

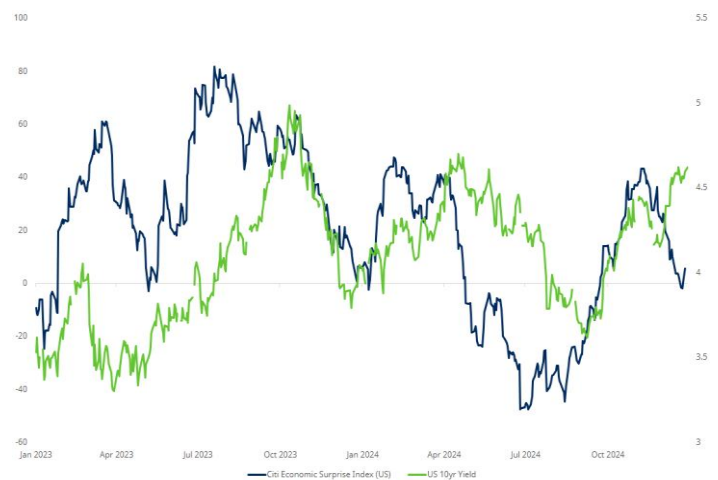
Schroder ISF* European Alpha Absolute Return

Fund Managers: Nick Kissack and Bill Casey | Fund update: December 2024

Performance overview

- Equity markets fell in December and there was no 'Santa Rally'. On the contrary, we had a Santa sell-off. The main reason we can see for this was December's Federal Open Market Committee meeting, with Chair Jerome Powell taking an increasingly hawkish tone in response to recent US labour market and inflation data. Global bond yields (ex-China) rose sharply, cutting off all hopes of a rally. In our view, there is a clear contradiction between softening US leading economic indicators and rising long-term bond yields (see Chart 1: 'An Odd Divergence'); one of these will be wrong.
- US technology stocks continue to lead global equities, sucking in capital from global markets and keeping the dollar strong. This trend is negatively impacting European equity markets in our view. The threat of tariffs from incoming President Donald Trump has also been weighing on global ex-US stock markets. For this vicious cycle (US market exceptionalism) to break, we need to see that Trump's bark is worse than his bite on trade, immigration and China. An end to the Russia/Ukraine war would also help in this regard.
- Global liquidity growth weakened through the fourth quarter as the US Federal Reserve (Fed) continued its quantitative tightening programme, China tries to support the yuan and the dollar remains strong. Real yields across Western markets remain elevated. The incoming US Treasury secretary will be hugely important in 2025 for the global liquidity picture.
- Investor positioning in European markets is far lighter than in the US, which is heavily overweighted. We are watching for signs of improving macroeconomic indicators and liquidity to become more constructive.

Chart 1: An Odd Divergence



Source: Schroders, Bloomberg as at 31 December 2024

Drivers of fund performance

- In October, the fund's gross return was -0.4%, compared to -0.5% for the MSCI Europe (Net TR) index, and 0.3% for the Euro Short Term Rate. Our average gross and net exposures were 205% and -9.7%. Our long book subtracted 2.1% and our short book added 1.7% in gross terms during the month. Cash and forex were flat.
- The fund has a modest short-market position with regards to our net exposure, as we still see full market positioning data across a range of metrics. With deteriorating earnings revisions in Europe and weak leading indicators, we refrain from taking on long beta/market exposure.
- We exited the month with a net exposure of -10.2% (-1.2% beta adjusted) and a gross of 202%. The fund's volatility is at the lower end of our 5-8% target range, the majority of which is equity-specific risk.

Past performance does not predict future returns. 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 (%) (needs 2024)

Year	Fund	Comparator 1	Comparator 2
2024	7.3	8.6	3.8
2023	-6.3	15.8	3.3
2022	-1.3	-9.5	-0.0
2021	-4.0	25.1	-0.6
2020	6.0	-3.3	-0.4
2019	-7.1	26.0	-0.3%
2018	-6.6	-10.6	-0.4%
2017	1.3	10.2	-0.3%
2016	0.0	2.6	-0.3
2015	8.4	8.2	0.0

Source: Schroders, net of fees, bid-bid, with net income reinvested. EUR C Acc share class as of 31 December 2024. The fund's performance should be assessed against its objective of providing a positive return over a 12-month period in all market conditions and compared against the MSCI Europe (Net TR) index and the Euro Short Term Rate (or an alternative reference rate). The comparator benchmarks are only included for performance comparison purposes and do not determine how the investment manager invests the fund's assets. In relation to the MSCI Europe (Net TR) index, the fund's investment universe is expected to overlap materially, directly, or indirectly, with the components of the comparator benchmark. The investment manager invests on a discretionary basis and there are no restrictions on the extent to which the fund's portfolio and performance may deviate from the MSCI Europe (Net TR) index. The benchmark(s) does/do not take into account the environmental and social characteristics or sustainable objective (as relevant) of the fund. Please see appendix III of the fund's prospectus for further details.

Top stock contributors:

- **A short position in a US-based construction products supplier** was the top contributor in the month, following weak earnings results and guidance. The construction industry in the US is experiencing a downturn, which is affecting pricing for construction goods. The business took advantage of tight supply chains and strong demand coming out of the Covid pandemic to raise prices more than input costs. We are now seeing falling margin expectations for the company, which are driving the stock price lower.
- **Renishaw, the UK-based precision measurement and calibration equipment manufacturer**, was a strong performer as

green shoots have begun to emerge at its end-markets where there has been a prolonged

downturn (e.g. consumer electronics and semiconductors). The death of the company's founder and long-term chairman has also sparked some speculation that the sales process for the business could be restarted.

- **Zalando** contributed positively after announcing the acquisition of smaller European peer About You. This consolidates Zalando's position in European online apparel and should drive synergies across both its B2B (business to business) and B2C (business to consumer) segments.
- **A short position in a Swiss-based construction materials supplier** positively contributed as its core construction end-markets remain weak, while key exposure to autos and China are a headwind for the company at the start of 2025.

Top stock detractors:

- **Entain**, the global gaming/gambling group gave back some of its gains made in November, when it released a good set of third-quarter earnings results. In December, Australia's anti-money laundering regulator opened civil penalty proceedings against its Australian subsidiary. In December 2022, Entain started a program to enhance anti-money laundering systems and processes, which is due to be completed in June. Previous precedent for the sector suggests any fines should be manageable for the company.
- **Anglo American** reversed some of its prior month's gains when it announced the sale of its coal assets to Peabody at a good price. Sentiment around a weak Chinese economy weighted on both iron ore and copper prices in December. We continue to believe there is significant value in the business as management works through its disposal programme.
- **Unite Group** shares fell, largely due to sharply rising bond yields in the UK. This hurt what is effectively a real estate business. A recent capital markets day in November confirmed the group's strong growth targets for this and next year.
- **Just Eat Takeaway.com** gave up some of its strong gains from November when it announced the sale of its US subsidiary,

Grubhub. Higher bond yields and energy prices in Europe were the likely cause of the falling share price, as both can impact consumer sentiment. The company has been trying to sell its US unit for several years, which has been a drag on growth and cashflow. The resulting business will likely exhibit improved growth and cash conversion, allowing for more optionality in the future.

Outlook/Positioning

- Equity markets enter 2025 awash with uncertainty. The advent of a second Trump term brings with it many binary paths as to relations with the rest of the world, especially China. Additionally, we are faced with waning liquidity after several years of monetary and fiscal excess. How central banks and governments decide to proceed from here, and the reaction from bond markets, matter hugely. Will the Fed be forced to stop its

quantitative tightening? Will China significantly increase fiscal spending? Can Europe dig itself out of its growth malaise? Central to much of this are trends in inflation.

- Issues that worry us in the current nascent year include: the corporate debt refinancing wall (2025/26), and whether there is sufficient liquidity growth to match it; US/China trade relations and tariffs; and the risk of a resurgence of inflation. We will be focusing on stock/thematic picking and aim to manage portfolio risk in the face of the macroeconomic outcomes mentioned above. To become more constructive on markets and risk, we will need to see both improved liquidity and lower real yields.

Risk considerations

Concentration risk: The fund may be concentrated in a limited number of geographical regions, industry sectors, markets and/or individual positions. This may result in large changes in the value of the fund, both up or down.

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.

Currency risk: The fund may lose value as a result of movements in foreign exchange rates.

Currency risk / hedged shareclass: 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. The fund may also materially invest in derivatives including using short selling and leverage techniques with the aim of making a return. 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.

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

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Issuer risk: The fund is permitted to invest more than 35% of its scheme property in transferable securities and money market instruments issued or guaranteed by an EEA State / governments of the following country: France.

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.

No capital guarantee risk: Positive returns are not guaranteed, and no form of capital protection applies.

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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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