Schroder Global Value Fund (Wholesale Class)

Fund commentary

The QEP Global Value strategy outperformed during the quarter beating the MSCI AC World index as well as significantly outperforming the MSCI AC World Value index. At a high level, contributions to outperformance were broad based across both regions and sectors as the strategy's focus on higher quality parts of the value universe was rewarded.

Stylistically, allocations to higher quality cyclicals was a key tailwind to performance during the quarter. Specifically, holdings in industrials (construction, manufacturing) and financials (banks) were additive on positive stock selection. Positioning within more defensive value was also additive, especially in staples and utilities. An underweight stance in staples coupled with positive stock selection (home products, drinks) added value. Robust stock selection in utilities, led by select deeper value names in the US (e.g. NRG Energy) also underpinned relative performance.

Most other sectors also proved beneficial, albeit by more marginal amounts. The main headwind in the quarter came from the technology and communication sectors as the Magnificent 7, outside of Apple, rebounded strongly fuelling a broader return to outperformance for the Growth index.

At a high level, the overall balance across our four value areas remains slightly in favour of Shareholder value (dividend, share buyback, surplus free cash flow) versus more cyclical value exposure from Book and Earnings value, a profile we've had in place since Q2 2024. Sources of Shareholder value remain broad rather than concentrated in the typical defensive sectors – we find opportunity across financials, high quality cyclicals and defensives.

At a regional level, we remain overweight Europe and the UK where attractively valued shareholder yield features prominently. We have taken profits in defensive areas such as telecoms, staples and utilities after some strong returns. Similarly, trimmed some 'hot' defensive yield exposure in insurance. But valuations largely remain cheap with a depth of opportunity, so we remain overweight these areas.

We have already benefited from rotating these profits into industrials (e.g. construction, transport, Korean & UK manufacturing) and IT holdings (e.g. IT services, comm equipment).

Market review

Global equity markets staged a strong rebound in Q2 2025, overcoming numerous headwinds to close the quarter at new highs. The MSCI World Index rose 11.5% in USD terms, lifting H1 gains to 9.5%. After signs of divergence early in the year, regional returns converged in Q2 as most major markets posted low double-digit gains despite further weakness in the US dollar. The trade weighted DXY index declined as much as 6.8% in Q2 and is now down 10.4% year-to-date, marking its steepest first-half decline in over five decades.

While questions around the durability of US outperformance persisted, the relative strength of non-US markets was less stark in Q2. Investor concerns over the US fiscal trajectory also intensified, but the impact on bond markets was limited: Treasury yields edged higher, while yields in Europe and other regions moved lower on softening inflation expectations and tentative monetary easing.

US equity markets experienced significant volatility. After peaking in mid-February, the S&P 500 declined over 7% ahead of the tariff escalation announcement on April 2nd. This was followed by a further 12% drawdown, before sentiment sharply reversed on news that tariff implementation would be delayed. The benchmark recouped its losses within nine trading days and ultimately ended the quarter at a record high, in step with broader global markets.

Corrections of this scale are not uncommon, but the velocity of the rebound was notable, particularly against the backdrop of a 12-day conflict between Israel and Iran in April. While this temporarily unsettled energy markets, the swift ceasefire helped oil prices stabilise. WTI ended the quarter below its March and year-start levels, reflecting both reduced geopolitical risk premium and subdued demand signals.

Investor confidence was underpinned by surprisingly resilient corporate earnings across regions. Despite lingering macro uncertainty, earnings beats were widespread, supporting valuations. However, the forward P/E of the S&P 500 climbed from 18x in early April to over 22x by quarter-end—placing it near the top of its 30-year range and over 30% above its long-term average.

Meanwhile, elevated intra-quarter market volatility disguised the ongoing strength of a handful of secular themes (namely AI, data centres, defence, EU fiscal beneficiaries). From a sector perspective, technology, communications, banks and industrials led the way whilst the laggards were the traditional defensive areas of staples, utilities, real estate and health care. According to MSCI's style indices, US Growth stocks rebounded strongly in Q2 whilst there was much less of a distinction between Growth and Value performance in other regions.

Outlook

At the outset of 2025, consensus expectations were unusually aligned: continued US equity market leadership driven by Big Tech, USD strength, and a modest economic deceleration that would still allow the Fed to cut rates two or three times. While valuations were elevated by historical standards, robust earnings growth and superior profitability were seen as justifying the premium. In essence, investors anticipated a continuation of the 2023–2024 playbook, underpinned by the assumption that American exceptionalism would persist.

The main disruption to this outlook has come from the breadth of President Trump's trade policy ambitions. While tariffs were expected, the rates announced on "Liberation Day" (April 2nd) far exceeded forecasts. The current effective US tariff rate stands near 15%, up from a pre-2025 average of just 2.5%. Although a 90-day implementation reprieve expires on July 9th, negotiations with key partners remain incomplete. While some progress has been made with China and the UK, a deal with the EU appears unlikely in the near term, meaning that a further extension is very likely. There is the possibility that the US Supreme Court rules against universal and reciprocal tariffs, but the response would instead be sector-based tariffs.

According to the latest Bank of America survey of investors, the market expects the final tariff rate to settle at 13%, broadly in line with the 10% baseline tariff announced on Liberation Day plus a variety of specific sectoral levies. The impact of this will predominantly fall on both US firms and consumers as higher input costs are passed through. According to the OECD, these tariffs may also cut 0.3-0.5 percentage points from global GDP growth due to lower trade volumes whilst adding 0.5-1% to US inflation in year one.

Irrespective of the final tariff configuration, higher trade barriers are likely to generate a temporary stagflationary impulse, elevating input costs and weighing on growth. While this dynamic alone may not derail central bank easing cycles, it complicates the policy response at a time when inflation persistence remains a concern. Understandably, the Fed appears cautious, reflecting both data dependence and uncertainty over Trump's policy direction. With US recession probabilities now sitting around 35–40% for 2025, downside risks appear underappreciated, particularly given the likelihood of a synchronised global slowdown.

Despite the tariff shock, equity markets have proved supremely resilient. The S&P 500's rebound was swift and broad-based, regaining pre-announcement levels within two weeks and reaching new highs by quarter-end. Notably, the rally extended beyond the mega-cap cohort, with broader market participation reflecting improved earnings breadth. Historically, recoveries of this speed and scale have often marked durable turning points, but such momentum is more typically observed following deep market lows, not late-stage bull markets.

The late 1990s "reset" (mid 1998) may be a good case study from the limited sample of similar historical occurrences as, like now, the US index then was also dominated by a handful of winners. It took almost two years and a 50% gain for the S&P500 before the market peaked. The risk of a "last hurrah" and a bubble forming should not be ruled out now, particularly if the dominant secular winners of recent years are regarded as the safest place to hide. Much will depend on whether these winners are able to sustain superior or at least stable earnings growth. That was not the case in the late 1990s (although it took investors some time to realise this), but this time may be different given the potential transformative impact of AI. However, we also know that not all the technology facilitators of the dot.com era that went on to reap the benefits. In particular, the massive over investment in telecom infrastructure is a salutary lesson to be sceptical of the hype given their subsequent poor performance.

In terms of market sentiment and what this means for the short-term outlook, positioning data suggests that investors are still cautious but not nearly as bearish as they had been at the start of the quarter. As extreme bearishness is usually a contrarian signal, the current lack of oversold indicators amid heightened geopolitical uncertainty could well offset any supportive tailwinds from the macro data and robust earnings, should they continue. The rapid recovery from early April also means that valuations are stretched again, particularly for the US market. This is despite a broadening of earnings growth away from the Mag-7 stocks, which are increasingly being driven by stock specifics rather than the 'FOMO flows' which have dominated the past decade. Equity markets often climb a wall of worry, but this heuristic will be tested if earnings do not hold up.

We are also back to wartime levels of debt in most major western economies without the potential of a post-war payback. High levels of debt-to-GDP have historically weighed on growth due to crowding out and placed upward pressure on bond yields. It isn't that surprising that US bond yields have edged up despite the Fed being in a broader easing cycle as the term premium has become the main determinant of yields. In terms of what this means for equities, the earnings yield on the S&P500 is now below Treasury yields, meaning that there is no benefit of taking on the additional risk of owning equities unless you have confidence that earnings growth will follow.

One course of action would be to move outside of the US. Investors have not needed to be overly concerned about regional diversification for the past decade but what has also become clearer this year is that the current unpredictability of US policy making has dented the case that American exceptionalism will continue. The dominance of the US, and the Magnificent-7 in particular, has led to a wider variation in the valuation between winners and losers. It's not unusual for relative valuations to remain stretched for protracted periods, but the underperformance of US equities so far this year, mostly to the benefit of Europe, does demonstrate the benefit of seeking broader opportunities.

The catalyst for rotation appears to have been a newly galvanized EU in response to Trump's America first policy as well as greater confidence in China's growth prospects. US dollar weakness and the fading power of rate differentials has further fuelled the arguments for diversification. So far, investors have not been particularly active in moving their allocations away from the US but the case for regional diversification remains compelling.

Equally, there appears to be more interest in moving down the size spectrum. This is not surprising given that the market cap of the mega-cap stocks in the US are close to a half-century high whilst the rest of the S&P500 is almost back to the 50 year low touched in the late 1990s. Nevertheless, we still have reservations about the balance sheet strength of many small companies. Instead, more Mid and Large cap stocks appear to sit in the sweet spot of affordable quality. But despite the attractiveness of such diversification, against the backdrop of slowing growth, we would also not rule out the late 1990s scenario that markets return to the narrow and unhealthy leadership of Big Tech/AI with a buy on the dip mentality taking indices to new highs. Whether it can sustain these highs will again depend on the strength and concentration of earnings growth across the market.

A bout of stagflation, even if it is regarded as temporary, is usually regarded as the worse of all worlds for equities due to the combination of slower growth and a squeeze on margins at a time when policy makers are constrained in their ability to cut rates. However, Schroders analysis of equity market performance since 1926 suggest that this rule of thumb hides a great deal of nuance. It is true that stocks perform worse during inflation than at other times, but the difference is not statistically significant. Historically, equities have outperformed cash and kept pace with inflation during such periods. There can be lower conviction of strong returns but predicting doom is also not appropriate. Moreover, good performance in stagflationary periods is not dependent on the market having fallen beforehand. Nor are rate cuts a necessary ingredient, which should provide some comfort to equity investors today.

Performance during stagflation also varies a lot between sectors, and across historical episodes but defensive areas have typically performed better whilst more cyclical sector such as technology, consumer discretionary and financials have struggled. Resources have also performed well historically but this is because high commodity prices have often been a driver of inflation.

At the risk of being reductive, we would posit that the current market backdrop will lead to greater variation in performance at the company level. Balance sheet resilience and pricing power will be important. What we can say with some degree of certainty is that this all implies that volatility is likely to return with a good probability of sharp short-term corrections. This lends itself to an ongoing focus on Quality within our stock selection process, particularly on company financial strength, whilst avoiding overpaying. We are also well placed to benefit from elevated uncertainty due to our disciplined approach to rebalancing, which effectively enables us to harvest excess short-term volatility. Similarly, the breadth of our investment universe will be a tailwind in an environment where the dispersion of stock performance is greater.

In summary, while equity resilience has been notable, starting valuations may limit the room for further re-rating. Much of the good news appears to already be reflected in prices. Going forward, market returns are likely to be driven more by alpha than beta. With the Q2 earnings season approaching in mid-July, we will soon gain greater clarity on how companies are managing rising input costs, policy uncertainty, and divergent global demand. This environment favours a disciplined, valuation-aware approach with an emphasis on quality and diversification

Active Ownership

The QEP investment team works in close collaboration with Schroders' Sustainable Investment team to facilitate our engagement activity. Company engagements play an important role in our process, with the information gained helping us to understand the sustainability issues corporations face and the specific strategies in place to address them. It also allows us to promote change and make clear our transition expectations for the companies in which we invest. The central store of engagement information available to us, covering all Schroders firmwide engagements, also provides useful qualitative information on issues that may otherwise be difficult to capture from traditional ESG data sources. Schroders' engagement blueprint includes six priority engagement themes capturing issues relating to environmental (climate change, natural capital & biodiversity), social (human rights, human capital management, diversity & inclusion) and corporate governance.

A range of companies held across the QEP investment desk were engaged with on various environmental, social and governance topics over the course of the second quarter. Climate issues continue to be an important area of focus. We engaged with TSMC (Taiwan Semiconductor Manufacturing Co.) on their decarbonisation strategy and encouraged them to pursue a science-based targets approach. TSMC has ambitious targets as it aims to position itself as a sustainability leader in the semiconductor industry. These environmental targets include achieving 60% renewable energy usage by 2030 and 100% by 2040. TSMC also confirmed they are looking to hit peak emissions this year, which we will monitor and look to engage with the company on in the future. We encouraged TSMC to improve transparency in their ESG requirements regarding suppliers. The company communicated that they have started to promote water positive initiatives to improve conservation given the high volumes used in their operations. They have also started to include ESG metrics in their compensation structure.

We also engaged with Mercado Libre on climate related issues, specifically discussing the company's strategy to reduce carbon emissions and promote sustainability. The company confirmed their emphasis is on emission reduction, managing waste and transitioning to renewable energy sources. They are testing various initiatives such as the use of electric vehicles, biofuel trucks and bikes for transportation and aim to recapture close to 100% of any waste generated. The company is transitioning to renewables with a target to achieve 100% renewable energy usage by 2035. In addition, Mercado Libre is continuing to explore different avenues to sustainable logistics. The company is committed to incorporating sustainability considerations into its decision-making processes and we will continue to monitor their progress.

Our stewardship process extends to a proactive voting programme, a mechanism we leverage using the weight of Schroders' asset base and associated voting rights to drive our engagement priorities. We make considered use of our voting rights, acting in line with our fiduciary responsibilities in what we deem to be the best interests of our clients. As a firm, Schroders votes on all resolutions unless we are specifically restricted from doing so with all voting carried out by Schroders' corporate governance specialists. We voted at over 1,200 meetings on more than 18,000 resolutions for companies held across the QEP desk in the second quarter of 2025. Within these votes, around 14% were not with management. Votes against management were focussed on compensation plans, the election of directors or auditor related. For example, we voted against North American health care equipment provider Danaher's executive remuneration proposal given significant retention awards granted that are not subject to performance conditions. We also voted against Shopify's board proposal due to concerns around diversity on the board and its overall composition.

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