

Schroder ISF* Global Bond

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Market overview

- Global bond markets generated widely varying returns during August, buffeted by economic data and political developments.
- US Treasury yields fell sharply at the start of August as official figures showed a decline in new jobs created during July, with downward revisions for prior months. This negative economic development, which prompted the US President to immediately dismiss the head of the office responsible for the numbers, led markets to consider much more seriously the prospect of a near-term interest rate cut from the Federal Reserve (Fed).
- Against a backdrop of increasing political pressure from the Trump administration, comments from Fed principals later in the month—including Chair Jerome Powell in his speech at the Jackson Hole conference—appeared to move towards the prospect of earlier rate cuts. They highlighted an increased focus on weakness on the labour market side of its dual mandate, rather than on inflation: the Consumer Price Index (CPI) report in mid-August duly came in lower than expected, defying widespread expectations for a tariff-driven rise.
- Although the shorter end of the US Treasury market performed well in response, longer-dated bonds 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.
- In contrast, European government bond yields rose steadily through August as the economic outlook appears to be improving. Survey data indicated a continued recovery in manufacturing and other cyclical sectors. With inflation broadly stable, the European Central Bank's (ECB) view appears to be that the current interest rate policy is accommodative enough and that further cuts are not necessary. German fiscal expansion in coming years contributes another negative factor for European government bonds, while a looming political showdown over fiscal policy in France also provides reason for concern.
- Gilt yields also rose. The Bank of England (BoE) cut rates to 4% but voting in favour of the move was less clear-cut than observers expected, indicating that the BoE is likely to continue its gradual approach and that further cuts are not imminent. Inflation figures supported this stance by coming in slightly higher than expected, while positive signs of improving activity in the UK economy suggested that growth may be less stagnant than previously thought.
- Japanese government bonds also continued to sell off significantly. Inflation is now well above the Bank of Japan's (BoJ) 'neutral' level of 2%, with expectations continuing to rise (as consumers extrapolate their recent experience of higher food prices in particular). Wage growth has reached 2% for the first time since the early 1990s—an era when policy rates were higher, and labour more plentiful. The government's weak position means it is under political pressure to increase public spending, all of which feeds concerns that the BoJ will prove to be behind the curve.
- 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 for fund performance

- Fund performance was positive and outperformed the benchmark during August. Rates strategies were the primary driver of outperformance, particularly through a curve steepening trade in the US.
- A similar strategy in the eurozone rates market was also additive.
- Cross-market positioning also made a positive contribution as we benefited from the politically driven weakness of the French government bond market through an underweight versus Germany.
- A defensive position in Japanese government bonds, where we adopted an underweight duration stance, also contributed as the market weakened on ongoing fiscal concerns.
- Asset allocation was additive, as an overweight in securitised assets, mainly rate-sensitive US agency mortgage-backed securities (MBS), performed well.
- The contribution from corporate bonds was neutral, reflecting the limited risk profile of our exposure to this asset class.

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

Portfolio activity

- In line with our macroeconomic views, directional interest rate risk remains slightly underweight versus the benchmark, with portfolio duration reduced further during the month through the introduction of an underweight to Japan.
- We have greatest conviction in curve steepening strategies where we maintained the core position in the US (overweight 5-year with a corresponding underweight to the 30-year segment). Longer-dated Treasuries remain under pressure amid concerns over fiscal policy and Fed independence.
- We also added to our existing European steepener towards the end of the month. Our expectations are for the curve to steepen on greater bond issuance following the shift to a more expansionary fiscal policy in Germany. We have also expressed our relatively constructive economic view through an underweight to German duration, given signs of a continued cyclical recovery across the eurozone.
- In the UK, we expect the BoE to continue its gradual approach to interest rate cuts. We initiated a new position at the short end of the gilt market curve, looking to capitalise on the likelihood of further rate cuts being delayed until later in 2026. This is essentially a curve 'flattener' trade.
- We also closed the cross-market long UK versus Germany because of our decreasing conviction in the UK economy weakening from now on.
- Elsewhere, we initiated a cross-market position short French OATs vs German bunds. Our view is that France's increasingly challenging fiscal and political situation (with potential strikes and shutdowns now planned for September) makes the bond market fundamentally expensive versus eurozone peers.
- In asset allocation, we added additional exposure to covered bonds, notably in Italy, reflecting their more attractive valuations relative to other areas of investment grade credit. US agency MBS remains our highest conviction asset class.

Outlook/positioning

- 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.
- Meanwhile, we expect the BoE to continue its cautious approach to easing monetary policy conditions. The more hawkish element to the latest Monetary Policy Committee meeting and the resilience of the growth outlook may be challenging for gilts in the near-term.
- The fund's corporate credit risk remains flat to the benchmark given poor valuations, 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	-2.1	-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.

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