Schroders

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Schroder ISF* Global Bond

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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.
- The US Court of International Trade ruled that President Trump's administration did not have the authority to impose baseline 10% or reciprocal tariffs through the use of emergency powers. While the administration can still invoke other legislation to implement these tariffs, it clearly complicates ongoing attempts to negotiate concessions from its trading partners within the 90-day extension period (due to end on the 9 July). Some tariffs – including those on autos – are exempt from this ruling.
- Other high deficit countries were vulnerable to the sell-off. A combination of worsening fiscal conditions, and a structural supply and demand imbalance for Japanese Government Bonds (JGBs) prompted a significant bear steepening of the yield curve (where longer-maturity bonds incur larger losses than shorter-maturities). Meanwhile, the UK gilt market did not escape, with the shift higher in yields reflecting investors' concerns about the country's fiscal outlook. Although the Bank of England (BoE) cut its base rate by 25bps to 4.25%, April's inflation data was higher than expected, and the market is sceptical over the scope for future rate cuts.
- 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.
- Credit markets continued to recover from the early April sell-off. Within investment grade corporates, US credit spreads tightened more significantly versus their Euro denominated counterparts, although both markets generated positive excess returns over government bonds.
- The biggest beneficiary of the improvement in risk sentiment was US high yield. An easing of US recession concerns combined with a more conciliatory outlook on tariffs supported strong investment flows into the asset class. The rally was broad-based across sectors as spreads contracted sharply, leaving them at tighter levels than pre-Liberation day. Euro denominated high yield also had a positive month but underperformed the US.

Drivers for fund performance

- The fund delivered returns in excess of the benchmark during May, with credit strategies driving outperformance.
- Our exposure to US high yield was a notable contributor to performance amid an improved environment for risk assets.
- Within investment grade credit, where we hold a broadly neutral position across euro and US dollar corporates, positive security selection boosted returns.
- The fund's rates strategy detracted overall, principally due to an overweight to US duration held early in the month. A cross-market position, overweight US versus Germany, also had a negative impact on relative performance.

Portfolio activity

- 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 ~~on~~ the real economy, so far, the US economy has been resilient.

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

- This was achieved by converting an overweight to the US to a cross-market overweight versus the eurozone. Subsequently we also sold eurozone duration on an outright basis following a sharp fall in government bond yields as President Trump threatened to invoke a potential 50% tariff against all EU imports to the US.
- Elsewhere, we focused on exploiting market mispricing between the UK and Canada through a cross-market position in the front-end of the yield curve favouring UK duration. Our view was that on a comparable basis, the market was too optimistic on rate cuts in Canada, given greater fiscal stimulus is expected later this year.
- Despite the recent market moves, we believe yield curves still have the potential to steepen structurally given the renewed focus on debt supply. We added yield curve steepening strategies, firstly in the US and subsequently in the UK, where there are well-known fiscal vulnerabilities.
- Minimal changes were made to the fund's asset allocation. Despite the rally, US high yield CDX continues to provide attractive carry to the portfolio and we continued to sell protection (holding a long exposure).
- We have retained more neutral positioning in both US and euro investment grade credit, while maintaining our preference for US agency mortgage-backed securities (MBS) through a significant overweight. The MBS market continues to offer an attractive income relative to its credit risk.
- Currency risk remains low. We closed an overweight to the euro versus US dollar, which had worked well, and introduced a modest overweight to the Mexican peso against the US dollar. Any fading of tariff risks should help contain volatility, making emerging market currencies more attractive.

Outlook/positioning

- While immediate recession fears have abated, last month did little to quell the ongoing uncertainty around tariffs. We believe the market will continue to focus on trade-related news, as well as the consequences for fiscal deficits and the risk of additional bond supply.
- The resilience we have observed so far in global growth is partly attributable to a front-loading of demand prior to tariff hikes. However, we expect the US economy to slow over the coming months, with hard data moderating, but importantly not drastically. Despite the dialling back, tariffs have not been completely removed. While the US Court of International Trade's ruling to block most of President Trump's tariffs will complicate the path ahead, there are still several provisions the administration can invoke.
- The uncertainty being created from the fluid trade agenda translates into a difficult business environment to make investment and hiring decisions. The outlook is largely contingent on the response from the US corporate sector to the significant sentiment shock. However, there will be some buffer here as profit margins remain close to record highs.
- We also cannot totally dismiss the idea that tariffs risk raising price pressures over the coming months. So far, we have only seen a minor impact from tariffs feeding through into inflation data. However, with businesses already warning of higher prices, we expect this to be a theme that plays out through the summer months.
- Meanwhile, deficit vulnerabilities are likely to continue to be a focus. The market will be watching closely for concessions as President Trump's Reconciliation Bill passes through the Senate.

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	-2.1	-1.2	-1.7
2023	4.5	5.4	5.7
2022	-19.1	-18.4	-16.2
2021	-5.7	-4.8	-4.7
2020	8.4	9.2	9.3
2019	8.8	9.7	6.8

2018	-3.5	-2.6	-1.2
2017	7.1	8.0	7.4
2016	2.1	3.1	2.1
2015	-5.1	-4.2	-3.2

Source: Schroders, net of fees (where applicable), bid-bid, with net income reinvested as at 31 December 2024. Target is BBgBarc Global Aggregate TR.

Risk considerations

- **ABS and MBS risk:** The fund may invest in mortgage or asset-backed securities. The underlying borrowers of these securities may not be able to pay back the full amount that they owe, which may result in losses to the fund.
- **Bond Connect risk**: The fund may be investing in the China Interbank Bond Market via the Bond Connect which may involve clearing and settlement, regulatory, operational and counterparty risks.
- **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.
- **Currency risk / hedged shareclass**: The hedging of the share class may not be fully effective and residual currency exposure may remain. The cost associated with hedging may impact performance and potential gains may be more limited than for unhedged share classes.
- **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 country: United States of America.
- **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.

Important information