

Schroder ISF¹ Emerging Markets Debt Total Return

SFDR
Article 8

Quarterly fund update

Second quarter 2024



Review:

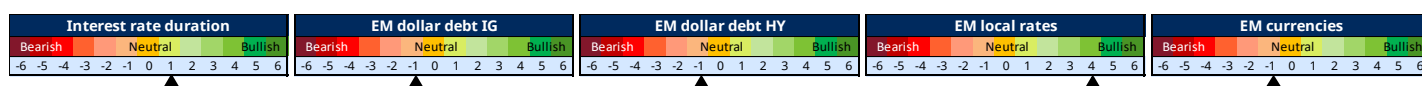
- **EM bonds and currencies traded with a soft tone.** Higher US treasury bond yields, a firm US dollar, election related uncertainties in key EM countries and renewed fiscal policy concerns in Brazil were major headwinds for EM assets. EM dollar debt showed some resilience by achieving a modest quarterly gain of +0.3%, based on the EMBI GD index. In contrast, EM local currency debt, as measured by the GBI EM GD, ended the quarter with a negative performance of -1.63%. This underperformance of local currency debt was mostly due to the sell-off in the Mexican peso in the aftermath of the June general election and the pressures on Brazilian local bonds and currency as investors' concerns about President Lula's fiscal policy intentions re-escalated.
- **Portfolio activity in Q2 was broadly defensive,** as overall portfolio cash balance increased from 10.6% to 22.3% of NAV during the quarter. This defensive stance was due to: **(i)** our decision to take profits on some of the sovereign dollar debt issuers that have reached less appealing valuation levels after a period of outperformance. This led to a drop in the portfolio's EM dollar debt exposure from 29.7% to 17.9% of NAV; and **(ii)** market pressures leading us to activate our tactical risk control measures. In this regard, currency hedging was increased, which led to the overall FX exposure dropping from 54% to 37% of NAV. We stand ready to reinvest cash and reduce currency hedging in the next quarter given our long-term constructive view on various EM local rates markets (see outlook section below). A more detailed presentation of the portfolio's current exposures is presented in page 6 of this report.
- **Fund performance was negatively impacted by the sell-off in EM local currency debt.** The fund had a quarterly negative return of -1.08% in gross US dollar terms with the key contributors to this outcome being: (i) US dollar debt had +16bps of positive impact; and (ii) local currency debt contributed -124bps, of which -33bps was due to modestly higher local rates, +77bps was generated by income, and -168bps was from currency depreciation. The main negative contributors by country were as follows: Mexico (-100bps) and Brazil (-65bps). In contrast, South Africa (+50bps) was the main positive contributor as the country's assets rebounded strongly following the general election and the formation of a coalition government that does not include some of the most ex radical members of the ANC.

¹Schroder International Selection Fund is referred to as Schroder ISF throughout this document.

Investment outlook

Global economic environment

- **The global growth cycle remains broadly in the recovery phase** despite some weaker data prints recently. While public sector balance sheets are a major source of concern, there is no evidence of excessive imbalances in the private sector. EM economies and asset prices have already adjusted to a widely publicised China's disappointing growth trajectory. Moreover, the upturn in the global trade cycle is still firmly in place, which is particularly supportive for several emerging economies.
- **The recent global disinflation process is entering a more difficult phase.** The drops of energy and agricultural commodity prices from their 2022 peaks have already been fully reflected in global consumer price indices. Sticky services inflation, reaccelerating global freight costs, the possibility of energy price resurgence and unsustainably lax fiscal policies in developed economies still require a cautious interest rate duration stance. We take comfort from the fact that several EM countries still adhere to some policy orthodoxy and maintain a level of real rates that are so elevated that some negative inflation or fiscal outcomes should be absorbed reasonably well by EM debt.
- **Despite severe tightening in global monetary policies, the financial liquidity environment remains benign.** The accumulated stock of global liquidity remains significantly above trend and should continue to provide some cushion for the global economy. While our measures of official liquidity provisions are deteriorating somewhat, global private credit impulse indicators are recovering from depressed levels. The rebound in EM FX reserves growth is also continuing.
- **We remain neutral on the commodities complex.** We expect oil price to increase moderately towards the low 90s on account of resilient global demand, disappointing supply growth from the US and Brazil and continued OPEC supply discipline. In contrast, agricultural prices should remain in their recent depressed ranges, in the absence of weather events.
- **The recent increases in geopolitical risks have already been reflected to some extent in EM asset prices.** An extremely busy election cycle in EM has recently been completed after flare-ups in volatility (in Mexico, India, South Africa and Indonesia). This leaves us with the upcoming US presidential election as the next major political risk event. This US election has the potential to further depress sentiment towards EM. However, we are encouraged by the much improved EM balance of payments that are expected to provide some ammunition to weather this possible storm.
- **A significant disparity in EM debt valuations has appeared.** EM local debt has cheapened substantially this year as the recent backup in yields occurred while disinflation continued. This is particularly the case for the highest real yielding 10-year governments of Brazil, Colombia, Mexico, Peru, India, Indonesia, South Africa and Hungary. In contrast, our measures of EM dollar investment grade valuations are in extremely overvalued territory with the current EMBI GD IG index spread of 120bps being close to historical lows. Value in EM dollar high yield has also deteriorated to more neutral levels but there are still very attractive pockets of value in sovereigns such as Egypt, South Africa, Argentina and Panama.
- **US dollar strength appears to be regaining momentum.** A cautious and selective stance towards EM currencies is warranted. The greenback remains extremely overvalued and susceptible to the unsustainably high US twin deficits. However, a potential start of the Fed easing cycle remains one of the required catalysts for a cyclical US dollar downturn.
- **All these sectorial views are summarised in the scorecard below:**



Scores are attributed based on a combination of macro-economic fundamental, valuation, technical and sentiment factors. These scores serve as a guide for our overall EMD portfolios' positioning.

Asia

- **China's domestic demand remains weak** as various policy initiatives have not been bold enough to boost the economy. Housing, retail sales, credit and money growth continue to weaken. Robust manufacturing and exports support the current muddle-through. However, in the absence of decisive pro-growth actions in the next quarter, an unequivocally bearish view will be warranted, especially if exports and manufacturing start to slow and the US political environment turns more hostile.
- **Our long-standing bullish view on Indonesian and Indian local government bonds is maintained.** The recent backup in 10-year Indonesian bond yield to 7.1% offers a good re-entry opportunity as inflation remains well-behaved and policy continuity will be assured following recent elections. The same assessment is also valid for India, where 10-year bonds also offer a yield of 7% at a time when credit growth is peaking and GBI EM index inclusion is boosting foreign portfolio demand.
- **We still view other key Asian fixed income markets as unappealing.** Despite some attractive real effective exchange rate valuations (notably in Malaysia and Thailand), there is no visible positive catalyst for a convincing currency rally.

Eastern Europe, Middle East and Africa

- **Inflation, growth and trade accounts have now normalised in Central Europe (CE4) after the Covid and Ukraine invasion shocks.** Hungarian bonds are the most attractive in CE4 given high nominal and real yields still on offer, the hawkish stance of the central bank that should improve its inflation fighting credentials and provide support for the Forint.
- **We have turned bullish on South Africa** now that the general election has passed and the first coalition government in the country's post-apartheid history is formed. Local 10-year yield (11.2%) and sovereign dollar spreads (300bps) offer value as external financing needs are low and disinflation is likely to resume.

- **The return to monetary orthodoxy in Turkey is starting to produce positive outcomes.** An encouraging turnaround in the Balance of payments and inflation dynamics has been initiated. We will keep increasing our exposures to the Lira, local and hard currency debt markets as these improvements gain more traction.
- **Despite their strong rebounds from 2022-23 lows, Egypt, Nigeria, Senegal, Ivory Coast and Oman remain the most attractive opportunities EMEA sovereign dollar debt.** In Egypt, diversifying into local currency debt markets is now warranted following recent maxi devaluations, sharp rate hikes and stronger external positions.

Latin America

- **With 9.9% yield, ten-year local bonds in Mexico remain our favourite pick in the region** given historically high real yields relative to US Treasury bonds, strong government balance sheet and stable external accounts. However, the recent correction of the peso may continue until the new administration reassures markets on its policy intentions, REER overvaluation is corrected and heavy investors' positioning has unwound.
- **Despite attractive bond yields in Brazil (11.9%) and in Colombia (10.8%), a neutral stance is warranted.** Our long-standing bullish stance will be reinstated when we see reassuring fiscal policy signals from both countries.
- **We remain bullish on the Chilean Peso** given its cheap valuations, growth picking up and current accounts improving. Despite good fundamentals, we are neutral for now on Peruvian assets given deteriorating political and fiscal dynamics.
- **In sovereign dollar debt, we remain fundamentally positive on Ecuador, Dominican Republic, Costa Rica and Paraguay.** In Argentina, we are scaling back our exposures after recent outperformance as President Milei's good progress on his economic shock therapy has already been reflected in sovereign dollar bond prices.

EM corporates

- **Given already tight CEMBI spreads, carry and idiosyncratic stories can still provide solid returns** on credits with low leverage. EM corporates have fully regained bond market access, leading to low refinancing risks and default rates that are back to historical norms for High Yield names. Fundamentals remain supported by firm commodity prices and a continued cyclical upturn in countries benefiting from easing financial conditions and rebounding global manufacturing.
- **We are bullish Peruvian corporates via subordinated financials** as growth recovers, rates normalise and social unrest abates. We are neutral on higher-beta markets like Brazil, Colombia and Mexico, where we favour commodity/export-oriented names over those sensitive to domestic growth or capital markets given current fiscal and political uncertainties.
- **We remain bullish Turkish corporates and financials** as the government still appears to be committed to policy orthodoxy with less interventionism in the banking sector, continued disinflation efforts and recovering FX reserves.
- **We reinstated our bullish stance on Indian corporates** as bond supply risks have not materialised and the election is now in the rear-view mirror. In Indonesia and China, limited supply is supportive but the lack of value warrants a neutral stance.

Quantitative analysis

- **The average EM country risk score remains in positive territory despite some erosion.** Key positive contributors are: improving "Growth Dynamics", lower levels of "Hot Money" and higher FX reserves positively impacting "Sovereign External Liquidity Measures". Latin American countries are still progressing in their macro-economic adjustments (despite some fiscal worries) and Central Europe is catching up in returning to balance of payments sustainability.
- **The valuation model identifies EM IG spread as extremely overvalued at 120bps and the high yield sub-sector as fairly valued at 700bps.** In contrast, **GBI-EM local rates valuations improved markedly** as falls in inflation and the recent backup in yields have taken real yields to historically high levels. Ex-ante real rates are particularly attractive in South Africa, Hungary, Mexico, Brazil, Colombia, Peru and Egypt. **EM FX valuations are broadly less appealing** with MXN remaining overvalued despite the recent sharp depreciation post elections.

Chart and Sentiment analysis

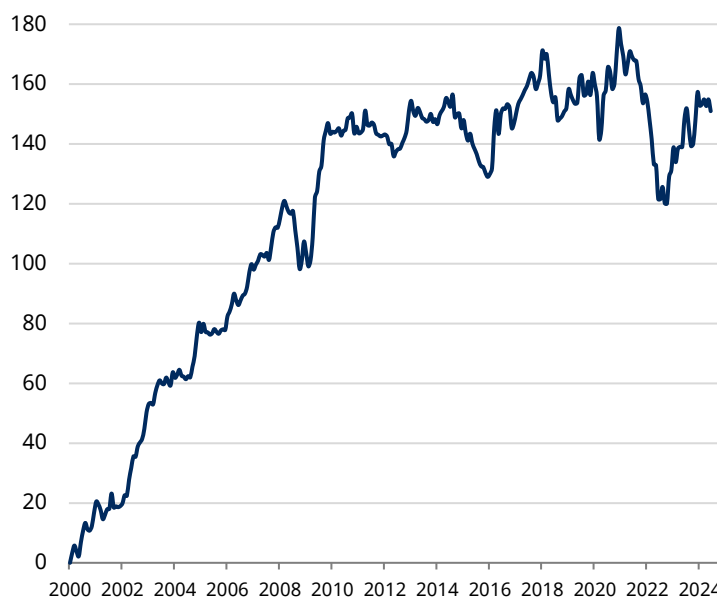
- **Our long-standing yield target of 5% for the US 30-year was reached last year.** However, after a brief attempt to initiate a new bull trend, our Technical Model has turned less constructive with a new upside target of 5.3% activated.
- **The outlooks for EM local yields and EM IG spreads are neutral** as these appear to be stuck in a range. While inflows into EM dollar debt appear to be recovering somewhat, **the chart outlook for EM high yield has deteriorated** as spreads have reached overbought levels and the tightening trend of recent months is losing momentum. **Technicals for EM currencies are neutral** as a washout in heavy EM FX market positioning has occurred but the long-term dollar uptrend is still in place.

Fund performance as at 28 June 2024 (%):

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 amounts originally invested. Exchange rate changes may cause the value of investments to fall as well as rise.

USD A accumulation shares net

Since Jan 2000 ¹	Fund	GBI-EM GD ²	EMBI GD
Annual rate of return	3.84	5.85	7.12
Volatility	6.23	11.35	8.93
Sharpe ratio	0.36	0.41	0.64
Sortino ratio	0.60	0.59	0.68
Correlation	1	0.78	0.68
Positive quarters	60.82	62.89	70.10
Maximum drawdown	-21.02	-29.32	-25.85
Best month	6.34	9.84	7.59
Worst month	-5.54	-14.07	-16.03
Max 12m rolling return	27.66	38.87	41.56
Min 12m rolling return	-17.72	-21.54	-24.28



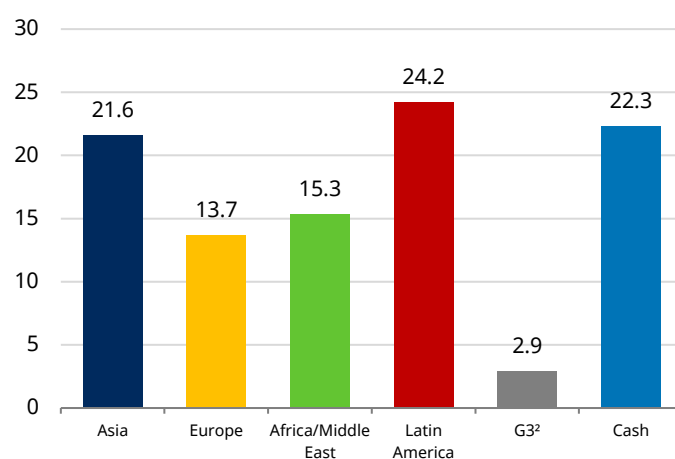
Source: Schroders. ¹Inception 31 January 2000. ²JPM EMBI Global Diversified used as a proxy before 31/12/02 at which point GBI-EM Global Diversified launched. **Please note the fund is an total return fund therefore, the EMD indices are for illustrative purposes only.**

%	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	YTD
2000 ¹		3.30	2.40	-1.90	-1.52	4.66	3.55	2.35	-1.89	-0.39	1.36	3.97	16.75
2001	3.18	-0.77	-1.59	-2.59	1.24	1.67	0.12	4.30	-3.78	0.31	-0.24	0.31	1.90
2002	0.78	2.25	-0.15	4.34	3.14	2.90	-0.07	2.54	0.94	0.86	2.37	3.80	26.31
2003	1.86	0.24	-0.30	2.50	1.66	0.99	-0.64	-0.12	1.34	-0.98	-0.64	2.75	8.93
2004	-1.14	0.63	1.03	-1.19	-0.23	-0.52	0.64	-0.23	2.19	2.14	3.91	2.60	10.13
2005	-1.76	1.58	-1.50	-0.11	-0.42	0.26	0.79	-0.52	-0.37	0.63	0.21	-0.10	-1.34
2006	2.51	0.92	1.32	1.90	-1.18	-0.84	0.85	0.84	0.34	1.23	2.47	1.42	12.36
2007	-0.93	0.85	0.65	1.07	-0.09	-0.28	0.60	-1.14	2.18	2.36	0.80	-0.04	6.11
2008	1.36	1.73	1.07	-0.84	-0.85	-0.26	0.39	-2.91	-2.78	-3.45	1.41	3.15	-2.20
2009	-1.89	-2.15	1.03	3.80	6.34	0.97	2.95	0.85	3.60	1.35	1.07	-1.43	17.39
2010	0.27	-0.11	0.27	0.30	-0.99	0.65	0.15	1.56	0.11	0.52	-2.64	0.92	0.96
2011	-0.87	0.08	0.46	2.55	-1.89	-0.11	0.42	-0.30	-1.17	-0.19	-0.23	0.12	-1.21
2012	0.15	-0.27	-1.08	0.04	-1.71	0.59	0.39	0.12	0.78	0.70	1.08	2.59	3.38
2013	1.37	-1.39	-0.59	1.05	-0.48	-0.82	-0.19	-0.34	0.23	0.83	-1.08	0.38	-1.08
2014	-0.68	1.21	0.56	0.56	1.18	-0.55	-0.59	1.59	-2.94	0.41	0.07	-1.97	-1.24
2015	1.14	-1.77	-1.03	0.97	-1.34	-0.78	-0.74	-1.02	-0.68	-0.12	-0.84	-0.57	-6.61
2016	0.41	0.85	5.75	2.47	-3.16	2.72	0.76	-0.04	0.62	-0.43	-2.72	0.58	7.76
2017	1.36	1.29	0.59	0.57	0.67	0.54	0.90	0.76	-0.46	-1.58	0.70	1.06	6.55
2018	3.14	-0.98	0.54	-2.50	-2.34	-1.23	0.64	-2.98	0.23	0.32	0.62	0.45	-4.17
2019	2.51	-0.70	-0.71	-0.49	0.14	3.26	0.34	-2.56	0.18	1.63	-1.73	2.86	4.66
2020	-1.41	-1.59	-5.54	1.30	4.62	0.66	3.02	-0.56	-2.17	0.69	3.83	3.17	5.69
2021	-1.89	-1.47	-2.28	1.31	1.58	-0.61	-0.49	-0.12	-2.22	-0.92	-2.19	1.16	-7.94
2022	-0.93	-2.34	-2.66	-3.48	-0.15	-4.84	0.00	1.83	-2.42	-0.04	4.09	0.92	-9.88
2023	3.32	-2.08	1.91	0.27	0.00	3.88	1.44	-2.59	-2.47	0.31	3.21	3.85	11.30
2024	-1.73	0.16	0.64	-0.87	0.88	-1.54							-2.47

Source: Schroders. ¹ Inception 31 January 2000.

Fund positioning as at 28 June 2024 (%):

	US\$ Debt	Local Debt	FX ¹	Total
Latin America				
Argentina	1.8			1.8
Bahamas	0.6			0.6
Brazil	1.0	5.4	-2.7	6.4
Chile	0.1		1.8	1.9
Colombia	0.4	2.3		2.7
Costa Rica	0.6			0.6
Dominican Republic		0.4		0.4
Ecuador	0.9			0.9
Mexico	0.4	8.5	-3.6	8.9
Asia				
China	1.0			1.0
India	0.2	7.1	-3.4	7.3
Indonesia		8.7	-5.3	8.7
Malaysia			2.6	2.6
Pakistan	1.8			1.8
Singapore	0.2			0.2
Central Eastern Europe				
Czech Republic			1.1	1.1
Hungary	0.3	3.7	-1.3	4.0
Latvia		0.3		0.3
Poland		3.2	-3.1	3.2
Romania		0.5		0.5
Slovenia		0.1		0.1
Turkey	1.5	0.7	2.2	4.4
Ukraine		0.1		0.1
Africa and Middle East				
Burkina Faso	0.5			0.5
Egypt	0.9	1.3		2.2
Ivory Coast	1.7			1.7
Nigeria	1.2		0.4	1.6
Senegal	1.2			1.2
South Africa	1.1	6.5		7.6
Tanzania	0.1			0.1
Zambia	0.4			0.4
Total EM	17.9	48.8	8.1	74.8
G3				
G3 FX			2.9	2.9
Cash				22.3
Grand Total	17.9	48.8	11.0	100.0



Fund Summary (%)

Yield to maturity	8.9
FX exposure	37.3
Duration (years)	3.9
Average credit rating	BBB+
Corporate bond exposure	5.88
Current yield	5.55
No. of holdings	99
Fund AUM	US\$1,100m
EMD TR strategy AUM	US\$1,973m





Source: Schroders.

¹ FX positions in red are hedges of local debt positions. FX positions in black are outright long FX forward positions. Total includes only active long outright FX forwards and NDFs and excludes hedges of local debt.

² Can include short and long dated government securities issued in G3 countries. Difference in some numbers due to rounding.

Proprietary sustainability metrics (SFDR Article 8)

Schroder ISF EMD Total Return ESG – 28 June 2024

Overall impact 	Fund coverage: 100% Fund -1.8%	Reference benchmark coverage: 99% Reference sustainability benchmark -3.6%
Environmental impact 	Fund -1.7%	Reference sustainability benchmark -2.6%
Social impact 	Fund -0.0%	Reference sustainability benchmark -0.7%
Governance impact 	Fund -0.1%	Reference sustainability benchmark -0.3%

Source: Schroders – 28 June 2024. The Schroders Impact score is based on Schroders' proprietary tool, SustainEx. Overall impact is an indication of the fund's impact compared to its benchmark. All holdings exclude cash and currency holdings. Impact on People indicate the fund's underlying benefits and harms compared to its benchmark. Metrics shown are a sample of the total underlying metrics. See definitions slide for more details. Benchmark data 50% JP Morgan EMBI Global Diversified (USD Unhedged) and 50% JP Morgan GBI EM Global Diversified (USD Unhedged).

Risk considerations:

Bond Connect risk: The fund may be investing in the China Interbank Bond Market via the Bond Connect which may involve clearing and settlement, regulatory, operational and counterparty risks. **Capital risk / distribution policy:** As the fund intends to pay dividends regardless of its performance, a dividend may represent a return of part of the amount you invested. **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. **Credit risk:** If a borrower of debt provided by the Fund or a bond issuer experiences a decline in financial health, their ability to make payments of interest and principal may be affected, which may cause a decline in the value of the Fund. **Currency risk:** The fund may lose value as a result of movements in foreign exchange rates, otherwise known as currency rates. **Currency risk / hedged share class:** The currency 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, which are financial instruments deriving their value from an underlying asset, 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. **Emerging markets & frontier risk:** Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty, operational and liquidity risk than developed markets. **High yield bond risk:** High yield bonds (normally lower rated or unrated) generally carry greater market, credit and liquidity risk meaning greater uncertainty of returns. **Interest rate risk:** The fund may lose value as a direct result of interest rate changes. **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: United States of America. **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, meaning investors may not be able to have immediate access to their holdings. **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. **Operational risk:** Operational processes, including those related to the safekeeping of assets, may fail. This may result in losses to the fund. **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 chosen by the investment manager. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.

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