

FUND COMMENTARY – Q1 2025

CT STRATEGIC BOND FUND



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Fund Manager

Summary

- In total-return terms, both sterling investment-grade (IG) credit and euro high-yield (HY) credit posted gains for the first quarter (Q1).
- Over the period, the fund made a net return of 0.99%¹ (based on 12 pm prices, unadjusted income reinvested).
- Credit spreads no longer look cheap, though outright yields are elevated, which in our view offers an interesting entry point for those seeking income.

Market Background

The two markets in which the fund primarily invests – sterling IG and euro HY – both posted gains for the quarter, with the latter faring best in total-return terms. The positive returns were driven by coupon income: yields rose on underlying UK gilts and (especially) German Bunds, and both markets suffered from a widening in credit spreads (the yield difference between corporate and risk-free government bonds of the same maturity).

Softening US economic data saw traders price in more US interest-rate cuts this year. As the period progressed, key consumer confidence indices hit successive multi-year lows: worries about inflation and President Trump's tariff policy featured heavily in respondents' survey answers. Falling Treasury yields across the curve suggested that investors were more worried about the hit to growth from a potential trade war than a related rise in inflation.

Having largely taken directional cues from US Treasuries for much of Q1, Bunds sold off in March in response to events in Germany. The trigger was a deal between the Chancellor-elect and his prospective coalition partners to create a €500 billion infrastructure fund and to loosen fiscal rules to exempt defence spending from the country's 'debt brake'. Separately, EU leaders agreed an €800 billion plan to bolster military capabilities across the bloc's member states. The UK, which had already promised greater defence spending, pledged to ease regulations to speed up the purchasing of military equipment.

While uncertainty about the immediate economic outlook limited the rise in short-dated yields, the realisation that the abrupt shift in fiscal policy would likely result in higher deficits across Europe pushed longer-dated yields higher. The underperformance of Bunds versus Treasuries and gilts came despite widening interest-rate differentials in the relevant economies. The European Central Bank cut its key interest rate by 25 basis points (bps) twice in Q1, taking it to 2.5%. The Bank of England made just one 25-bp cut, to 4.5%, while the Federal Reserve kept US rates unchanged at 4.25–4.5%.

Overall, the 10-year Bund and gilt yields respectively rose 37 bps to 2.74% and 11 bps to 4.68%, while the US equivalent fell 36 bps to 4.21%. Meanwhile, credit spreads widened amid mounting concern about slowing US growth and the potential for a global trade war. In IG, there was significant divergence by region: the US market fared worst in spread terms, followed by the UK. Euro IG spreads tightened, supported by Germany's fiscal plans and some positive economic data from the eurozone; euro HY spreads widened, but held in much better than their US counterparts.

Performance and Positioning

Net of fees, the fund made a positive return of 0.99%¹ for the quarter (based on 12 pm prices, unadjusted income reinvested), while its peer group on average made return of 1.38%.

Within the fund, interest-rate-related effects accounted for most of the positive return. A long position in euro duration (sensitivity to changes in interest rates) detracted as Bund yields soared; however, our long in US duration added value as yields fell sharply. At the same time, our short in Japanese government bonds (JGBs) helped performance: JGBs were weak in Q1, with yields rising as the Bank of Japan raised interest rates and indicated that additional hikes will follow in 2025. Credit strategies also added value: industry positioning proved unfavourable, but credit selection effects were strongly positive.

Overall, duration (which measures sensitivity to changes in interest rates) was little changed over the quarter, edging up from 4.9 years to 5.0 years, as a reduction in US duration was offset by a reduction in our JGB short position. We retained broad exposure to curve steepening (i.e. we are underweight at the long end) in government bond markets.

As regards US duration, we sold Treasuries in January and early February, as markets scaled back US rate-cut expectations. Later in February we added back US duration by switching some eurozone exposure into Treasuries following a weaker-than-expected US purchasing managers' index. We reversed this trade in mid-March for a profit as euro rates underperformed following the significant shift in German fiscal policy.

Meanwhile, the reduction in our JGB short position was mostly delivered in January, as we realised some profits after the aforementioned rise in yields. We made some tactical adjustments to eurozone and UK duration but both exposures were broadly unchanged over the quarter as a whole. At the margin, we increased exposure to Australian duration.

In the credit side of the portfolio, we took advantage of a range of new issues. The largest of these (by position size) included deals from Bacardi (drinks), Heimstaden (real estate), Synopsis (semiconductor design automation), Heathrow Airport, and Celanese (chemicals). We were also active in the secondary market, for example starting positions in BP (oil & gas), Atos (IT services), Infrastrutture Wireless Italiane and XPLR (energy infrastructure), while increasing exposure to Centene (managed healthcare).

On the sales side, we exited issuers including National Bank of Greece, Foncia (real estate), Arqiva (telecoms infrastructure), Carnival (cruises), and Asmodee (board games). We also reduced positions in Bellis (vehicle formed to acquire Asda), Emerald (vehicle for the acquisition of HVAC company Copeland), Atlantica Sustainable Infrastructure, Swisscom (telecoms) and Telefonica among others.

Outlook

The fund's duration remains towards the high end of our historical range. This represents a modestly constructive view on certain government bond markets given the elevated yields still on offer, combined with our expectations of some risks to the global economy.

At present, meaningful estimates of the impact of Trump's trade tariffs are all but impossible to calculate. What seems most likely, however, is that inflation will be higher and growth lower than previously envisioned. This complicates the picture for central bankers looking to support their economies by cutting interest rates.

Lower growth, with the risk of recession, would be a less positive – or even negative – environment for credit spreads, especially for more levered and cyclical issuers. With spreads having widened in Q1 and still further in April, at least some of the bad news is already priced into valuations. And while spreads (at the time of writing) are still inside (i.e. more expensive than) historic averages, outright yields are comfortably above long-run means, which should continue to attract investors seeking income.

The IG market is also supported by robust credit fundamentals, such as low leverage for corporates and high levels of capital for banks. The picture is not quite as robust in the HY market, where defaults are expected to rise. We maintain a preference for IG over HY, and generally prefer shorter-dated HY bonds over longer-dated ones.

While we have a neutral-to-defensive view on credit risk, we continue to see idiosyncratic opportunities to add value in credit. At the sector level, we still favour defensive areas such as regulated utilities, telecoms and non-cyclical industrials.

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. Net performance for the Z income GBP share class (ISIN: GB00B882QB67) based on 12 pm bid-to-bid prices, unadjusted income reinvested, net of fees. All data in GBP. Source: Morningstar as of 31 March 2025.

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 may enter into financial transactions with selected counterparties. Any financial difficulties arising at these counterparties could significantly affect the availability and the value of fund assets.

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 materially in derivatives (complex instruments linked to the rise and fall of the value of other assets). A relatively small change in the value of the underlying investment may have a much larger positive or negative impact on the value of the derivative.

Leverage occurs when economic exposure through derivatives is greater than the amount invested. Such exposure, and the use of short selling techniques, may lead to the fund suffering losses in excess of the amount it initially invested.

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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