Schroders

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# Schroder ISF* China Local Currency Bond

**Fund Manager: Julia Ho | Fund update: June 2025**

## Market Overview

- China's economy bounced back, with 2Q GDP rising 5.2% y/y. However, June activity data indicated worsening structural imbalances – industrial production rose, whereas retail sales and fixed investment growth softened. CPI inflation turned positive, while PPI deflation deepened. Meanwhile, the property market remained under pressure, with national home sales volume/value declining.
- The US has lifted the export restrictions imposed in late May on semiconductor design software, airplane engines, and ethane, while China has approved export licences on rare earth and other critical materials. These recent actions confirm that both countries may now be back to the terms of deals agreed on in Geneva in May and suggest that the downside of bilateral trade could be more contained.
- RMB appreciated 0.6% against the USD, while the 10-year China Government Bond yield was litter changed at 1.65%.
- The Fund (CNH C Acc, net of fees) posted 0.35%, modestly trailing its benchmark, the Markit iBoxx ALBI China Onshore Index, which returned 0.42%.

## Drivers of Fund Performance

- Rates positioning was the key contributor to active returns, while security selection detracted from performance.
- Our overweight China duration and residual long US duration delivered positive returns as both China and US rates rallied.
- However, security selection within the China government bonds sector offset the gains from rates positioning.

## Outlook and Positioning

- On the surface, the Chinese economy remains on solid footing – as validated by Q2 GDP growth beating expectations. Looking beneath, a bulk of this growth was driven by front-loading of exports. Improvements in consumption spending appear to have lost momentum, with the impulse from trade-in subsidies have beginning to fade.
- As we move into the second half of the year, there are certainly some challenges on hand. An uncertain global growth environment similarly paints for uncertainty for China's exports sector as well. In addition, household confidence still has room to recover, with current savings rate still elevated compared to pre-Covid levels. This indicates the presence of excess deposits that could potentially be used for spending and investing to boost growth, should consumer sentiments improve.
- Given that growth pressures appear less than previously feared, policymakers are not likely in the rush to expand their policy easing aggressively. That said, we still expect incremental policy support in the near term, with authorities maintaining their accommodative bias. This means that onshore rates will remain supported, while real yields should stay attractive.
- A reduced need for major easing, coupled with impending US Fed rate cuts, will likely decrease the pressure on the CNY stemming from the US-China rate differential. In addition, a weak USD environment should further support the CNY.
- Staying up in quality remains key for China credits. Policymakers are expected to reduce the tail risk in the system, contributing to a stable backdrop for China credits. Additionally, the relaxation of the Mutual Recognition of Funds scheme could unlock longer-term flows into the China credit market. We remain defensive, favouring issuers within the Consumer, Transport, Utilities, and Financials sectors.

## Calendar Year Performance (%)

| Year | Fund[1] | Index[2] |
|---|---|---|
| 2024 | 7.6 | 8.4 |
| 2023 | 5.6 | 4.6 |
| 2022 | 1.1 | 3.5 |
| 2021 | 4.9 | 6.1 |
| 2020 | 2.0 | 2.5 |
| 2019 | 4.2 | 4.4 |
| 2018 | 7.6 | 8.5 |
| 2017* | 0.4 | 1.7 |
| 2016* | 2.8 | 4.1 |
| 2015* | 2.3 | 2.2 |

Source: Schroders as at 31 December 2024, based on Schroder ISF China Local Currency Bond C Acc CNH share class, net of fees, bid to bid. [1] The fund was renamed Schroder ISF China Local Currency Bond Fund from Schroder ISF RMB Fixed Income Fund effective 1 July 2019. There was no change made to the investment objectives or strategy.

[2] With effect from 1 May 2019, Markit iBoxx China Onshore index began to include Chinese policy bank bonds.

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

*The fund changed investment strategy focus from China offshore investment grade bonds to China onshore bonds, effective 1 June 2017.

Past performance is not a reliable indicator of future results, prices of shares and the income from them may fall as well as rise and investors may not get the amount originally invested.

## Risk Considerations

The capital is not guaranteed.

In order to access restricted markets, the fund may invest in structured products. Should the counterparty default, the value of these structured products may be nil.

Non-investment grade securities will generally pay higher yields than more highly rated securities but will be subject to greater market, credit and default risk.

A security issuer may not be able to meet its obligations to make timely payments of interest and principal.  This will affect the credit rating of those securities.

Investments in money market instruments and deposits with financial institutions may be subject to price fluctuation or default by the issuer. Some of the amounts deposited may not be returned to the fund.

Currency derivative instruments are subject to the default risk of the counterparty.  The unrealised gain and some of the desired market exposure may be lost.

Investments denominated in a currency other than that of the share-class may not be hedged. The market movements between those currencies will impact the share-class.

Investment in bonds and other debt instruments including related derivatives is subject to interest rate risk. The value of the fund may go down if interest rate rise and vice versa.

Emerging markets will generally be subject to greater political, legal, counterparty and operational risk.

Emerging equity markets may be more volatile than equity markets of well-established economies. Investments into foreign currencies entail exchange risks.

The fund may hold indirect short exposure in anticipation of a decline of prices of these exposures or increase of interest rate.

The fund may be leveraged, which may increase its volatility. The fund enters into financial derivative transactions. If the counterparty were to default, the unrealised profit on the transaction and the market exposure may be lost.

Changes in China's political, legal, economic or tax policies could cause losses or higher costs for the fund.