Schroders

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Schroder ISF* EURO Bond

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

Market overview

- May was another volatile month for global bond markets. While a de-escalation of China-US trade tensions eased US recession fears, the market's focus quickly switched to concerns around US fiscal sustainability. The Reconciliation Bill, which was approved by the House of Representatives and is now required to be passed by the Senate, was seen as worsening the US budget deficit, driving longer-end Treasury yields higher.
- European government bond markets in comparison had a much better month, with only modest yield rises in core markets – such as Germany. Peripheral markets outperformed, with yields on 10-year Italian bonds falling slightly over the month.
- Ahead of the European Central Bank (ECB) monetary policy meeting in early June, markets were expecting a further 25 basis point interest rate cut. Although eurozone inflation remained slightly above its 2% target in April, the impact of lower oil prices has yet to feed through into consumer prices.
- Despite the ongoing uncertainty, credit markets continued to recover from the early April sell-off. Within investment grade (IG) corporates, US credit spreads tightened more significantly versus their Euro denominated counterparts (marking an outperformance), although both markets generated positive excess returns over government bonds.
- US IG spreads are once again trading at tighter levels versus the EU, at the margin a reflection of the continued headwind of euro-denominated investment grade supply, which is well ahead of previous years to date. Most notably, US corporates have been capitalising on the interest rate differential to tap lower borrowing costs in the euro-denominated market.

Drivers of fund performance

- European bond markets generated positive returns during May and the fund delivered returns in excess of the benchmark.
- Credit strategies drove the month's outperformance, particularly an off-benchmark exposure to US high yield (HY)
- An overweight to euro-denominated IG credit also contributed as spreads tightened, amid a much-improved environment for risk assets. Similarly, an overweight to securitised credit was additive.
- The fund's rates strategy detracted overall, principally due to a long US duration position held early in the month. A cross-market position – overweight US versus Germany – also detracted from relative performance.

Portfolio activity

- Within our scenario framework, we reduced the probability assigned to a 'hard landing' and subsequently reduced headline duration. While we recognise that it might be too early for the tariff-induced volatility to have impacted the real economy, so far, the US economy has been resilient.
- The reduction in headline duration was achieved by converting an overweight to the US to a cross-market overweight versus the eurozone (selling German duration).
- Later, we also sold eurozone duration on an outright basis. Our bearish view on eurozone duration is based on the reality that the ECB has already significantly eased policy, combined with our relatively upbeat growth outlook for the region.
- Elsewhere, our aim was in exploiting market mispricing between the UK and Canada through a cross-market position in the front-end of the yield curve favouring UK duration.

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

- We believe yield curves still have the potential to steepen structurally given the renewed focus on long-dated debt supply. We added yield curve steepening strategies, focusing on the US and on the UK, where there are well-known fiscal vulnerabilities.
- Minimal changes were made to the fund's asset allocation. We added some exposure to euro-denominated IG and covered bonds out of US mortgage-backed securities during the month.
- Despite the rally, US high yield continues to provide attractive carry to the portfolio, and we continue to sell protection (long exposure) in US high yield CDX (credit default swap indices).

Outlook

- The notable decline in energy prices since the beginning of the year is accelerating the disinflation process across the eurozone and has allowed the ECB to ease monetary policy conditions. In fact, risks of inflation undershooting the target have risen, particularly given the recent euro strength.
- Nevertheless, with rates now in the middle of the ECB's neutral range (the level of interest rates where the economy is thought to be balanced), it becomes naturally harder to action further rate cuts.
- From a macroeconomic perspective, eurozone activity data (both survey and hard data) reflect some improvement at a time when US data is softening. An easing of financial and credit conditions have been a major support for eurozone corporates, and we believe that there's room for further improvement in growth to come. We expect this convergence story between the US and the eurozone economies will continue to play out over time.

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