Schroders

Marketing material for professional clients only

Schroder ISF* EURO Bond

Fund Manager: Julien Houdain, James Ringer, Martin Coucke & Global Unconstrained Fixed Income Team | Fund update: July 2025

Market overview

- Trade negotiations dominated news flow during July, while markets were also preoccupied by renewed concerns over fiscal deficits which saw global government bond yields rise.
- The US faced conflicting pressures from tariffs and fiscal policy. President Trump signed the 'Big Beautiful Bill' into law, with the net impact from tax reductions, increased spending on defence and border security and cuts to social security judged to be negative for the country's deficit.
- Following weeks of negotiations between the EU and the US, a baseline tariff rate of 15% on almost all EU goods entering the US was agreed, providing more clarity. The EU also committed to significant spending on US military equipment and energy.
- With investors preoccupied by renewed concerns over rising fiscal deficits, government bond yields rose in the US and across European markets. The German budget deficit for 2025 is forecast to increase substantially, funding increased defence spending and infrastructure investment, and is more front-end loaded than had been anticipated when borrowing limits were relaxed in the spring.
- The European Central Bank (ECB) kept interest rates unchanged for the first time in a year, with President Lagarde striking a surprisingly hawkish tone. Accordingly, investors scaled back expectations of further interest rate cuts. Despite uncertainty over trade tariffs, the eurozone economy unexpectedly expanded during the second quarter with signs of a recovery in consumer spending.
- Credit markets posted further gains, outperforming government bonds. Euro denominated corporates equally produced positive total and excess returns as spreads compressed for the third consecutive month. Spread tightening was broad based across sectors, with insurance and real estate investment trusts (REITS) among the outperformers.

Drivers of fund performance

- The Fund delivered a positive total return and outperformed the benchmark during July.
- An overweight to euro-denominated investment grade credit was the main contributor as credit spreads compressed for a third consecutive month.
- Exposure to off-benchmark US dollar high yield was also additive, with positive sentiment driving an outperformance of lower-rated issues.
- The contribution from rates was positive but to a lesser extent.
- An outright underweight to Germany, as well as a cross-market position favouring the UK, worked well. Although yields rose in both markets, the front end of the German curve underperformed the UK as a relatively hawkish sounding ECB contributed to market weakness.
- A curve steepening trade in the eurozone was also beneficial.
- The main detractor came from a steepening strategy in the US. While the US curve initially steepened, it later flattened following the Federal Reserve's monetary policy meeting.

Portfolio activity

- The main change to asset allocation was the closure of our US high yield position, held through credit default swap indices. Given the strong performance of high yield bonds and a significant tightening in credit spreads over recent months, valuations look expensive and vulnerable to some reversal in the event of any softening in economic indicators.
- In line with our macroeconomic views, we remained modestly defensive in terms of overall duration. Accordingly, we reduced our short position in Germany versus the UK.
- Within rates, our highest conviction is in curve positioning. We rotated some of our directional German short exposure into an existing steepening strategy. This reflects our view that the disinflationary narrative in the eurozone should continue to underpin relative outperformance of the shorter end of the curve.
- We also added to our US curve steepening trade, taking advantage of mid-month Treasury curve flattening.
- We opened a tactical short position in US inflation to offset some of the more cyclical credit exposure in the portfolio.

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

Outlook

- The deal between the EU and the US provided some relief that the threat by the Trump administration to impose 30% tariffs had been avoided, with some sectors including aircraft and component suppliers securing an exemption. Furthermore, the combination of higher fiscal spending and more accommodative monetary conditions should underpin a recovery in eurozone economic activity. Although conditions in the manufacturing sector remain challenging, the latest eurozone PMI survey for July highlighted a further expansion in private sector activity. This improvement appears to be a response to the European Commission's recent relaxation of fiscal rules, allowing for additional spending on defence.
- Inflation is expected to decline further based on lower energy prices, as the recent spike in the oil price quickly dissipated, and the weaker US dollar.
- We also expect corporate fundamentals to remain stable and the default rate to stay low.
- Monetary policy should continue to provide some support for bond markets, although the ECB's programme of interest rate cuts looks to have run its course.
- With the eurozone bond markets heavily influenced international developments, as well as domestically driven idiosyncratic risk, it is imperative to have a strategic but agile approach to portfolio construction. We believe that recognising and reacting to regime changes when they happen, while being disciplined enough not to overreact to news headlines, is key to generating positive excess returns.
- For euro-denominated credit in particular, we are mindful that credit spreads at index level measured over government bonds have compressed significantly over recent months.
- We are looking to enhance returns through careful bond selection, identifying market mispricing at an issuer level.

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 (A Acc)	Fund (I Acc)	Target
2024	2.4	3.3	2.6
2023	6.7	7.6	7.2
2022	-20.3	-19.6	-17.2
2021	-3.3	-2.5	-2.9
2020	4.5	5.5	4.0
2019	6.6	7.5	6.0
2018	-1.1	-0.2	0.4
2017	1.1	2.0	0.7
2016	2.9	3.9	3.3
2015	0.2	1.1	1.0

Source: Schroders, net of fees (where applicable), bid-bid, with net income reinvested as at 31/12/2024. Target benchmark: Bloomberg Barclays EURO Aggregate. The fund aims to provide capital growth and income in excess of the target benchmark. The fund's investment universe is expected to overlap to a limited extent with the components of the target benchmark.

Risk considerations

- **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.
- **Contingent convertible bonds**: The fund may invest in contingent convertible bonds. If the financial strength of the issuer of a contingent convertible bond falls in a prescribed way, the value of the bond may fall significantly and, in the worst case, may result in losses to the fund.
- **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.
- **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 countries: France and Germany.
- **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. Therefore, the fund may underperform other funds that do not apply similar criteria. The fund may invest in companies that do not reflect the beliefs and values of any particular investor.

Important information

webpage. A summary of investor rights may be obtained from https://www.schroders.com/en/lu/professional-investor/footer/complaints-handling/. For your security, communications may be recorded or monitored. Issued by Schroder Investment Management (Europe) S.A., 5, rue Höhenhof, L-1736 Senningerberg, Luxembourg. Registration No B 37.799. Distributed in the UK by Schroder Investment Management Ltd, 1 London Wall Place, London EC2Y 5AU. Registration No 1893220 England. Authorised and regulated by the Financial Conduct Authority. Information for Switzerland: Schroder Investment Management (Switzerland) AG is the Swiss representative («Swiss Representative») and Schroder & Co Bank AG is the paying agent in Switzerland of the Luxembourg domiciled Schroder International Selection Fund. The prospectus for Switzerland, the key information documents, the articles of association and the annual and semi-annual reports may be obtained free of charge from the Swiss Representative.