Schroders

Schroder ISF* EURO Equity

Fund Manager: Martin Skanberg | Fund update: Q1 2024

Performance overview

– Eurozone equities gained sharply in Q1. The fund also advanced but lagged the MSCI EMU's strong gain.

Drivers of fund performance

– Stock selection in the consumer discretionary sector weighed on relative returns. Selection in the industrials sector added value.

– Chipmaker **Infineon Technologies** was the main individual detractor from relative returns. The shares have been affected by weak demand for power semiconductors from the industrials sector, notably for energy transition applications. In addition, there are fears around growing competition from Chinese companies making power semiconductors for electric vehicles.

– Payments group **Worldline** also weighed on relative performance. Weak discretionary spending in Europe is a headwind, given that it receives higher fees for discretionary transactions than for staples.

– Within healthcare, **Philips** was a detractor amid some profit taking after a strong 2023. The shares were also under pressure after news of a consent decree with the US Food & Drug Administration regarding certain sleep apnoea products. Philips will halt the sale of these products in the US although it can still service existing products and supply replacement parts.

– In consumer discretionary, boiler and heat pump manufacturer **Ariston Holding** weighed on relative returns. Demand for heat pumps has fallen sharply in some countries after the removal of incentives to have them fitted. Ariston does also supply conventional gas boilers.

– On the positive side, our positions in defence groups **Saab** and **Hensoldt** supported relative returns. Hensoldt is a new position in the portfolio in the quarter. Its specialism is electronics and sensors used in radar, surveillance, battlefield communications, etc. Both stocks are benefiting from European governments increasing their spending on defence as a percentage of GDP due to the war in Ukraine. The European Union is also putting together more support for governments and industry, for example in terms of planning capacity. Europe has to make up for 30 years of underinvestment in its defence capabilities. **Airbus** is another beneficiary of this increased spending, with c.20% of its business in defence. Its civilian aircraft business is performing well too, particularly in comparison with the manufacturing difficulties being experienced by Boeing.

– In the healthcare sector, biotech group **Zealand Pharma** added value. It has three obesity programmes that are drawing investors' attention. Zealand is also in partnership with Boehringer Ingelheim for a weight loss drug that has shown effectiveness in treating MASH, a serious liver condition. Successful results from Phase II clinical trials were released in February.

– Semiconductor equipment maker **ASML Holding** added value. The surge in AI is leading to increased demand for high-end memory chips and the tools to make them. There is good visibility for ASML looking ahead to 2025-26.

Portfolio activity

– A new position is **Renishaw**. It is a technology leader in precision measuring, metrology and additive manufacturing. The company is exceptionally well placed to benefit from the expected demand recovery in semiconductors, electronics and machine tooling capex. With the founders having previously put the business up for sale, the company is now improving its investor engagements which should better reflect its strategic appeal.

– Another new holding is **Pluxee** which was spun out of **Sodexo** during February. Pluxee is an employee benefits and vouchers business. The strength of its business model should become visible now it is a standalone entity.

– We initiated a new position in Danish freight forwarder **DSV**. It has formed a joint venture with Saudi Arabia's PIF to provide logistics services to the Neom project, which implies a bigger capital commitment than is typical for the firm. However, Neom is a vast project and should prove accretive to earnings. Disruption to shipping in the Red Sea is also likely to put upward pressure on freight rates and demand for freight forwarding. A further catalyst could be the acquisition of DB Schenker which is up for sale and could bring synergies and EPS accretion.

*Schroder International Selection Fund is referred to as Schroder ISF throughout

– Another new holding in **Henkel**. Its business is split between adhesives (60%) and cosmetics/household care (40%). We have trimmed our holding in **Beiersdorf** in order to move proceeds into Henkel which we feel has an opportunity to improve the performance of its skincare category as it prunes some lower margin products from its range. A turn in the manufacturing sector would also benefit the adhesives business.
– We exited insurer **Ageas** and French bank **SocGen**.

Outlook/positioning

– Eurozone shares have had a strong start to 2024. March brought signs that investors are now seeking out lowly valued and unloved areas of the market, rather than sticking with recent winners. If this trend persists, then it should prove positive for Europe relative to the US, value rather than growth, and for smaller companies relative to larger ones. Indeed, flows into European equities are showing signs of improvement. The path of interest rate cuts is increasingly well understood and it appears investors are keen to take on more risk.
– Leading indicators are improving more quickly in the US than in Europe. However, there are some signs of the upturn coming through in Europe too, for example in the latest German industrial production data. Early cycle stocks in sectors such as industrials, materials and IT will be the first beneficiaries of improved economic momentum.
– Our Blend strategy draws the best ideas from both value and growth parts of the market. We continue to maintain our diversified approach, with limited tilts to any particular investment style.

Calendar year performance (%)

	Fund	Target	Comparator
2023	6.3	18.8	17.0
2022	-14.3	-12.5	-13.4
2021	22.3	22.2	22.0
2020	-0.7	-1.0	-1.7
2019	24.7	25.5	23.8
2018	-17.0	-12.7	-13.9
2017	16.2	12.5	11.8
2016	2.3	4.4	3.3
2015	14.7	9.8	11.4
2014	7.2	4.3	3.1

Source: Schroders, as at 31 December 2023. Fund performance is net of fees, NAV to NAV with net income reinvested, EUR C Acc. Please see factsheet for other share classes.

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The fund's performance should be assessed against its target benchmark being to exceed the MSCI European Monetary Union (Net TR) index and compared against the Morningstar Eurozone Large Cap Equity Category. The fund's investment universe is expected to overlap materially with the components of the target benchmark. The comparator benchmark is only included for performance comparison purposes and does not have any bearing on how the investment manager invests the fund's assets.

Risk considerations

Counterparty risk: The fund may have contractual agreements with counterparties. If a counterparty is unable to fulfil their obligations, the sum that they owe to the fund may be lost in part or in whole.
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Currency risk / hedged share classes: The hedging of the share class may not be fully effective and residual currency exposure may remain. The cost associated with hedging may impact performance and potential gains may be more limited than for unhedged share classes.
Derivatives risk: Derivatives may be used to manage the portfolio efficiently. A derivative may not perform as expected, may create losses greater than the cost of the derivative and may result in losses to the fund.
Higher volatility risk: The price of this fund may be volatile as it may take higher risks in search of higher rewards.
IBOR Risk: The transition of the financial markets away from the use of interbank offered rates (IBORs) to alternative reference rates may impact the valuation of certain holdings and disrupt liquidity in certain instruments. This may impact the investment performance of the fund.
Liquidity risk: In difficult market conditions, the fund may not be able to sell a security for full value or at all. This could affect performance and could cause the fund to defer or suspend redemptions of its shares.
Market Risk: The value of investments can go up and down and an investor may not get back the amount initially invested.
Operational risk: Failures at service providers could lead to disruptions of fund operations or losses.
Performance risk: Investment objectives express an intended result but there is no guarantee that such a result will be achieved. Depending on market conditions and the macro economic environment, investment objectives may become more difficult to achieve.
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