Schroders

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Schroder ISF* EURO Bond

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Market overview

- Global bond markets generated widely varying returns during August, buffeted by economic data and political developments.
- European government bond yields rose steadily through August, with benchmark 10-year French government bond yields sharply higher on growing political instability. The rise in longer-dated yields across Europe reflected mounting concerns about the sustainability of fiscal deficits.
- Eurozone economic indicators continued to highlight a trend of improvement with the purchasing managers index (PMI) for August highlighting a pick-up in business activity across the manufacturing and services sectors. The survey was the strongest since May last year, registering its eighth consecutive monthly gain. This strengthened the prevailing view that the European Central Bank (ECB) would leave interest rates unchanged at its September meeting, as investors scaling back expectations for any further rate cuts with the ECB's programme of monetary easing increasingly likely to have run its course.
- Elsewhere, although the shorter end of the US Treasury market performed well in response to expectations for a September rate cut, longer-dated Treasuries continued to be plagued by concerns around the fiscal spending levels implied by last month's budget bill, as well as worries about the Fed's independence being compromised.
- Credit spreads were generally flat over the month. A relatively benign corporate environment in the US (and lower concerns around tariff levels) meant that US corporates outperformed European indices.

Drivers of fund performance

- The Fund outperformed the benchmark during August.
- Fund outperformance over the month was driven by asset allocation and rates positioning.
- In credit markets, an overweight to corporates (specifically an overweight to EUR financials) and securitised issues contributed positively.
- In rates, there were major contributions from the portfolio's curve-steepening trades in Europe and especially in the US. Yields declined at the short end of the US curve as a Fed rate cut in September began to look more likely.
- There were small positive contributions from underweight duration exposure to Europe and short Japan.

Portfolio activity

- We moved the portfolio's headline duration slightly further underweight, by initiating a short 5-year Japanese government bond position through swaps. The trade is a good proxy for rising short rate expectations in Japan. Inflation is now at levels not seen consistently since the 1990s, and the Bank of Japan seem increasingly likely to hike interest rates sooner rather than later.
- The portfolio retains an overall duration underweight in Germany. With the market displaying almost no risk premium for the possibility of future rate hikes down the line. We do not believe the shift in either growth outlook or the ECB's stance is fully priced yet and we continue to see room for higher yields in core European markets.
- Towards the end of the month, we initiated a cross-market position, short French OATs versus German bunds. France's increasingly challenging fiscal and political situation (with potential strikes and shutdowns now planned for September) makes the bond market look fundamentally expensive relative to eurozone peers.
- We closed the cross-market position long UK vs Germany because of our decreasing conviction in the UK economy weakening from here. The BoE has indicated that its previously steady path of interest rate cuts is now less clear as the economy shows more positive signs of activity, and disinflation looks to have stalled.
- We maintained the core curve position of a US steepener, as long US Treasuries remain under pressure amid concerns over fiscal policy and Fed independence. We also added to our existing European steepener towards the end of August.
- We made changes in overall allocation, trimming corporate bond exposure to reduce risk, given how spreads have compressed over the summer. We added additional exposure to covered bonds, notably

*Schroder International Selection Fund is referred to as Schroder ISF throughout this document in Italy, reflecting their more attractive valuations relative to other areas of investment grade credit.

Outlook

- From a macroeconomic perspective, acknowledging the importance of softer US labour market data for both the path of US interest rates and global markets, we have increased the probability assigned to a 'hard landing' or recession. However, our strong base case remains for a benign, 'soft landing' environment to be maintained over the foreseeable future.
- The US has evolved into a low-hire, low-fire labour market. In our view, there is every reason to believe we will see stabilisation from here rather than continued downward momentum. However, the latest weakness has two major implications. Firstly, a softer labour market is more vulnerable than a strong one. Secondly, a weaker labour market clearly has an impact on the Fed's ability and willingness to ease monetary policy.
- For the eurozone, we believe the US trade deal has averted the tail-risk of a more negative external shock, especially given it has moderated the impact on EU exports of pharmaceuticals and autos. Under this deal we see the growth headwind as manageable, while the impact should not derail the recovery in the eurozone we have been anticipating throughout 2025.
- We have reduced the fund's exposure to corporate credit risk as valuations in the investment grade market have become stretched, but we will look for opportunities to add exposure on the back of market weakness as our fundamental outlook for credit markets remains solid.

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:

Risk considerations

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.

- **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