

Schroder ISF* EURO Corporate Bond

Fund Manager: Patrick Vogel | Fund update: March 2025

Market overview

- 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. European credit spreads ended the month slightly wider, but still trading at tighter levels compared to the US. Notably, there was a significant slowdown in inflows into the euro investment grade bond market during the month.
- 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 Germany's 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 (yields move inversely to price). The yield curve steepened, with longer dated bonds rising in anticipation of higher borrowing costs in the future, while shorter maturities were supported by current expectations of easier monetary policy conditions. The European Central Bank (ECB) cut its main interest rate by 25 basis points as expected.

Drivers of fund performance

- The Fund underperformed its benchmark after fees during March.
- Spread duration was longer than the benchmark, which detracted from Fund performance as credit spreads widened.
- Security selection in the utilities, real estate and subordinated insurance sectors detracted.

- An underweight allocation to senior banking and telecoms sectors was additive.

Portfolio activity

- As credit spreads widened, we took the opportunity to add back an element of exposure to financials. We purchased a subordinated bond issue from a leading French insurer, offering an attractive coupon.
- We also added several holdings in the banking sector, from an Austrian lender as well as a leading US investment bank.
- In the energy sector, we added a holding in an oil and gas exploration group focused on the North Sea. The company is a low-cost producer, benefitting from solid cash flows despite the lower oil price while its gas contracts are longer term and indexed. The issue was priced on an attractive credit spread.
- The fund remains underweight in cyclical sectors, although we added a holding in a German automotive and industrials supplier, which should benefit from increased expenditure on infrastructure and defence programmes.
- We continue to identify investment opportunities in emerging market bonds. Governments have been more fiscally disciplined, comparative to developed markets. In addition, from an income perspective the available coupon on emerging market bonds is attractive.
- As spreads widened, we reduced holdings in core government bond markets.

Outlook/Positioning

- For some time now, the eurozone has struggled with declining competitiveness, high energy prices, a downbeat global manufacturing backdrop and, in the case of Germany, a lack of ambition to fiscally stimulate its economy.
- However, a combination of increased self-reliance for security reasons and a change in leadership appears to have heralded a change in Germany's fiscal backdrop. The infrastructure and defence-led package announced by chancellor Merz represents a significant change in the level of proactivity among

German policymakers. We believe this could stimulate further spending in other eurozone countries or facilitate joint debt or loan issuance at the EU level.

- Bond markets have already responded sharply to the change in outlook. The dramatic market moves in recent weeks, and the strong outperformance of European corporates over the US with credit spreads at tight levels historically, leads us to maintain a strong emphasis on quality and a cautious approach to adding to more cyclical sectors. While industrials, in particular, should benefit from increased infrastructure and defence spending In Germany, this has already been reflected in tighter spread levels.

Calendar year performance (%)

	A Acc	I Acc	Target**
2024	6.0	7.0	4.7
2023	9.7	10.8	8.0
2022	-16.4	-15.6	-13.9
2021	-1.2	-0.2	-1.0
2020	4.6	5.6	2.6

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.

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

- From this perspective, we are looking for security specific opportunities in the single-A and AA rating segments, as it is historically cheap to go up in quality.
- Going forward, a combination of positive carry and idiosyncratic opportunities should underpin total returns from the European investment grade market.

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.

2019	8.8	9.9	6.3
2018	-2.9	-1.9	-1.1
2017	4.6	5.6	2.4
2016	5.8	6.9	4.8
2015	0.7	1.8	-0.4

Source: Schroders, as at 31/12/2024. All performance net of fees (where applicable), NAV to NAV (bid to bid), EUR. ** ICE BofA Euro Corporate Index.

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.

Emerging and less developed markets: The fund may invest in emerging and less developed markets. Investing in emerging and less developed markets is subject to greater risks than investing in securities of developed countries such as ownership and custody risks, political and economic risks, market and settlement risks, liquidity and volatility risk, legal and regulatory risks, execution and counterparty risk, and currency risk, which may adversely affect the net asset value per share of the fund and investors may as a result suffer losses.

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.

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.

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