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Schroder ISF* EURO Corporate Bond

Fund Manager: Patrick Vogel | Fund update: May 2025

Market overview

- Credit markets continued to recover from the early April sell-off, as a de-escalation of China-US trade tensions eased US recession fears. US labour market data for April was encouraging, while purchasing managers surveys highlighted a continued expansion in activity despite the uncertainty surrounding US trade tariffs.
- The broad rally in risk assets was reflected in investment grade (IG) credit markets, where spreads tightened during May particularly in the US market. Both the US and euro IG markets generated positive excess returns over government bonds.
- In the euro IG credit market, fund flows into short-dated mandates remain very strong, while the supply of new issuance is well ahead of previous years to date. Most notably, US corporates have been capitalising on the interest rate differential to tap lower borrowing costs in the euro-denominated market.
- May was another challenging month for government bond markets, particularly for longer-dated issues as the focus quickly switched to concerns around fiscal deficits and their sustainability. Most notably in the US, where the Reconciliation Bill passing through Congress was viewed as worsening the budget deficit.
- In contrast to other sovereign markets, European government bonds performed relatively well 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.
- Ahead of the European Central Bank (ECB) monetary policy meeting in early June, markets were expecting a further 25 basis point interest rate cut. Although eurozone inflation remained slightly above its 2% target in April, the impact of lower oil prices has yet to feed through into consumer prices.

Drivers of fund performance

- The Fund outperformed its benchmark after fees during May.
- Spread duration was longer than the benchmark, which contributed to Fund performance as credit spreads tightened.
- Security selection in services, healthcare, subordinated financials, particularly insurers, contributed as did positioning in the real estate sector, where lower interest rates have led to a more favourable backdrop for refinancing activity.
- Exposure to Romanian sovereign debt was also additive, as the second round of presidential elections resulted in a victory for the pro-EU centrist candidate.
- An underweight allocation to telecoms sector detracted over the month.

Portfolio activity

- Broadly, we have maintained a barbell strategy with a strong emphasis on issues rated single-A and AA, particularly in the healthcare sector and from major technology companies trading on attractive credit spreads relative to swaps. In addition, we are focusing on higher beta sectors such as energy, where we can identify several issuers that are well placed to weather an extended period of lower oil prices.
- During May, we purchased a holding in a 5-year, AA-rated new issue from a leading European pharmaceutical group, as well as an A-rated issue from a major consumer name, and in the capital goods sector a 5-year security from a building materials provider underpinned by solid cash flows.
- While the Fund remains underweight in the autos sector, given prevailing uncertainty and risks around the impact of proposed US trade tariffs, we established a holding in a hybrid IG issue from a leading European manufacture. This came to the market on an attractive yield, relative to swaps. We consider that much of the potential downside to the business arising from tariffs on exports to the US is reflected in this valuation.
- Among other consumer cyclicals, we added a new issue from a travel & leisure business which came to the market on an attractive yield.

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

- On the disposals side, we sold down holdings in core European government bond markets to fund selected investment opportunities, primarily in the new issue market.

Outlook/Positioning

- The immediate prospects for the eurozone economy are heavily contingent on the outcome of trade negotiations with the US, following the introduction and subsequent suspension of significant tariffs in early April.
- Although conditions in the manufacturing sector remain challenging, the eurozone PMI (purchasing managers index) is now signalling potential expansion. This improvement appears to be a response to the European Commission's recent relaxation of fiscal rules, allowing for additional spending on defence. Furthermore, Germany's easing of the 'debt brake', alongside the recent announcement of a €500bn infrastructure and defence fund, has increased optimism within the manufacturing and industrial sectors.
- Inflation is expected to decline further based on lower energy prices and the weaker US dollar.
- We also expect corporate fundamentals to remain stable and the default rate to stay low.
- Monetary policy should continue to provide some support for bond markets, with interest rates projected to stabilise around 1.75% by the year end.
- Bond markets have already responded sharply to the change in outlook. The dramatic market moves in recent weeks, lead us to maintain a strong emphasis on quality and a generally cautious approach to investing in more cyclical sectors. While industrials should benefit from increased infrastructure and defence spending in Germany, this has already been largely discounted by investors.
- In addition, we are also looking to identify companies with business models that are mostly insulated from the trade uncertainty. We see idiosyncratic opportunities in higher yielding issuers and single A-rated names.
- Overall, we remain very mindful of credit risk particularly in view of the economic uncertainty. Going forward, a combination of positive carry and idiosyncratic opportunities should underpin total returns from European credit markets. For now, uncertainty persists, which makes an agile approach to portfolio construction crucially important.

Calendar year performance (%)

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.

	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
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.

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 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.

Important information