

Schroder ISF* Global Equity Yield

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Performance overview

- Global equities gained in the quarter.
- The fund underperformed the MSCI World index.

Drivers of fund performance

- The portfolio posted a positive absolute return for Q1 but underperformed the benchmark. Stock selection in information technology and communication services weighed on relative returns. Stock selection within financials added value.
- In the communication services sector, our positions in telecoms firm **BT Group** and broadcaster **RTL Group** were among the main individual detractors. RTL reported weakness in the TV advertising market in Germany, which offset strength in streaming income.
- Lack of exposure to Meta Platforms also weighed on relative returns, as did zero exposure to NVIDIA in the information technology sector.
- Elsewhere, our position in tyre maker **Continental** weighed on relative returns. The firm's outlook statement was weaker than some in the market had hoped.
- US real estate brokerage **Marcus & Millichap** was also among the detractors. Hopes of imminent interest rate cuts had supported the shares in late 2023. Investors may have taken some profits now that rate cuts appear slightly more distant.
- On the positive side, several of our banking sector holdings were among the leading individual contributors. These included **NatWest Group**, **Intesa Sanpaolo**, **KB Financial** and **Citigroup**. Banks continue to look relatively attractively valued and to announce sizeable returns to shareholders. NatWest said it plans to buy back up to £300 million of its own shares in 2024. The group confirmed that interim CEO Paul Thwaite will remain in post on a permanent basis. Italy's Intesa Sanpaolo also announced a new share buyback plan in the quarter.
- The portfolio also benefited from lack of exposure to Apple and Tesla.
- A positive contributor within the communication services sector was **Nippon Television Holdings**. The company announced its fiscal Q3 results and said it will buy back shares worth 7 billion yen.

Portfolio activity

- We have initiated a new position in **John Wiley**, a US publishing company that focuses on academic publishing and educational materials. Shares have been weak. The company has become somewhat sprawling after a period of acquisitions. However, John Wiley now plans to dispose of non-core assets and re-focus on the core business which should prove beneficial in the long term.
- We have also initiated a new position in supermarket group **Ahold Delhaize**. We see it as a good quality food retailer with a strong balance sheet. Despite being European listed, Ahold derives c.70% of profits from the US, offering differentiation versus other European food retail holdings. The valuation has come under pressure amid the remodelling of Stop & Shop stores in the US, as well as weaker margins in Europe due to rising energy costs and weaker volume/mix. Strikes in Belgium over the company's decision to franchise some stores have also been a negative recently. However, the longer-term structural threat from Amazon and online food retail appears to have receded.
- We also bought a new holding in US consumer electronics retailer **Best Buy**. It has defended its business well against the structural threat from Amazon. There is a debate to be had over whether electronic items bought during the pandemic will soon be replaced, which would be beneficial for Best Buy, or whether the pandemic was a one-off boost to sales, which could prove negative. But we view the valuation as attractive and think the balance sheet is in sufficiently good shape.
- We have exited oil major **Shell**. The shares have performed well recently, partly because of the volumes coming through after large capex investments of the 2010s. We also sold out of **Micron Technology** which has been a strong performer in recent months and has reached our estimate of fair value. Another exit was Japan's **Citizen Watch**. Again, this is because the shares have reached fair value. Gains have been supported by good business performance and news of a share buyback.

After the party comes the hangover

- Imagine a diligent, hard-working teenager who abides by a strict set of rules. They get up, they go to school, they pay close attention in class, they come home, they eat their dinner, they do their homework, and they go to bed. They have an 8pm curfew, and this keeps them on the straight and narrow. There simply isn't time to get distracted, tempted, or led astray.
- But they are doing well, so their curfew is relaxed. First to 9pm, which gives them a just little more free time; free time to go out and mess around with their friends, but not too much. So, it goes on. The curfew is relaxed again to 10pm, then to 11pm, then to midnight, until the entire concept of a curfew is forgotten. Now there is no curfew and no rules, and all manner of trouble ensues.
- If a teenager's behaviour is determined, in part, but the rules and environment in which they live in, this is also true of behaviour in financial markets.

What's the financial market's answer to a curfew? Interest rates.

- All kinds of behaviours flow from the structure of interest rates; they are like an inverse curfew. When interest rates are high, it's like having that 8pm curfew. There is a cost to capital, and it is allocated diligently. When rates are zero, it is like having no curfew whatsoever. All sorts of financial shenanigans begin taking place.
- This curfew analogy came from Tom Gaynor, CEO of Markel, who we had on The Value Perspective Podcast (available on all platforms) and it's a good one.
- When rates are zero there is plenty of capital sloshing around looking for returns, and investors are willing to take on increasing levels of risk for either lower returns or potential returns way out in the future. In a zero-interest rate environment, if you have an idea and decent pitch, you'll probably get funding. Some of those ideas will prove to be spectacularly successful, but history suggests a great many will prove to be undeserving of the capital that they've received.

Which leads us nicely to the impact of rates on corporates ...

- So perhaps the biggest impact of increasing interest rates is that the era of unlimited free money is likely to be over. In time, we believe we will view the last ten years as an aberration, an investment mistake, rather than the norm. We can all intuitively feel the changed environment around us, whether we actively notice it or not. The ability for an Uber to arrive in the time it

takes to stand up from your restaurant table and put on your coat, before travelling across your hometown for £5, has gone. In the last 5 years alone, Uber spent more than \$30 billion dollars of investors' money subsidising your trip home. They were happy to lose money in the pursuit of market share, trying to squeeze out competitors, before they focussed on making money. But what if a company achieves scale, as surely Uber has (operating in 72 countries, 10,500 cities, 118 million monthly users, and 6.3 billion rides), and it still can't make an economic return on capital? What then?

- Investors have subsidised our Spotify listening, they have subsidised our Netflix binging (and created the golden age of TV content) and have subsidised deliveries of all manner of goods from the internet. Uneconomic pricing has been used as a Trojan horse into our life across many different business models, disrupting markets and allowing start-ups to take significant market share. As consumers we have been spoiled by the recent generosity (a.k.a. tolerance for limitless losses) of Venture Capital, Private Equity and Growth investors. When interest rates are zero, it's easy to be generous as a financial backer. It's easy to disrupt. But with higher rates, the not-for-profit tech sector is under pressure as economic reality bites. According to PitchBook, which tracks US start-ups, 3,200 private venture backed businesses went out of business during 2023. These are not insignificant two-employees-in-a-garage-start-ups, as they had raised a combined \$27.2 billion (the GDP of Iceland).
- This dose of economic reality should, in turn, mean less pressure on incumbent businesses from start-ups. Traditional office companies are squeezed less when WeWork folds. Black cab drivers are busier when there are fewer subsidised Uber drivers competing.
- This reduction in pressure should ease the pressure on profits of more traditional businesses, which tend to be value investments rather than growth businesses. And if we consider the significant valuation dispersion between value and growth investments, the prospects of both profit growth, and re-rating, for value stocks look strong. This provides our team with significant confidence that recent performance can be continued over the medium term.

In an ironic turn of fate, the disruptors are being disrupted by the old normal level of interest rates

- Even spectacularly successful companies can be spectacularly poor investments – lofty valuations tend to leave a nasty hangover for the survivors.
- We started this letter by looking at the inextricable link between interest rates and risk

taking. The era of low interest rates provided false comfort to many investors and founders that they could eventually achieve profitability in the future, even, in some cases, the absence of a well-defined business strategy.

- But for those that do have good strategy, and do go on to be spectacularly successful, there is something else to think about. Some of today's 'old tech' behemoths, the ones that survived the dotcom crash and delivered products that changed the world, have still gone on to be spectacularly poor investments.
- In August 2000, Cisco stock was priced at \$64 per share. In the intervening 24 years the stock has fallen to \$50. If you include dividends, investors are just about breaking even. It's been a terrible couple of decades, and the crucial point about its terribleness is that Cisco's underlying results over the period have been very good. Cisco's earnings per share have grown at a compound annual rate of just shy of 10% since 2000.
- The problem was the stock was so expensive that it simply couldn't grow into its valuation.
- So, it really is the price you pay, and not the growth you get, that is the single most important determinant of your future returns.

Calendar year performance (%)

Year	Fund	Target	Comp. 1	Comp. 2
2023	16.3	23.8	11.5	
2022	-6.4	-18.1	-6.5	-11.8
2021	19.5	21.8	21.9	17.1
2020	-6.1	15.9	-1.2	4.6
2019	16.5	27.7	21.7	21.7
2018	-11.0	-8.7	-10.8	-11.4
2017	22.1	22.4	17.1	18.8
2016	12.1	7.5	5.4	5.6
2015	-6.3	-0.9	-3.0	-2.8
2014	7.2	4.9	1.1	1.4

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

The fund's performance should be assessed against its target benchmark, being to exceed the MSCI World (Net TR) index and compared against the MSCI World Value (Net TR) index (comp. 1) and the Morningstar Global Income Equity Category (comp. 2). 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 target benchmark or the MSCI World Value (Net TR) index.

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Risk considerations

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