Schroders

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Schroder ISF* European Innovators

Fund Managers: Leon Howard-Spink & Paul Griffin | Fund update: Q1 2022

Performance overview

– European equities fell in Q1. Rising inflation and central bank tightening weighed on sentiment early in the quarter; Russia's invasion of Ukraine has added to the uncertainty and risk aversion.
– The fund underperformed the MSCI Europe index.

Drivers of fund performance

– A number of more cyclically-exposed holdings were among the main detractors. This was due to concerns about the pressures on supply chains and rising cost inflation, as well as worries over the risk of recession.
– **Kion Group**, a market leader in forklifts and warehouse equipment, is facing rising costs amid higher prices of steel and other crucial inputs. Its main competitor warned on profits in March, while Kion followed suit in early April citing supply chain constraints. Semiconductor firm **Infineon** is an important supplier for the automotive industry. Supply chain problems are weighing on the ability of automakers to manufacture as many vehicles as planned. Also among the detractors was **Gerresheimer**, a maker of drug packaging and drug delivery devices. While the company has upgraded its medium-term guidance, cost pressures are weighing on profit margins in the near term.
– The operating environment clearly remains very difficult for management teams. However, we would say at this point that some of our more cyclical companies are looking attractively valued now and have good long-term growth prospects. Importantly, the issue right now is one of supply: Kion pointed to continued strong demand – which they are simply not able to fulfil.
– Information and analytics provider **RELX** supported fund returns as its relatively defensive profile found favour amid the volatility.

Portfolio activity:

– We exited our position in **Knorr Bremse**, a manufacturer of braking systems for rail and trucks. We found management's lack of willingness and/or ability to sufficiently raise prices concerning, especially given their strong market position. We concluded that rising input costs would likely see profitability suffer.
– Another sale was online travel platform **Trainline**. Continued regulatory risk from a UK government review into rail travel has weighed on the shares and it had become a small position in the fund. While the business could recover and grow in future, we decided to cut the < 1% position to use the capital for higher conviction ideas.

Outlook/positioning

– The past three months were challenging for the portfolio and for European equities as a whole. It remains to be seen what impact higher inflation and central bank tightening will have on business and consumer spending. The consequences on global trade and supply chains of the tragic events in the Ukraine are also unclear. As ever, we will draw on our experience of navigating volatile markets, aim to take a balanced view, and focus on our companies.
– We take comfort from the underlying strength of our businesses, most of which are global market leaders with strong balance sheets. The FY results season was on the whole positive, with more companies seeing upgrades to consensus numbers than downgrades. It's true that many businesses are experiencing short-term cost or availability pressures that are very hard to mitigate, but demand from end-customers is still robust for now.
– Above all, pricing power is one of the most important characteristics of businesses we invest in. Companies that are leaders in their markets have a greater ability to pass on inflation in costs to customers to protect earnings. Our discussions with management over recent weeks and months has centred on their pricing strategies.

*Schroder International Selection Fund is referred to as Schroder ISF throughout

Calendar year performance (%)

Year	Fund	Target	Comparator
2021	32.1	25.1	23.0
2020	-4.5	-3.3	-0.9
2019	28.2	26.0	24.5
2018	-14.5	-10.6	-12.7
2017	20.6	10.2	10.1
2016	8.7	2.6	1.2
2015	-0.2	8.2	16.0
2014	3.8	6.8	5.4
2013	25.9	19.8	21.9
2012	21.0	17.3	21.1

Source: Schroders, as at 31 December 2021. Fund performance is net of fees, NAV to NAV with net income reinvested, EUR C Acc shares. Please see factsheet for other share classes. The fund's performance should be assessed against its target benchmark being to exceed the MSCI Europe (Net TR) index, and compared against the Morningstar Europe Flex Cap Equity Category. 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.

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.

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.
Derivatives risk: 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. The fund may also materially invest in derivatives including using short selling and leverage techniques with the aim of making a return. When the value of an asset changes, the value of a derivative based on that asset may change to a much greater extent. This may result in greater losses than investing in the underlying asset.
Higher volatility risk The price of this fund may be volatile as it may take higher risks in search of higher rewards.
IBOR: 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.
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.
Market risk: The value of investments can go up and down and an investor may not get back the amount initially invested.
Sustainability risk: The fund has the objective of sustainable investment. 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.