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Markets

This Year's Top Bond Investors Disagree on Depth of US Recession

- Carillon Reams, Columbia bond funds outpace peers in 2023
- Gains mark rebound from pummeling suffered last year

by Michael Mackenzie and Ye Xie
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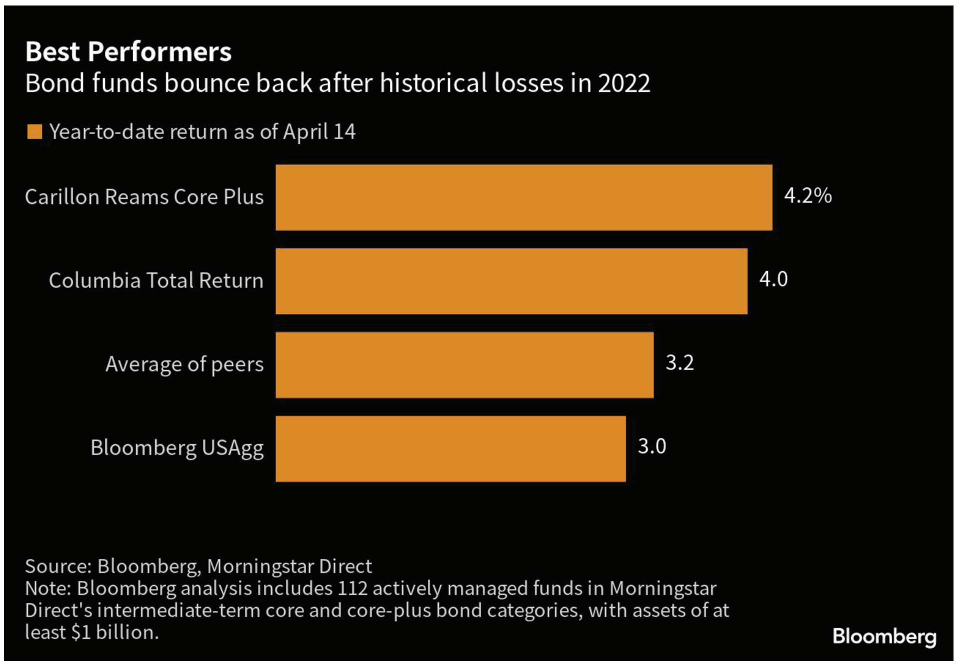
This year's top US bond managers agree that Federal Reserve interest-rate cuts are inevitable this year. The main debate they see is how deep the economic pain gets.

In a chaotic start to 2023 that featured the most volatile trading in more than a decade, the Carillon Reams Core Plus Bond Fund and the Columbia Total Return Bond Fund have delivered the best returns among 112 US peers that actively manage at least $1 billion.

The funds have led the pack in recouping some of the staggering losses that they and the rest of the bond world suffered last year as the Fed tightened policy at the fastest clip in decades to tame inflation. Now these managers are assessing the breadth of the fallout from those rate increases, in particular the risk of a credit crunch following a spate of bank failures.



After boosting returns last quarter by anticipating the big shifts in front-end Treasuries, Todd Thompson and his fellow managers of Reams Asset Management's Carillon Reams Core Plus Bond Fund are positioning for a soft landing as the more likely path for the economy. So, a slowdown but not necessarily a deep recession. It's a scenario they expect will benefit high-grade corporate debt. For Columbia Threadneedle, however, the outlook is more dire, and they're betting Treasury yields will revisit the lows seen in August 2022.

"The Fed is being overly aggressive in this cycle as they try and maintain their credibility in managing inflation," said Jason Callan, who alongside Gene Tannuzzo manages the $2.7 billion Columbia Total Return Bond Fund. "There is more likelihood of a harder landing."

The $1.3 billion Carillon Reams Core Plus Bond Fund earned 4.2% this year through April 14, after losing about 12% in 2022, data compiled by Bloomberg show. It edged out the 4% return for the Columbia fund, which plunged 17% last year.

For these funds and much of the rest of the fixed-income world, 2022 marked by far the worst performance of at least the past decade. On a three-year basis, both funds have outpaced roughly three quarters of their peers, data compiled by Bloomberg show.

The year-to-date ranking was based on an analysis of funds in Morningstar Direct's intermediate-term core and core-plus categories. The average return for the 112 funds was about 3.2% through April 14.

Inflation Focus

Data last week showed headline price pressures cooling, while core inflation remained elevated. Meanwhile, consumers' inflation expectations for the next year surged, leading traders to bet on at least another quarter-point hike by June, and then rate cuts by year-end.

Two-year yields swung some 20 basis points on two days last week, the latest in a series of whiplash-inducing sessions that have rewarded bond managers who nimbly adjusted the interest-rate risk in their portfolios.

Active managers now face another critical stretch to prove their mettle at a time when even Treasury bills offer rates around 5%. The challenge is that the central bank may prove less willing to ease to stem a credit crunch should inflation stay stubbornly high, even as Fed staffers see a "mild recession" ahead. The central bank's preferred inflation measure is still more than double its 2% target.

Reams Asset Management's Thompson acknowledges the risk that the Fed tightens again after a pivot.

"That's definitely part of the calculus for the steps ahead," he said.

'Scramble' Ahead

But a key for him now is preparing for easier policy as the cumulative effects of the Fed's tightening work to slow economic activity, while the banking turmoil crimps lending.

"Our thesis in credit is that you want to be on the long side and we do expect the Fed to pivot and ease," he said. "We think the market scrambles for income once we get into a Fed easing cycle," fueling demand for corporate debt.

For Callan, slowing headline consumer inflation and weakness in housing have emboldened his view that it pays to own bonds or have duration risk. The Columbia fund has a longer duration than the Bloomberg USAgg, lining it up for outsize returns should yields fall.

He sees potential for a 2.5% 10-year Treasury yield, if not lower, by year-end, from 3.58% now. That result could deliver a return of 7% to 10% on top of the fund's gain in the first quarter, he said. Among the caveats he cited – sticky inflation that keeps the Fed from cutting.

"There was a lot of volatility in Q1 and as we are rolling into Q2, there is more confidence in the headwinds of tighter policy, and the data is telling us things are slowing," he said.

Carillon Reams Core Plus Bond Fund Performance as of 03.31.2023

Average Annual Total Returns (%)

	QTD	YTD	1 YR	3 YR	5 YR	10 YR	Life of Class	Gross Expense Ratio	Net Expense Ratio (After Waiver)	Inception
Class A (at NAV)	4.13	4.13	-3.51	0.08	2.59	-	2.22	0.90%	0.80%	11/20/17
Class A (at Offer)	0.21	0.21	-7.12	-1.19	1.81	-	1.50	0.90%	0.80%	
Class C* (at NAV)	3.97	3.97	-4.22	-0.64	1.84	-	1.48	1.67%	1.55%	11/20/17
Class C* (at Offer)	2.97	2.97	-4.22	-0.64	1.84	-	1.48	1.67%	1.55%	
Class I	4.25	4.25	-3.12	0.50	3.02	2.28	5.50	0.65%	0.40%	11/25/96
Class Y	4.16	4.16	-3.49	0.10	2.61	1.88	3.41	0.96%	0.80%	11/12/09
Class R-3	4.09	4.09	-3.73	-0.14	2.36	-	1.99	1.18%	1.05%	11/20/17
Class R-5	4.23	4.23	-3.22	0.40	2.91	-	2.55	0.53%	0.50%	11/20/17
Class R-6	4.21	4.21	-3.13	0.50	3.01	-	2.65	0.56%	0.40%	11/20/17
Bloomberg U.S. Aggregate Index	2.96	2.96	-4.78	-2.77	0.91	1.36	-			

Calendar Year Returns (%)

	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Fund (Class A at NAV)	-12.15	-2.34	16.01	7.84	0.35	–	–	–	–	–
Fund (Class I)	-11.80	-1.96	16.56	8.29	0.76	3.51	3.57	0.10	2.32	-0.36
Bloomberg U.S. Aggregate Index	-13.01	-1.54	7.51	8.72	0.01	3.54	2.65	0.55	5.97	-2.02

Performance data quoted represents past performance which does not guarantee future results. The investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Net performance reflects a front-end sales charge or 3.75% for class A shares. A 1% contingent deferred sales charge for class C shares is charged on redemptions made within 12 months of purchase, but not at one year. The Fund's investment adviser, Carillon Tower Advisers, Inc., has contractually agreed to waive or reimburse certain fees and expenses through Feb. 29, 2024, and may recover/recoup previously waived expenses that it assumes within the following two fiscal years. Performance data quoted reflects reinvested dividends and capital gains. Returns less than one year are not annualized. Current performance may be higher or lower than the performance data quoted. Performance data current to the most recent month-end may be obtained by calling 1.800.421.4184 or visiting carillontower.com. Performance "at NAV" assumes that no front-end sales charge applied, or the investment was not redeemed. Performance "at offer" assumes that a front-end sales charge applied to the extent applicable. Class I and R shares have no sales charge and are only available to certain investors. See the prospectus for more information. *The Carillon Family of Funds will convert class C share accounts that are more than 8 years old to class A shares on the third of each month. Shareholders may continue to purchase shares in either class but will be required to pay a sales charge on new purchases of Class A shares.

Please consider the investment objectives, risks, charges, and expenses of any fund carefully before investing. Call 1.800.421.4184 or your financial professional for a prospectus, which contains this and other important information about the funds. Read the prospectus carefully before you invest or send money.

Risk Considerations: The return of principal in a fixed income fund is not guaranteed. Fixed income funds have the same interest rate, inflation, issuer, maturity and credit risks that are associated with underlying fixed income securities owned by the fund. Mortgage- and Asset-Backed Securities are subject to prepayment risk and the risk of default on the underlying mortgages or other assets.

High-yield securities involve greater risk than investment grade securities and tend to be more sensitive to economic conditions and credit risk. Foreign investments present additional risks due to currency fluctuations, economic and political factors, government regulations, differences in accounting standards and other factors. Investments in emerging markets involve even greater risks. Derivatives such as options, futures contracts, currency forwards or swap agreements may involve greater risks than if the Fund invested in the referenced obligation directly. Derivatives are subject to risks such as market risk, liquidity risk, interest rate risk, credit risk, and management risk. Derivative investments could lose more than the principal amount invested. The Fund may use derivatives for hedging purposes or as part of its investment strategy. The use of leverage and derivatives investments could accelerate losses to the fund. These losses could exceed the amount originally invested.

The Fund may, at times, experience higher-than-average portfolio turnover, which may generate significant taxable gains and increased trading expenses, which, in turn, may lower the Fund's return.

The Bloomberg U.S. Aggregate Bond Index is composed of the total U.S. investment-grade bond market. The market-weighted index includes Treasuries, agencies, CMBS, ABS and investment-grade corporates. It is not possible to invest in an index.

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