CARILLON REAMS UNCONSTRAINED BOND FUND

CARILLON FAMILY OF FUNDS

INSIGHT | COMMENTARY

FOURTH QUARTER | 2021

Investment Team

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Characteristics

Total Net Assets (billions): $1.23

Number of holdings: 127

Top Holdings

US TREASURY N/B T 0 1/4 06/15/23

US TREASURY N/B T 0 1/2 11/30/23

US TREASURY N/B T 0 3/4 12/31/23

US TREASURY N/B T 0 7/8 09/30/26

NOTA DO TESOURO NACIONAL BNTNF 10 01/01/23

MEX BONOS DESARR FIX RT MBONO 5 3/4 03/05/26

AESOP 2020-2A A

HERTZ 2021-1A A

GMCAR 2020-3 A3

FORD MOTOR CREDIT CO LLC F 3.37 11/17/23

Please consider the investment objectives, risks, charges, and expenses of any fund carefully before investing. Call 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.

Market Overview

President Biden announced that he will nominate current U.S. Federal Reserve (Fed) Chairman Jay Powell for a second term. Lael Brainard, considered Powell's main competition for the post and favored by liberal Democrats, will be nominated instead for the vice chair position. Shortly after this nomination was announced, Powell pivoted to a less dovish stance by retiring the term "transitory" as it relates to inflation and accelerating the tapering of the Fed's quantitative easing (QE) program. This latter action in effect pulled forward potential rate increases based on the previously communicated desire to exit QE before commencing a new series of rate hikes.

Congress passed the long-delayed bipartisan infrastructure bill in November, a key victory for President Biden's economic agenda. This legislation, which enjoyed broad support, likely would have passed many weeks ago had it not been tethered to the much more partisan fiscal package that has been dubbed the "Build Back Better" bill. The budget reconciliation process will now be needed for the Build Back Better bill to make it through the evenly divided Senate, made all the more difficult by Senator Joe Manchin, D-W.Va., declaring his opposition after meeting with President Biden late in the year. At a minimum, this will further delay the bill, but it also raises the possibility for it to be abandoned completely. For much of 2021 the market anticipated some version of this bill to eventually be passed by Congress, but unless prospects improve in early 2022, with mid-term elections looming in November, additional fiscal stimulus will either be less than previously anticipated or absent altogether.

Omicron quickly became the dominant COVID-19 variant after first appearing just before Thanksgiving, overtaking the delta variant in just a matter of weeks. Although the speed of transmission has been higher than previous variants, initial data indicate that its severity may also be milder. Investors appeared to latch onto this silver lining, as capital markets only wavered modestly and briefly when omicron burst onto the scene in late November.

Chinese authorities are intent on reining in excessive private sector debt, part of a broader recent emphasis on "common prosperity" and a strategic shift back toward socialism from a more market-based growth initiative. This presents a conundrum, however, with respect to its real estate sector and the ongoing woes of several large property developers. The state is loath to bail out wealthy investors in such enterprises, but must also avoid an uncontrolled, systemic failure with the potential to create widespread social unrest. Chinese officials have thus far taken a measured approach, and property developers' slow motion defaults have not yet spilled over to cause broader economic damage. Continuation of China's robust gross domestic product (GDP) growth – already a tall order under the best of circumstances – will be a virtual impossibility, however, until its property sector is back on solid footing.

Most risk assets advanced during the fourth quarter and 2021 closed on a strong note, although volatility notably increased following the onset of the omicron variant in late November. Within U.S. fixed income, spread sectors underperformed with the exception of high yield (HY) corporates. The investment-grade (IG) corporate option-adjusted spread (OAS) widened +8 basis points (bps); agency mortgage-backed securities (MBS) +5 bps; commercial mortgage-backed securities (CMBS) +7 bps; asset-backed securities (ABS) +9 bps; while HY corporates tightened -6 bps. U.S. Treasury rates rose at the front end, reflecting a more hawkish stance by the Fed regarding tapering and rate hikes, but the curve continued to flatten: 2-year, 5-year, and 10-year Treasury yields rose +46 bps, +30 bps, and +2 bps, respectively, while the 30-year rate declined -14 bps. (Source: Bloomberg)

Portfolio Review

Macroeconomic factors contributed, as favorable curve positioning and tactical duration management offset the Fund's overall positive duration stance during a quarter when most Treasury rates increased. The allocation to high yield (HY) corporates and a tactical short position in breakeven inflation also contributed. Exposure to non-U.S. holdings was the largest detractor during the fourth quarter followed by exposure to IG corporates, which posted negative total returns due to the increase in risk-free rates. Holdings in the commercial mortgage-backed securities (CMBS), asset-backed securities (ABS), and agency mortgage-backed securities (AMBS) sectors also produced slightly negative total returns and detracted a small amount.

The Fund's weight in IG corporates decreased quarter over quarter, with exposure focused on short-maturity and lower-beta credits to lower overall sensitivity to credit spreads. Exposure to HY corporates declined and remained at a low absolute level, as we viewed the sector as broadly unattractive at current spread levels. Non-U.S. dollar exposure, representing a mix of short-maturity foreign bonds and currencies, decreased during the fourth quarter and remained moderate on an absolute basis. The allocation to U.S. Treasurys increased, while the weights in agency MBS and cash equivalents decreased during the fourth quarter. CMBS exposure increased slightly but remained modest on an absolute basis. CMBS holdings were concentrated in well-structured senior securities due to their stable cash flow characteristics. The ABS weight increased but remained moderate on an absolute basis, with holdings focused on high-quality auto loan and credit card collateral.

The Fund's duration increased quarter over quarter, moving from slightly positive to moderately positive, but remained below the neutral range for the Fund. This duration stance reflected a view that real interest rates remained unattractive, but long-term rate risk was more balanced over the near term. The Fund continued to have minimal exposure to the 10-year-plus maturity segment of the yield curve, with holdings concentrated in the 0- to 1-year, 1- to 3-year, and 3- to 5-year segments of the curve. Relative to the prior quarter, the significant bias toward the 0- to 1-year portion of the curve was reduced and the allocation to the 1- to 3-year portion of the curve increased meaningfully.

Outlook

With the announcement and then somewhat abrupt acceleration of QE tapering, the Fed is indicating that it now sees a need for more concerted action to control inflation after spending most of 2021 dismissing it as "transitory." The Fed's own "dot plot," although traditionally unreliable for predicting actual Fed policy, currently indicates that rate increases will follow quickly after the QE taper is complete in March. The important takeaway is that the Fed is likely to continue this shift toward a more hawkish stance, absent any major economic or market disruptions, now that it has been set in motion.

President Biden's approval ratings dropped sharply in the second half of 2021 and most Democrats in Congress seem to be bracing for a difficult mid-term election cycle. This backdrop does not bode well for the advancement of additional Biden administration economic agenda items during 2022, the most notable being a robust "Build Back Better" bill favored by the liberal wing of the Democratic Party. This legislation is stalled at the moment and, at best, will be scaled down in order to win support from holdout Democratic senators like Joe Manchin.

As COVID-related supply disruptions clear, inflation should begin to moderate. Other sources of inflation such as a tight labor market and housing costs will likely not abate as quickly, however, and ongoing upward pressure from these two sources will probably keep the inflation rate above the Fed's 2% long-term target.

Valuations remain stubbornly high and largely unshaken, even in the face of periodic negative health news related to COVID. High inflation readings combined with low nominal Treasury rates have also resulted in real rates that are sharply negative, which is starkly at odds with the elevated valuations in risk markets. While divergences like this can persist for some time, they are expected to ultimately return to a more consistent historical relationship.

Risk Considerations: The Fund employs an unconstrained investment approach which creates considerable exposure to certain types of securities that present significant volatility in the Fund's performance, particularly over short periods of time. 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.

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.

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.

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, derivatives, and short sales 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.

Short-sale risk includes the potential loss of more money than the actual cost of the investment, and the risk that the third party to the short sale may fail to honor its contract terms, causing a loss to the fund.

Past performance is not indicative of future results and investing involves risk, including the risk of loss. All information as of December 31, 2021. Opinions expressed are the current opinions as of the date appearing in this material only. This material should not be construed as research or investment advice.

The information provided should not be construed as a recommendation to buy, sell, or hold any particular security. The data is shown for informational purposes only and is not indicative of future portfolio characteristics or returns. Portfolio holdings are not stagnant and may change over time without prior notice.

Basis points (bps) are units of measure often used in discussions of interest rates, equity indices, and yields of fixed-income securities. One basis point is equal to 1/100th of 1%.

A credit spread is the difference in yield between a U.S. Treasury bond and another debt security with the same maturity but different credit quality. Also referred to as "bond spreads" or "default spreads," credit spreads are measured in basis points, with a 1% difference in yield equaling a spread of 100 basis points. Credit spreads reflect the risk of the debt security being compared with the Treasury bond, which is considered to be risk-free. Higher quality securities have a lower chance of the issuer defaulting. Lower quality securities have a higher chance of the issuer defaulting.

An option-adjusted spread (OAS) measures the spread of a fixed-income security rate and the risk-free rate of return, which is typically calculated using U.S. Treasury yields for the risk-free rate. The spread represents the incremental yield above the risk-free rate that compensates investors for bearing the risk of defaults or downgrades of the underlying security.

A yield curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity

Duration incorporates a bond's yield, coupon, final maturity, and call features into one number, expressed in years, that indicates how price-sensitive a bond or portfolio is to changes in interest rates. Bonds with higher durations carry more risk and have higher price volatility than bonds with lower durations.

Beta is a measure of the volatility or systemic risk of a security or portfolio compared with the market as a whole.

Benchmark Index

The BofA Merrill Lynch USD 3-Month LIBOR Constant Maturity Index is based on the assumed purchase of a synthetic instrument having 3 months to maturity and with a coupon equal to the closing quote for 3-Month LIBOR. That issue is sold the following day (priced at a yield equal to the current day closing 3-Month LIBOR rate) and is rolled into a new 3-Month instrument. The index, therefore, will always have a constant maturity equal to exactly 3 months. It is not possible to invest in an index.

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