

Schroder ISF* China Local Currency Bond

Fund Manager: Julia Ho | Fund update: December 2024

Market Overview

- China's 4Q GDP came in significantly above expectations, growing 7.6%q/q. This growth was partly driven by solid export sector activity, while on the domestic front, the policy pivot and more growth-supportive macro policies led to some uptick in policy support areas, such as consumer goods and equipment upgrade for corporates. Meanwhile, real estate fixed asset investment remained a key drag, while deflationary pressures lingered.
- The PBoC announced it will suspend bond buying in January, owing to demand exceeding supply, and will restart at an appropriate time in the future.
- In December, the RMB depreciated by 0.24% against the USD, while the 10-year China Government Bond (CGB) yield fell to 1.67%.
- The Fund (CNH C Acc, net of fees) was up 2.12%, slightly trailing its benchmark, the Markit iBoxx ALBI China Onshore Index, which posted 2.20%.

Drivers of Fund Performance

- Rates strategies and negative FX carry from the long USD position were the primary detractors of returns. Spreads strategies were flat.
- While our residual long US duration (positive carry) contributed to returns, these gains were more than offset by our curve positioning, particularly underweights at the front-end and ultra long-end of the CGB curve.
- Although individual contributions from credit allocations were modest, key contributors included the TMT and Financials, which marginally aided returns.

Outlook and Positioning

- The growth outlook in 2025 remains challenging amid significant uncertainties. Key concerns include the likely rise of US-China tensions with potential aggressive US tariff hikes on China, as well as escalation of non-tariff trade and investment curbs. While the property drag may diminish in 2025, it is likely to persist, potentially continuing to weigh on consumption demand.
- Looking ahead, we expect more domestic policy clarity once Chinese policymakers have assessed the US policies under the Trump administration and their potential impact on China's economy.
- The overall supportive stance of Chinese monetary policies should provide a stable backdrop for CGBs and policy bank bonds. Meanwhile, the potential suspension

of bond purchases by the People's Bank of China (PBOC) appears to reflect a policy recalibration rather than a structural shift toward higher CGB yields. Hence, we see limited room for further sell-offs for the CGB curve.

- While tariffs were not immediately imposed on China, risks remain elevated. Tariffs are expected to be a major catalyst for RMB depreciation ahead, along with other pressures, including a stronger USD – driven by US macro outperformance and Fed policy - and portfolio outflows. Nonetheless, the PBOC has recently shown greater resolution to keep its currency stable, providing short-term relief for the RMB.
- Over the secular horizon, the tailwinds for Chinese onshore bonds remain unchanged. Once US-China yield differentials settle at more favourable levels, foreign bond demand should increase, especially as Chinese onshore bonds are increasingly viewed as portfolio diversifiers. This is evident from their outperformance relative to US Treasuries over the past five years, and these bonds remain under-allocated in international investors' portfolios. Additionally, the longer-term trends of RMB internationalization and de-dollarization should support the currency.
- We expect the fundamentals of China corporates to remain resilient, supported by potential policy stimulus aimed at mitigating tail risks. We continue to favour investment grade credits, including Financials, Industrials, and Transport.

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. ¹The 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.

*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.

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