Schroders

Schroder Multi Asset Income Fund

Portfolio Review

The Schroder Multi-Asset Income Fund delivered a return of 0.9% (net of fees) for May and 8.2% (net) over the 12 months to May 2025, which is 4.0% over the RBA cash rate for the past year. Over the medium term, the Fund continues to deliver on its performance objective of 3% over the RBA cash rate, before fees. Over 3 and 5 years, the Fund has returned, net of fees, 6.8% p.a. and 5.2% p.a. which is 3.1% p.a. and 2.9% p.a. over the RBA cash rate, respectively.

Largest contributors

The largest contributor to performance was global equities which added 1.10%, commodities including gold equities added an additional 0.10%. Emerging market and Australian equities each added 0.10%

Largest detractors

The largest detractors were duration exposures, -0.20% (particularly US rates) and derivative hedges on US equities (-0.15%) and derivative hedges on high yield credit (-0.12%).

Market Review

Equity markets performed strongly in May, primarily driven by an easing of trade tensions between the US and China, with both countries significantly lowering their tariff rates for imports from each other, while a trade deal was also negotiated between the US and the UK. On the economic side, data remains resilient in the US, with solid jobs growth and Q2 GDP indicators suggesting a rebound from the negative Q1 GDP figure. Survey data in the US remains mixed, with the University of Michigan consumer sentiment and US CEO confidence both still at relatively low levels, while the Conference Board consumer confidence indicator has partially rebounded. In the second half of the month, the Moody's credit rating downgrade of US sovereign debt, sparked concerns about the sustainability of the US government's fiscal policy. Global trade uncertainty also fluctuated towards the latter stages of the month, with President Trump initially raising the tariff rate against the European Union to 50%, before delaying this increase until July 9. Locally, the Reserve Bank of Australia (RBA) cut its policy rate by 0.25% in May and implied a more dovish outlook, with financial markets currently pricing in 3 to 4 additional 0.25% rate cuts over the next year.

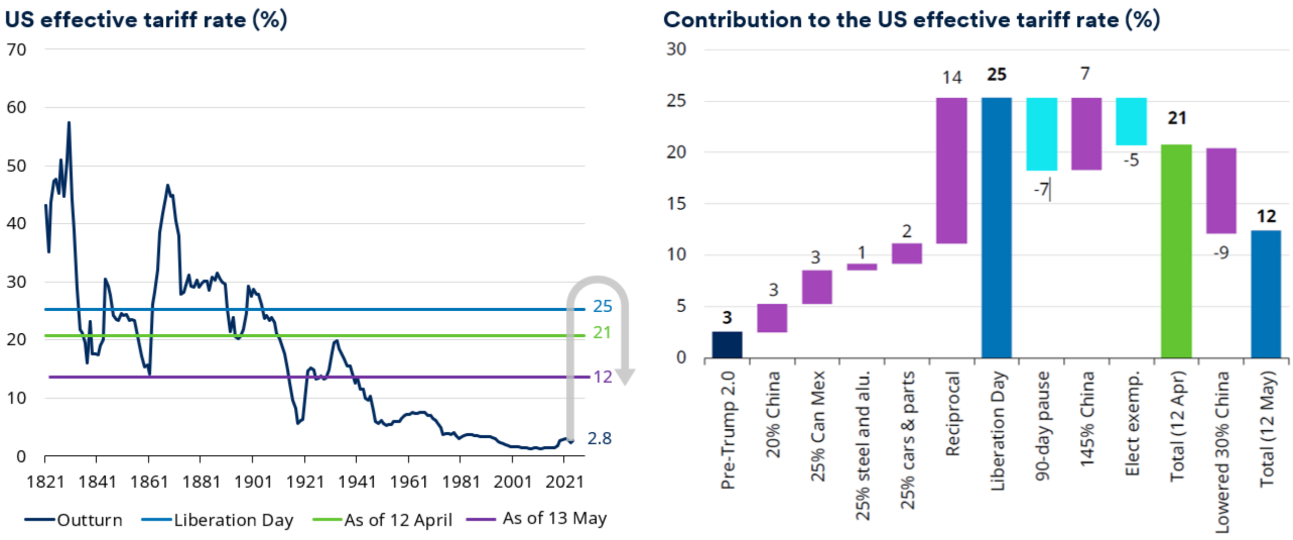
Global developed market equities delivered a strong return of 6.0% in local currency terms during May, while Australian Equities returned 4.2%. Emerging market equities also produced a solid return of 4.3% in US dollar terms during the month. At a sector level, the Tech sector was the standout performer both in Australia and globally. In fixed income, bond yields moved higher, particularly in the US with the 10-year bond yield increasing by 0.24% to finish at 4.4%, while in Australia the 10 year bond increased by 0.1% to finish at 4.26%. 10-year bond yields also moved higher in Germany and Japan by 0.06% and 0.18% respectively. Credit spreads tightened across sectors, most notably in US high yield where spreads moved almost 70 basis points tighter. Within currency, the US dollar index was broadly flat for the month, while a number of Asian currencies were the standout performers, most notably the Taiwanese dollar which appreciated by 7.0% in May relative to the US dollar. The Bloomberg commodity index fell by 0.6% in May, however oil rebounded from its lows, with the Brent oil benchmark rallying by 3.5%.

Market Outlook

Another month and another policy reversal. On April 2nd, Liberation Day, Trump unveiled sweeping tariffs across all trading partners, which resulted in a tit-for-tat tariff escalation between the US and China. The total effective tariff rate on US goods rose to a peak of 30%, which, if left for long, would have set the course for a US recession. In early May, the US and China lowered tariffs on each other from 145% and 125%, respectively, down to 30% and 10% for 90 days, causing the current effective tariff rate to settle somewhere around 12%, effectively removing the economic pain while the US negotiates with its trading partners. Thankfully, I don't even have to write about the brief escalation of EU tariffs to 50%, or the US trade court ruling that tariffs were unlawful, as these were both resolved within days. While we could easily see Trump ratchet tariffs higher again if he believes this will increase his negotiating power, we believe peak tariff fear is behind us and the market will instead turn its attention now to fiscal policy.

The rest of the year will likely entail more volatility as the market narrative oscillates between Trump's growth policies and his protectionist policies. Even if the market is starting to move on from tariffs, Liberation Day did more than liberate us from our money – it also dented the US economy. Uncertainty has caused consumption to slow and for businesses to pull back from hiring and capital expenditure plans. Corporates are unlikely to lift a finger until Trump shows his hand. Only once the trade war is over can they start to make long-term investment plans. This has caused our global economics team to downgrade their US growth forecast from an above-trend 2.5% to slightly below-trend 1.7% real GDP growth for 2025. This assumes the trade war ends with 10% universal tariffs globally and 30% on China, resulting in an effective tariff rate around 12%, which is where we've currently settled.

Chart 1: Easing of US-China trade tensions brings the US effective tariff rate to 12%



145% on China represents the additional 91% imposed since Liberation Day on 2 April.
Source: Schroders Economics Group. 12 May 2025

We are monitoring the job market and domestic consumption to see if the hit to growth was worse than expected. Recent weak first quarter GDP was muddied by large swings in net trade and inventories as companies tried to front-run tariffs, but underlying domestic demand so far seems weaker but not broken. Higher tariff rates will likely lift US inflation to above 3% both this year and next, which would hinder the US Federal Reserve (Fed) from cutting rates as aggressively as the market desires. The likely worsening of the fiscal deficit from Trump's 'Big Beautiful Bill' will also put upward pressure on long-end bond yields, which could ultimately hurt the economy and equity market. However, fiscal stimulus and deregulation should keep growth afloat in 2025, even though there will be bumps along the way.

Recession is no longer a given in the US but still remains a risk. If there is a larger slowdown below trend growth or recession, the US will be in a difficult spot. Tariffs lead to higher inflation, which would prevent the Fed from cutting rates to defend growth. The US fiscal position is already dire, which would only get worse if economic activity rolls over. This would limit the usual stimulus from monetary and fiscal policy. This is not true in other parts of the world, as any slowdown would be disinflationary as tariffs only effect the US market. Central banks globally have already started to cut rates and increase fiscal stimulus and have the capacity to do more if growth weakens further. Europe is also undergoing more economic intervention. After a decade of austerity, Germany has announced plans to spend an extra 3.5% of GDP on fiscal stimulus, focusing on defence spending, infrastructure and tax cuts. Combined with further progress on inflation, our economics team anticipates the European Central Bank (ECB) will reduce the deposit rate to 2%. This should see Eurozone growth increase from 1% this year to 2% by 2026.

In Australia, the Reserve Bank of Australia (RBA) is set to deliver a soft landing as inflation has continued to gradually moderate and the labour market remains resilient. Activity indicators point to the risk that growth may not be rebounding as quickly as expected. The RBA will need to return the cash rate to a neutral stance over the coming months. Australian growth is likely to return to trend at around 1.5% assuming the RBA cut rates to 3%. The most obvious risk to the downside remains the global backdrop and its uncertain transmission to the local economy, particularly any damage to China through the trade war. Despite the fiscal position of both the federal and state governments deteriorating, this will help support growth and we remain in good fiscal standing compared to other countries. If we did experience a more significant slowdown, the government could stimulate to support growth. A larger fallout could see the need for the RBA to take policy into stimulatory territory, taking the cash rate below 3% to defend growth. This means we view the likelihood of an Australian recession as low.

Portfolio changes

We increased our equity allocation from 16% at the end of April to 20% in May, predominantly through increasing US equities. US equity positioning is still very light, where systematic traders could reallocate given strong momentum and falling volatility. We retain overweight positions in Europe and emerging markets given the monetary and fiscal support available to these economies. We also added 0.5% to Latin American equities, through our internal active strategy, as we believe that region remains exceptionally cheap. Countries like Brazil currently have very high real rates but appear to be approaching the end of their rate hiking cycle, as inflation is coming under control. We have similarly increased our allocation to emerging market local currency debt by 1% to 5%. A weaker US dollar provides an extra tailwind for the region.

Our credit exposure increased by almost 12% over the month. While spreads have tightened from their April wides, there were still opportunities to take advantage of spreads in early May. We added 3% to Australian investment grade credit and 1.5% in European investment grade credit. We also added an additional 6% to Australian residential mortgage-backed securities which will likely be supported by further official rate cuts by the RBA. We also reduced the global high yield hedge by 2%. While we are not out of the woods, the reduction of recession risk and potential for volatility in equities over the next few months as policy oscillates makes earning income from credit attractive. The addition to equities and credit saw our cash allocation drop from over 28% down to 12% by the end of May.

In currencies, we maintained the total foreign currency position at 11%, but made a number of changes in the mix of foreign currencies, we continue to reduce USD exposure and after a strong rally, we moved short British pounds (GBP) by selling 2.0% in favour of the Euros (+3.5%) and Japanese yen (+3%). We added a further 1% to emerging market debt which increased exposure to EM currencies to 5%. In addition, we added 1% to gold to take the total commodity position to 4%.

We reduced our fund duration from 1.75 years down to 1.5 years. We took profit on the front end of curves, particularly in Australia and Europe, which outperformed US treasuries. We also rotated some exposure from the front end of UK and Germany back to US 10 years after the US underperformed. We now hold most exposure in Australia and then US rates focused on shorter dated maturities out to 5 years, with small remaining exposure across amongst Germany, the UK and emerging markets.