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Schroder ISF* EURO Corporate Bond

Fund Manager: Patrick Vogel | Fund update: July 2025

Market overview

- Despite ongoing uncertainty as investors awaited the outcome of trade negotiations, July was another positive month for credit markets. Spreads in the euro investment grade (IG) market tightened further, generating excess returns over government bonds.

- Following weeks of negotiations between the EU and the US, a baseline tariff rate of 15% on almost all EU goods entering the US was agreed, providing more clarity. The EU also committed to significant spending on US military equipment and energy.

- With investors preoccupied by renewed concerns over rising fiscal deficits, government bond yields rose in the US and across European markets. The German budget deficit for 2025 is forecast to increase substantially, funding increased defence spending and infrastructure investment, and is more front-end loaded than had been anticipated when borrowing limits were relaxed in the spring.

- The European Central Bank (ECB) kept interest rates unchanged for the first time in a year, with President Lagarde striking a surprisingly hawkish tone. Accordingly, investors scaled back expectations of further interest rate cuts. Despite uncertainty over trade tariffs, the eurozone economy unexpectedly expanded during the second quarter with signs of a recovery in consumer spending.

- Second quarter corporate earnings announcements in Europe were mixed. Results from the financial sectors and in healthcare were encouraging but cyclical industries, notably chemicals, energy and construction, are still struggling. In the consumer discretionary sectors, earnings guidance from leading auto manufacturers has been downgraded, reflecting the likely impact of US trade tariffs.

- As was the case in June, technical factors – namely fund flows into European credit markets - drove spread tightening, which was broad based across sectors with insurance and real estate among the outperformers. Inflows into euro-denominated IG credit remain focused on the shorter dated maturity segment as deposit rates have fallen in line the ECB interest rate cuts. In addition, Asian investors looking to diversify away from the US have been increasing exposure to higher yielding European credit.

Drivers of fund performance

- The Fund outperformed its benchmark after fees during July.
- Exposure to subordinated financials, particularly within the insurance sector, contributed to Fund performance as credit spreads tightened further.
- Off benchmark exposure to Romanian sovereign debt was also additive, as an end to political instability and a package of measures to address the fiscal deficit have averted the risk of a downgrade in the sovereign credit rating.
- Security selection in the energy, services, healthcare, utility and financial services sectors was additive.
- Our holding in a European payments company rebounded, after we had focused exposure on the short-dated bonds where spreads tightened over the month.
- Security selection in real estate and media sectors and our underweight exposure to senior banking and telecommunications detracted.

Portfolio activity

- Over the month we have reduced exposure to BBB-rated securities in the IG market and also sold down HY securities. Given spread tightening, valuations at index level look vulnerable to some reversal should we see any softer economic data.
- We increased exposure to AA-rated securities over the month, and parked cash in Treasury bills and short-dated sovereign debt, awaiting suitable investment opportunities in credit markets.
- With less primary market activity in July, participation in new issues was limited. We added a holding in a German auto supplier, offering a high coupon on a private placement.
- In the utility sector, we added a holding in an energy group with assets across central and eastern Europe which came to the market on an attractive valuation relative to the European IG utility sector.

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

- On the disposals side, we took profits on our position in a US investment bank which we had purchased after the post 'Liberation Day' sell-off in early April. Subsequently, credit spreads have tightened significantly.
- We sold holdings in several leading European auto manufacturers given the downside risks from US trade tariffs.
- We exited our holding in a US media group following the announcement of an exchange and tender.

Outlook/Positioning

- The deal between the EU and the US provided some relief that the threat by the Trump administration to impose 30% tariffs had been avoided, with some sectors including aircraft and component suppliers securing an exemption. Furthermore, the combination of higher fiscal spending and more accommodative monetary conditions should underpin a recovery in eurozone economic activity. Although conditions in the manufacturing sector remain challenging, the latest eurozone PMI survey for July highlighted a further expansion in private sector activity. 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, as the recent spike in the oil price quickly dissipated, 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, although the ECB's programme of interest rate cuts looks to have run its course.
- However, we are mindful that credit spreads at index level measured over government bonds have compressed over recent months. We have a strong emphasis on quality, reducing exposure to HY credit and within the IG market increasing the allocation to AA-rated securities.
- With August traditionally a quiet month in terms of both new issuance and trading volumes, as a tactical measure we have increased exposure to short-dated sovereign debt offering an attractive carry over cash.
- Any widening of credit spreads should present investment opportunities to reinvest into credit markets.

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 (%)

	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.

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