹.

Interest-rate-related effects detracted fractionally from relative performance. Being overweight eurozone duration was unhelpful as Bund yields rose, although curve positioning was beneficial, particularly the underweight in the 15–25-year segment.

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.

Credit strategies had a neutral impact on relative returns in aggregate. The exposure to agency/quasi-government debt was beneficial but security selection detracted.

Activity

The fund began the quarter with an overall duration of 0.30 years long, although we brought duration in line with the benchmark in the middle of January. We retained this positioning for the remainder of the quarter. The initial overweight position was in European rates, while we were neutral in gilts over the quarter.

We began January with overweight duration in the eurozone. We significantly reduced this in the middle of January. Following the sell-off in early March, we took advantage of improved valuations to add back duration. We moved further overweight towards the end of the month.

We participated in a new issue from the European Financial Stability Facility. In agency/quasi-sovereign debt, we bought new bonds from German development bank KfW, the Canadian province of Alberta the German state of North-Rhine-Westphalia, and French state-owned housing-financing agency Caisse de Refinancement de l'Habitat (CRH). We also participated in new offerings from Canadian pension funds Omers and Caisse de dépôt et placement du Québec (CADEPO).

In credit, we participated in several new offerings via the primary market. In financials, these included bonds from Allianz, Caixabank, DNB Bank and, for example. In utilities we initiated a new position in Italgas and increased exposure to grid operator Stedin and water company Severn Trent. We also topped up holdings in telecoms giant AT&T, IT firm IBM, TotalEnergies and RCI Banque, the financing arm of Renault; all via the primary market.

Sales included BNG Bank, paper and packaging company Bunzl and Australian telecoms firm Telstra. We also swapped out some of our existing holdings in Allianz and RCI Banque for the aforementioned new issues.

Outlook

As the post-Covid peak in headline inflation fades in the rearview mirror, and core inflation edges towards target levels, prices are likely to remain a concern. Central banks are lowering interest rates carefully, with the debate shifting to how much further they will cut, and the extent to which assumed 'neutral' rates have been reset higher in the post-Covid environment (neutral rate is the rate of interest that neither restricts nor stimulates the economy).

The first months of President Trump's second term have led to a chaotic, seismic shift in both domestic and international policy. This has sent shock waves through inflation expectations and market sentiment. If enacted for more than a short period, tariffs will almost certainly cause prices to rise in the US, and retaliatory actions will likely lift inflation elsewhere. At this stage, it remains unclear where tariff rates may settle, but authorities seem wary that the progress to date on reining in inflation may be lost in a trade war. Aside from inflation concerns resurfacing, government balance sheets could come under pressure if a swathe of countries, particularly in Europe, start to increase defence spending.

In Europe, economic data releases will continue to determine the pace and quantum of interest-rate cuts and the direction of government bond yields. The weak state of northern European economies prompted the ECB to lower interest rates at its first two meetings of 2025. That said, the world is changing rapidly, and increased defence spending will have positive repercussions for growth in some economies, which may offer some counterbalance to the damage that US tariffs will cause.

The BoE's easing cycle is also continuing – albeit at a slower pace – supported by benign projections for inflation over the long term. However, forthcoming employment tax increases at the company level will test economic resilience, which, coupled with spending cuts and rising household bills, may trigger a downturn that the Bank will have to attempt to arrest.

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 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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