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Schroder ISF* European Special Situations

Fund Managers: Leon Howard-Spink & Paul Griffin | Fund update: Q1 2025

Performance overview

– Pan-European equities gained in Q1. The fund underperformed the MSCI Europe index.

Drivers of fund performance

– The fund significantly lagged its benchmark in Q1. In any discrete time period, there are two key reasons for performance relative to our benchmark. First, have we had a greater amount of single stock successes or failures? Secondly, have the style or factor moves in the broader market been more of a headwind or support? This quarter, we can point to one holding (**Soitec**) which did surprise with a profit warning, causing us to exit the stock and therefore lock in a permanent loss. Otherwise, under performance has largely been a case of significant market rotations going against the portfolio with our allocation within financials and industrials sectors having the biggest negative impact.

– In the weeks following President Trump's inauguration, growing debate around potential tariffs and how they might stoke continued inflationary pressures saw energy and financials outperform. This hurt the portfolio's relative performance given our underweights in these sectors.

– Another key – and Trump-related development – was the move by Germany to release its debt brake and commit more money to defence spending, as well as infrastructure investment. This saw a rotation within industrials into aerospace & defence and the more operationally geared capital goods names, and out of lower vol areas such as commercial and professional services (where we have several investments in high quality, relatively defensive franchises such as Bureau Veritas, Experian and Relx). Earlier in the quarter, following the news around DeepSeek there was another rotation out of those names heavily geared into data centre and electrification themes.

– Turning to individual companies, among the main detractors this quarter was **Bunzl**. This is another example of the kind of professional services business that suffered in the market rotation, but there is nothing fundamentally wrong with the business.

– In the capital goods sector, our holdings in cable maker **Prysmian** and electrification specialist **Schneider Electric** were also among the detractors. Both stocks were negatively affected by worries over the persistence of spending on artificial intelligence (AI) and related industries including data centres and energy efficiency.

– **Soitec**, a manufacturer of substrates used in the manufacturing of semiconductors, was a detractor. The company surprised the market with a profit warning that further undermined investor confidence in management. We have sold our holding.

– **BE Semiconductor** suffered from volatility in the semiconductor area. We think the long-term prospects for the company are strong based on the move to hybrid bonding, in which it is a leader.

– Our underweight in financials was detrimental for relative performance overall but we do own Nordic bank DNB which was the leading individual contributor.

– Eyewear and eyecare specialist **EssilorLuxottica** continued its good recent run. The market is very positive on the potential for top line growth to accelerate and the prospects for developing new smart glasses. While we continue to forecast a positive period ahead for the company, we feel the valuation has moved too far, too fast and we took substantial profits over the quarter, taking the stock out of the top 10.

– German mega cap **Siemens** was another positive contributor amid signs of an inflection point for its industrial automation business, which should see margin expansion this year.

Portfolio activity

– During the quarter we continued our efforts to diversify the sources of growth within the fund, particularly in the context of uncertainty around the outlook for tech/AI spending.

– We initiated positions in two strong franchises in the financials space: Italian bank **Intesa Sanpaolo** and Swiss insurer **Zurich Financial**. Intesa has attractive exposure to wealth management in northern Italy, which is one of the richest regions in Europe. We see Zurich as a well-run insurer that delivers consistently over time. We are still underweight financials.

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

- Another new position is pharmaceutical group **AstraZeneca**. The shares had pulled back following a scandal in China over alleged unpaid import taxes, giving us a chance to build a holding. Management has driven best-in-class research & development which we think can contribute to significant sales growth to the end of the decade.
- Among consumer stocks, we initiated a position in Zara owner **Inditex**. We see the business as high quality. Another new holding is luxury goods group **Richemont**. We think there is an opportunity in the "hard luxury" (watches & jewellery) space in which Richemont specialises.
- We initiated new positions in consumer staples groups **Beiersdorf** and **Unilever** (the latter in the early days of Q2) and added to positions in Alcon and **Novonesis**. This is part of a move at the margin to increase the allocation to more defensive holdings.
- We reduced the size of our position in semiconductor equipment maker **ASML Holding** and other cyclical holdings such as **Saint Gobain**, Siemens and Hexagon as part of this move to de-risk the portfolio.

Outlook/positioning

- At the time of writing in early April, markets have experienced an extremely volatile few days following the Trump administration's tariff announcements. Even before the "Liberation Day" measures were revealed, we had been reducing exposure to technology and capital goods areas of the market in acknowledgement of heightened uncertainty, bringing down the cyclicality and beta of the fund. We remain invested in those areas, however – we have not sold to zero. At the same time, we have been increasing the weightings of more stable and defensive holdings, with the new positions in Beiersdorf and Unilever being prime examples. For both stocks, we should add that there are very clear idiosyncratic drivers in the years ahead – largely around dynamic management teams driving faster top-line growth; we have not added to consumer staples names purely as a response to the macro backdrop.
- We are monitoring developments closely and drawing on the significant analysis being carried out by research teams across Schroders' network. The scope and magnitude of the proposed tariffs mean that many companies may have a significantly different outlook for earnings in the next three or four years. Some of the implications of these tariffs in the short to longer term could be higher prices for the US consumer leading to a potential recession; disruption across multiple supply chains and potential margin compression; reshoring of manufacturing to the US; and heightened geopolitical risk. Any of these may exert prolonged pressure on markets. We are alert to any longer-term implications for the growth rates of our companies.
- While these tariffs, if implemented in full, are serious developments for the global economy that of course command full attention, it's also important not to overreact to short-term news flow and be panicked into acting based on the latest headline. This is especially the case when we only have part of the picture. We are conscious of the volatility of decision-making from the current White House which could mean a reversal of the moves we have seen in recent days and weeks. Other countries and regions are still considering how to respond to the tariffs and the situation is still very fluid. We have dialled down the cyclicality of the portfolio in acknowledgement of significantly higher uncertainty, but we are not moving away from cyclical exposure entirely.
- A key consideration at these times is the indebtedness of our portfolio holdings. Companies that do have higher than average gearing are among the more defensive companies in the portfolio – as such, we are relatively confident that a prolonged economic downturn should not cause debt issues. Amid all the uncertainty, we feel it is more important than ever to focus on the fundamentals of our companies, with a particular emphasis on pricing power and quality of franchise. Our companies in aggregate are market leaders with strong operating margins and high ROEs, underpinned by good secular long-term growth prospects.

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	MSCI Europe net return
2024	4.2	8.6
2023	18.2	15.8
2022	-28.2	-9.5
2021	26.9	25.1
2020	11.7	-3.3
2019	35.9	26.7
2018	-16.8	-10.9
2017	16.2	10.2
2016	1.2	2.6
2015	17.7	8.2

Source: Schroders, as at 31 December 2024. Fund performance is net of fees, NAV to NAV with net income reinvested, EUR C Acc. Please see factsheet for other share classes. The fund's performance should be assessed against its target benchmark being to exceed the MSCI Europe (Net TR) index. The investment manager invests on a discretionary basis and there are no restrictions on the extent to which the fund's portfolio and performance may deviate from the target benchmark. The investment manager will invest in companies or sectors not included in the target benchmark in order to take advantage of specific investment opportunities.

Risk considerations

Concentration risk: The fund may be concentrated in a limited number of geographical regions, industry sectors, markets and/or individual positions. This may result in large changes in the value of the fund, both up or down.
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.
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. 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.
Higher volatility risk: The price of this fund may be volatile as it may take higher risks in search of higher rewards.
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.
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.
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Operational risk: Failures at service providers could lead to disruptions of fund operations or losses.
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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