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Schroder ISF* EURO Corporate Bond

Fund Manager: Patrick Vogel | Fund update: March 2024

Market overview

- Against a relatively benign economic and market backdrop, yields fell across the major government bond markets in anticipation of interest rate cuts commencing in June. The Federal Reserve (Fed), European Central Bank (ECB) and the Bank of England left interest rates unchanged. The Fed's Summary of Economic Projections (SEP) showed no change to its forecast for three rate cuts this year, despite forecasting lower unemployment and higher core inflation compared to December's release. The accompanying statement also set a dovish tone.
- At its meeting in early March, the ECB lowered forecasts for inflation, and is now expecting the consumer price index to decline to its 2% target next year. Accordingly, bond markets are anticipating that the ECB will cut interest rates in June. Economic indicators for the Eurozone released last month highlighted that business activity, as measured by the Purchasing Managers index (PMI), is being lifted by a rebound in the services sector. While business activity in both the German and French economies continued to contract, the picture was brighter elsewhere. Notably, southern European economies have been outperforming, benefiting from a recovery in tourism, while they have less exposure to the manufacturing cycle.
- European investment grade corporate bonds outperformed government bonds over the month as spreads continued to tighten. With spread compression the main theme, high beta areas of the market continued to outperform the broader index, with subordinated and senior financials, as well as BBB- rated credit, particularly strong. The technical backdrop remained supportive with new issues over four times oversubscribed, and continuing inflows into European investment grade credit funds.
- The US 10-year Treasury yield fell from 4.24% to 4.2%, and with the curve still heavily inverted, the yield on the benchmark 2-year remained unchanged at 4.6% on the month. The 10-year German bund yield fell from 2.41%. to 2.3%, while equivalent yields in the Italian and Spanish markets fell further, from 3.84% to 3.66%, and from 3.28% to 3.15% respectively.

Drivers of fund performance

- The fund outperformed its benchmark after fees during March.
- An overweight in spread duration made a positive contribution as credit spreads tightened further.
- Exposure to corporate hybrid issues, particularly in the real estate sector, had a positive impact.
- An emphasis on subordinated financials was additive, particularly within the insurance sector.
- Security selection amongst senior financials was beneficial.
- An overweight in bonds rated BBB- was also additive.
- The main detractor came from a holding in a state-owned utility group, which weakened on ESG concerns.

Portfolio activity

- Activity was once again focused largely on deploying cash in the primary market with the volume of new issuance providing several investment opportunities to diversify the portfolio.
- We reduced generic banking exposure and selectively added to new issues in East European and Nordic countries where credit fundamentals are strong and valuations more attractive. These included holdings in Polish and Slovenian banks, the former a development bank which is government-guaranteed and the latter benefitting from a strong balance sheet with profitability underpinned by market share and capital generation.
- In the telecoms sector, we participated in a new issue from the government-owned operator of the Australian broadband fibre network, which exceeded its financial targets last year and benefits from a strong liquidity profile.
- In basic resources, we added to our holding in a mining group has taken further steps to strengthen its balance sheet by targeting cost cutting

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

opportunities and additional capex discipline. Its commodity profile is skewed towards metals that are fundamental to the shift towards de-carbonisation.

- In the healthcare sector, we participated in a new issue from a bio-pharmaceutical company specialising in immunology and neurology. We believe the outlook is favourable for bio-pharmaceutical companies, as the barriers to entry for generic competition are higher than in other segments of the pharmaceutical industry.
- On the disposals side, we reduced exposure to some peripheral European banks on the back of the recent outperformance, while we also took profits on a holding in a hybrid issue from an Iberian utility group.
- Amongst telecoms, we sold down our holding in a wireless operator following its recent upgrade to investment grade status.

Outlook/Positioning

- Consistent with our central thesis of a 'soft landing', firming goods demand has driven an upturn in the global manufacturing cycle. The US has led the way, but the Eurozone has been a more recent beneficiary of this cyclical uplift, with a more accommodative interest rate outlook offering additional support. Not only does it appear that the region's manufacturing cycle has turned, but the services sector also seems to be recovering, feeding through to the labour market. Leading indicators are signalling a clear improvement and, given the weakness of growth expectations for the region, the hurdle for positive surprises is easy to beat.
- Expectations on the timing and the extent of interest rate cuts have shifted in recent months. At the start of the year, investors were expecting the Fed to begin cutting rates in March. At the time of writing, bond markets are pricing in June to be the most likely timing for a first cut by the Fed. Indeed, the second quarter of the year has started with a sell-off in Treasuries driven by stronger than expected manufacturing data that has amplified concerns over the extent of US interest rate cuts this year. Our view is that there is a higher probability for an earlier rate cut by the ECB than from the Fed.
- Credit spreads have continued to tighten, however there is still dispersion in the market, with single A's offering good value relative to history and other rating buckets.
- Moreover, we expect the supportive technical backdrop to continue into the second quarter with demand for new issues and inflows into investment grade credit funds set to remain strong.

Calendar year performance (%)

	A Acc	I Acc	Target**
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
2014	8.8	9.9	8.3

Source: Schroders, as at 31/12/2022. All performance net of fees (where applicable), NAV to NAV (bid to bid), EUR. ** ICE BofA Euro Corporate Index.

Past performance is not a reliable indicator of future results. The value of investments and the income from them may fall as well as rise and investors may not get the amount originally invested. Some performance differences between the fund and the benchmark may arise because the fund performance is calculated at a different valuation point from the benchmark. Please see the respective fund factsheets for the performance of other share classes.

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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