

Schroder ISF* Global Bond

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Market overview

- March saw a significant change in the global macroeconomic landscape. US exceptionalism continued to be challenged as heightened policy uncertainty led to a sharp fall in sentiment and raised concerns of recession. Meanwhile, Germany's fiscal regime change drove a much-improved reflationary outlook across the eurozone.
- Germany's parliament approved plans by incoming Chancellor Friedrich Merz to loosen borrowing limits, exempting spending on defence and security from strict debt rules. It also enabled the creation of a €500 billion infrastructure fund designed to run for the next 12 years.
- German bunds bore the brunt of the ensuing sell-off across the eurozone, with yields recording their biggest daily jump since Germany's reunification in 1990 on the initial announcement. The yield curve steepened, with longer dated bonds rising in anticipation of higher borrowing costs in the future, while shorter maturities were supported by expectations of easier monetary policy conditions. The European Central Bank (ECB) cut its main interest rate by 25 basis points as expected.
- US Treasuries outperformed all other major government bond markets. Ongoing policy uncertainty continued to cloud the outlook for the US, with market participants expecting a weaker growth outcome as a result. Meanwhile, the Federal Reserve kept interest rates unchanged for a second consecutive meeting while announcing a slowing in the pace of quantitative tightening.
- The spring statement was the key event in the UK, with the gilt market watching closely for any signs of budget slippage that could lead to a breach of the government's fiscal rules. In the event, considering the latest benefit changes and reforms to public services, the Office of Budget Responsibility (OBR) kept the government's fiscal headroom unchanged at £9.9 billion. Encouraging inflation data also helped gilts recover some of their earlier losses.
- In investment grade credit markets, euro corporates outperformed on a spread basis, with the difference in yield between corporate and government bonds

dipping below that of the US for the first time since January 2022.

- Euro corporates later unwound some of their spread tightening, as focus shifted from planned increases in fiscal spending to looming trade policy risks. This left spreads slightly wider at the end of the month, but still trading at tighter spreads compared to the US.

Drivers for fund performance

- The Fund posted a positive total return and outperformed its benchmark over the month.
- A cross-market overweight to the US versus the eurozone contributed given the outperformance of Treasuries.
- Yield curve steepening strategies in Europe worked well given the reflationary outlook.
- Asset allocation, in the form of an overweight to US Mortgage-Backed Securities (MBS) detracted given heightened market volatility.
- Exposure to US high yield bonds was a drag on returns.
- In rates, an overweight duration position in the UK detracted.

Portfolio activity

- We were strategically positioned for markets to react to an element of fiscal convergence between the eurozone and the US. This materialised sooner than we anticipated with Germany's surprise pivot on its strict debt rules.
- Bond markets saw the move as reflationary and the eurozone sold off sharply in response. We closed the cross-market underweight in the eurozone versus the US position for now given the swift market reaction. Preferring to trade further fiscal convergence through currencies, we introduced an overweight to the euro versus both US dollars and sterling.
- The improved eurozone outlook drove a steepening of European yield curves as investors priced in higher

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borrowing costs in the future. Following the market move, we locked in profits, closing an overweight position in 10-year part of the curve and an underweight in the 5-year segment.

- We consider the European inflation-linked market has moved to overprice the reflationary outlook, particularly when energy and wage inflation is softening. Accordingly, we initiated a cross market short Europe versus the US in inflation swaps.
- On duration (interest rate risk), we maintained a modestly positive stance overall as a 'soft landing' remains our base case. Nevertheless, headline duration was reduced in March through the closure of our UK position, given the country's fiscal situation remains sensitive to a rise in global bond yields.
- Within asset allocation, given the market move, our long-standing valuation preference for euro over US dollar denominated investment grade credit has now weakened given the spread premium of euro over US dollar credit has mostly disappeared. We accordingly added to the US, reducing the underweight position.
- Similarly, we used the weakness of US high yield to sell protection on credit default swap indices (CDX), which we consider the most liquid means of adding exposure.
- Elsewhere, we maintained a significant overweight exposure to agency mortgage-backed securities (MBS). Given the tightness of spreads, we took some profits on covered bonds and switched this exposure into government-related debt instead.

Outlook/positioning

- As we enter the second quarter of the year, there remains a great deal of uncertainty around the global outlook. 'Liberation Day' proved to be worse than expected by the market. President Trump's executive order introduced a universal tariff along with a variety of country-specific reciprocal tariffs, with some exclusions.
- Nevertheless, there is a degree of scepticism around the permanency of some of these new tariffs. In fact, Trump mentioned that tariff rates could be negotiated down if other countries lower their trade barriers to US products. We await signs of negotiations aimed at lowering tariff levels to below those initially imposed. There will however be much more volatility, with a clear risk that the situation escalates into a global trade war, with more severe consequences for risk assets.
- While our base case remains for a 'soft landing' (i.e. positive growth, albeit at a slower pace) increased tariffs carry risks of a 'hard landing' (positive for bonds) and 'no landing' (negative for bonds). This means we retain a positive view on duration but we cannot be overly enthusiastic at this stage.

- As it stands, there is little doubt that there will be a significant inflationary impact, while tariffs are also likely to be growth negative. We anticipate further weakness in survey data, although it is difficult to extrapolate the actual real impact on activity given current uncertainties about how businesses might respond in this environment.
- Importantly, from an interest rate perspective, we believe the Fed will focus on the growth element rather than the inflation shock, particularly if the labour market shows signs of weakness.
- From a corporate perspective, given the ongoing uncertainty, companies are unlikely to commit at this point to significant capital expenditure (Capex) investments. Supply chains have taken a hit overnight, but it will take time—potentially multiple years—for supplies to be sourced from within the US. Overall, there is very little potential for goods substitution given the very thin manufacturing footprint in the US, which means companies will pass through some, if not all, of the tariff impact to consumers.
- When volatility increases, credit opportunities rise, and we are starting to see some of those appear. For now, we favour sectors that are not directly impacted by the trade war, like banks, with very strong fundamentals: we would expect investment banks to make strong profits out of market volatility. We are also considering real estate, which directly benefits from low interest rates, and the services sector where demand tends to be relatively sticky.
- In a matter of days, the announcement on tariffs all but eradicated the fiscally-stimulated optimism priced into eurozone sovereigns following the shift in Germany's fiscal stance. We will continue to monitor developments closely.
- It appears we have reached a pivotal moment for the global economy. Negotiations and the formulation of new trade agreements are the next steps. If that can be achieved, and clarity can be restored quickly, then the growth outlook will improve. If, however, reciprocal tariffs result in an escalation from all sides, this would inevitably be the worst-case scenario for both growth and inflation. As ever, the resulting shifts in economic dynamics impact different areas of the bond markets in different ways, providing us with the opportunities that allow our investment process to generate performance for our clients in fixed income.

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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