

Schroder ISF* EURO Bond

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

Market overview

- Geopolitical headlines dominated news flow during June, with the conflict in the Middle East and a spike in oil prices driving market uncertainty. Meanwhile, economic data reflected slowing growth momentum although concerns over an imminent recession remained low. With central banks nearing the end of their cutting cycle, attention is now shifting away from monetary policy towards the potential impact from fiscal policy.
- In contrast to other sovereign markets, European government bond yields rose in June, notably in Germany, as investors awaited more clarity on forthcoming trade tariffs.
- European central banks continued to ease monetary policy conditions with interest rate cuts by the Norwegian, Swedish and Swiss central banks alongside the European Central Bank (ECB). While the ECB's 25 bps rate cut was expected, the significant development was in President Lagarde signalling that they have now 'nearly concluded' their rate cutting cycle.
- Credit markets were resilient to ongoing geopolitical risks, and market volatility actually fell to the lowest in a year following the ceasefire in the Middle East. Investment grade (IG) credit spreads contracted across the US, euro and sterling denominated corporate bond markets, outperforming similar maturity government bonds.
- Given the resurgent appetite for risk, high yield (HY) corporates outperformed their IG in both the euro and US markets. In the UK, high yield lagged the robust performance in IG but still performed comparatively well versus gilts.

Drivers of fund performance

- The Fund delivered a positive total return and outperformed of the benchmark. Both rates and credit strategies were additive.
- In rates, cross market off-benchmark exposure to the UK versus Canada was the notable contributor.
- An underweight to Germany, both on an outright and cross-market basis versus the UK and US, also contributed.

- Curve positioning, most notably a US steepener, contributed modestly.
- In terms of asset allocation, the main contribution came from an overweight to euro-denominated IG credit, as spreads tightened over the month.
- Long exposure to US HY was also beneficial.

Portfolio activity

- In terms of strategy, despite several geopolitical risks, economic fundamentals are little changed over the month. Growth in the eurozone remains soft, but not to the degree that warrants recessionary concerns and there are signs of improvement.
- Accordingly, we have maintained headline duration at a modest underweight, preferring instead to exploit market divergence.
- We continue to see value in an overweight to the UK on a cross-market basis. We are seeing clearer signs of a slowdown in the UK labour market as well as a softening of underlying inflation pressures, such as wage growth, which warrants some convergence with market pricing for interest rates in other markets. During the month, we took profit and closed an overweight UK versus Canada and rotated into an overweight UK versus Germany position.
- Similarly, we used Germany to fund an overweight to the US, given our view that fiscal stimulus out of Germany suggests a positive medium-term trajectory for European growth. The position was later closed, taking profit following the ceasefire in the Middle East.
- We maintained a steepening bias on yield curve trades, but closed the position in the UK. We kept a similar strategy in the US and opened a position in the eurozone, where we expect the front end of the curve to perform comparatively well as inflation underwhelms.
- In asset allocation, we increased our exposure to euro-denominated covered bonds, reflecting their improved attractiveness in terms of valuation following recent underperformance against senior financials in the corporate bond markets.
- We managed our US HY exposure tactically over the month, trading around the US payrolls release, which we had identified as a potential risk to the position.

Outlook

- From a macroeconomic perspective, we continue to see a 'soft landing' as the likeliest outcome. This makes us generally cautious on outright duration, preferring instead to capture market divergence through cross-market strategies and yield curve positioning.
- Attention is beginning to turn more forcibly away from an easing of monetary policy to fiscal policy. When the ECB met in June, President Lagarde signalled that they were near the end of its rate cutting cycle, with several board members continuing to reiterate this message while not ruling out a further adjustment later in the year.
- There has been a substantial structural change in the German fiscal policy outlook, which we see as paving the way for a greater impulse from other eurozone countries, especially with regard to defence spending given changing geopolitical priorities. It will now be much harder, and it looks much less likely that they would want to, for Germany to block easier fiscal policy across the continent.
- At the time of writing, the outcome of trade negotiations between the EU and the US remains a key uncertainty as the 1st of August deadline for trade negotiations looms. In the meantime, high frequency indicators point to improving activity, generally a reflection of a stronger services sector.
- With the eurozone bond market at the mercy of international developments, as well as domestically driven idiosyncratic risk, it becomes even more important 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, with the recent tightening of credit spreads, we look 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.

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