

Schroder ISF* US Dollar Bond

Fund Manager: Lisa Hornby and Neil Sutherland | Fund Update: Q2 2024

Market overview

- The second quarter was notable as signs of weakness began to show in June for risk assets. Political uncertainty in Europe, with the surprise election results early in June, initiated the weakness. Growing concessions (June's 4 basis point average is the largest concession of any month this year) and moderating flows into investment-grade corporates re-enforced this theme. That being said, by historical standards the concessions are still low and the 9 basis point (bp) widening in June is still modest given the starting point at or near cyclical tight levels. The economic data was generally on the supportive side showing moderating inflation (headline PPI unexpectedly declined -0.2% MoM vs. +0.5% Apr and +0.1% consensus) and a softening employment picture (272k NFP print vs 180k consensus however unemployment rose to 4.0%), and Treasury yields fell in expectation of lower yields (despite the Fed indicating only 1 cut this year). Some of the weakness could be attributed to the healthy levels of corporate new issuance however even that was discounted as front loading to get ahead of the elections later this year.
- For the quarter, option adjusted spreads as measured by the Bloomberg Corporate Bond Index were wider by 4 bps ending at 94 bps. Excess returns for corporates relative to duration neutral Treasuries were marginally negative (-4 bps) with financials the best (23 bps), followed by industrials (-16 bps) and utilities (-24 bps). Among the broad sectors of the Bloomberg Aggregate Bond Index securitized assets (-7 bps) were similar to corporates whereas sovereigns (-14 bps) were notable under-performers given the surprise results in European elections. Tax-exempt municipals (20 bps) beat Treasuries despite the sector notably underperforming in May on the back on heavy supply. Treasuries were higher on the quarter (20 bps as measured by the 10-year tenor) however they were up by as much as 50 bps late in April, rallying from that point as the data generally supported the view that inflation was coming down consistently (Core-CPI came in far below expectations in May at +0.163% MoM vs. +0.292% April and +0.3% consensus), albeit slowly, and the labor market was cooling albeit still healthy).

Drivers of fund performance

- The portfolio outperformed the benchmark over the quarter due to contributions from asset allocation and issue selection.
- Asset allocation was driven from the overweights to banking and MBS and ABS. Issue selection was also positive with contributions driven by banking, energy and MBS as well.

Outlook/positioning

- Looking forward to July, we remain cautious to see if the recent weakness persists. The portfolio is generally overweight to risk assets, albeit less so than would be appropriate at better valuations. The recent widening of credit spreads is notable however it easily could be considered a short-term consolidation if things improve from here. With summer upon us and seasonal factors historically supportive of risk assets, any weakness may warrant de-risking. Also, with yields falling the attractiveness of the all-in yield for corporates is diminished and ultimately could result in weakening demand for US fixed income. The portfolio has ample supply of Treasuries to exchange for risk assets should opportunities arise.

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 (%)*

Year	Fund	Target	Comparator
2023	5.4	5.5	4.7
2022	-16.0	-13.0	-9.8
2021	-1.4	-1.5	-1.5
2020	10.3	7.5	6.9
2019	9.3	8.7	7.7
2018	-1.6	0.0	-1.1
2017	4.4	3.5	3.6
2016	2.8	2.7	2.2
2015	-1.2	0.6	-0.7
2014	6.0	6.0	4.4

Source: Schroders, as at 31 December 2023. Fund performance is net of fees, NAV to NAV with net income reinvested, C Acc shares. Please see factsheet for other share classes. The target benchmark is Bloomberg Barclays US Aggregate Bond Index and comparator is Morningstar USD Diversified Bond. The fund's investment universe

is expected to overlap to a limited extent with the components of the target benchmark.

Investment Objective

The Fund aims to provide income and capital growth in excess of the Bloomberg US Aggregate Bond (TR) index after fees have been deducted over a three-to-five-year period by investing in fixed and floating rate securities denominated in USD.

Risk considerations

- **ABS and MBS risk:** The fund may invest in mortgage or asset-backed securities. The underlying borrowers of these securities may not be able to pay back the full amount that they owe, which may result in losses to the fund.
- **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.
- **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.
- **Credit risk:** A decline in the financial health of an issuer could cause the value of its bonds to fall or become worthless.
- **Currency risk:** The fund may lose value as a result of movements in foreign exchange rates.
- **Currency risk / hedged share class:** 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.
- **High yield bond risk:** High yield bonds (normally lower rated or unrated) generally carry greater market, credit and liquidity risk.
- **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.
- **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.
- **Market risk:** The value of investments can go up and down and an investor may not get back the amount initially invested.
- **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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