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Schroder ISF* EURO Equity

Fund Manager: Martin Skanberg | Fund update: Q4 2024

Performance overview

– Eurozone equities fell in Q4. The fund outperformed the MSCI EMU index with a positive absolute return.

Drivers of fund performance

– Stock selection in the consumer discretionary and industrials sectors supported relative returns. Positioning in healthcare was a small detractor.

– Several of our consumer discretionary holdings were supported by an easing cost of living crisis in several European countries. Inflationary pressure is abating and wages rising. Hotelier **Accor** was among the beneficiaries, as was online retail platform **Zalando**.

– Also within consumer discretionary, holding company **D'Ieteren** added value. Its underlying businesses are car parts providers, including Autoglass. We initiated a position in September after a fall in the share price. This came amid a deal between the controlling families to transfer the business to just one family. This deal involved paying a significant special dividend but taking on large amounts of debt at the operating company level. That higher debt burden was concerning to some shareholders but the dividend was paid in Q4 and the shares have since recovered.

– Lack of exposure to LVMH was advantageous as with the luxury goods sector under pressure amid reduced consumer demand following a period of price hikes.

– Within industrials, several of our holdings were positive contributors to performance. These included defence stock **Hensoldt**. Donald Trump has said NATO members should spend 3% or more of GDP on defence. During December, Hensoldt held a capital markets day where it upgraded its profit targets. There is high demand for its surveillance equipment.

– Also within industrials, **Siemens Energy** added value amid ongoing strong demand for its grid infrastructure and gas turbines. The growth of artificial intelligence and data centres is one driver of the grid demand, while gas is perceived as a flexible and economical power source. Siemens Energy's latest results showed robust order intake for both divisions. Its valuation still lags that of US peers.

– Aircraft maker **Airbus** was another positive contributor. Shares had come under pressure in the summer after it was forced to cut delivery guidance due to lack of availability of engines and landing gear. However, deliveries are now picking up and the orderbook remains very robust.

– Healthcare equipment group **Philips** was the main individual detractor. In October, Philips warned that demand in China has deteriorated and cut its sales guidance as a result.

– Brakes and breaking specialist **Knorr-Bremse** was another detractor. The company is continuing to optimise its portfolio via the sale of lower margin products. Demand from rail remains high but the trucks sector remains in slowdown.

– In the materials sector, pulp and paper firm **Billerud** was a detractor. Its Q3 results were good but it flagged a return of pricing pressures in Q4. The stimulus measures announced by the Chinese authorities in October are not enough to spark a restocking cycle in the materials sector.

– Spirits producer **Pernod Ricard** was another detractor amid reduced demand from China, destocking in the US, and the threat of tariffs.

Portfolio activity

– We have added to our healthcare exposure via a new position in dialysis specialist **Fresenius Medical Care**. Reimbursement rates are rising and there are signs that treatment growth is turning positive once more. Fresenius Medical Care is poised to roll out HV HDF dialysis machines in the US. These are already used in Europe and have superior filters which lead to distinct clinical benefits. The sale of the machines and associated products should be another driver for the shares.

– Another new position is **Novonesis**, formed via the merger of Novozymes with Christian Hansen. The merged company is an innovation leader specialising in enzymes and microbials for use across multiple industries while enabling energy and water efficiency.

– The portfolio has been underweight the luxury goods sector but as valuations in the sector have declined, we have taken the opportunity to initiate a position in **Moncler**. It is affected by soft Chinese demand but as a newer brand and leader in outerwear we feel it has scope for growth. There is also merger & acquisition optionality.

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- Another new position is **INWIT**, the Italian telecom infrastructure business. Again, we see it as a potential candidate for M&A. It has lower debt levels than peers but should still benefit from lower interest rates. It also has predictable cash flows.
- We bought a position in **Stora Enso**, a pulp and paper producer. It is taking steps to cut costs to improve operational performance. However, the key attraction is its forestry assets. These are in short supply given the lack of availability of Russian pulpwood. Stora plans to sell 12% of its forestry assets but there is potential for a more transformational deal to take place.
- We sold out of the last remining small positions in **Aperam**, **Fortum**, **Swiss Re** and **Neste Corporation**.

Outlook/positioning

- Investors await Donald Trump's inauguration as US president to find out more details of his policy agenda, including trade tariffs which may have a substantial impact on certain sectors in Europe. We are also awaiting political developments in France and Germany. The situation in France looks quite difficult given political fragmentation and little agreement on how to proceed. There could be some severe weakness in the domestic services sector in the coming year.
- The situation in Germany, however, looks more encouraging. Germany clearly faces multiple challenges to its industrial model but there does appear to be recognition that change is necessary. Friedrich Merz's CDU (Christian Democrat Union) is likely to emerge as the largest party and his proposed tax cuts could be beneficial for growth. A key issue remains the potential reform of Germany's debt brake, which could enable greater borrowing to allow for more aid to Ukraine as well as more spending on defence and infrastructure.
- European shares remain attractively valued when compared to the US and there are deep value opportunities in certain sectors, as well as pockets of growth. Meanwhile, sectors such as banks and insurers offer attractive income.
- 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.

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amount originally invested.

Calendar year performance (%)

	Fund	Target	Comparator
2024	13.2	9.5	7.2
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

Source: Schroders, as at 31 December 2024. Fund performance is net of fees, NAV to NAV with net income reinvested, EUR C Acc. Please see factsheet for other share classes.

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.
Sustainability risk: The fund has environmental and/or social characteristics. This means it may have limited exposure to some companies, industries or sectors and may forego certain investment opportunities, or dispose of certain holdings, that do not align with its sustainability criteria. Therefore, the fund may underperform other funds that do not apply similar criteria. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.

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